

November 26, 2018

The Malevolent Hegemon: Part I

Since the election of Donald Trump, there has been much discussion about the demise of the “Liberal International Order,” or LIO. Several books on the topic have been published recently¹ and the general tenor is that the U.S. is giving up global leadership and the world is in trouble. We have been making this argument as well for a rather long time. However, there is an alternative viewpoint, which is that the U.S. isn't giving up global leadership but is ending the LIO for something different.

What we may be seeing is not a retreat from the world but a significant change in management style, hence the title of this week's report. We have dubbed this new style “The Malevolent Hegemon,” as opposed to “The Benevolent Hegemon” or the LIO, which describe how the U.S. managed the world from 1945 until 2008. We argue that the LIO began to wane under the Obama administration but a replacement model wasn't evident. The Trump administration does appear to be creating a new model of hegemony.

In Part I of this series, we will begin with the basics of hegemony. From there, we will describe the unique model of U.S. dominance, *Pax Americana*, with the U.S. as a benevolent hegemon. Part II will discuss why the U.S. has become jaded with this

role, which has spawned the search for another model. Part III will analyze what appears to be the emergence of a new model, which we describe as the malevolent hegemon. We will discuss the differences between the two models. With this analysis in place, we will examine the possible outcomes from this shift. At the conclusion of the series, we will discuss potential market ramifications.

The Basic Role of the Hegemon

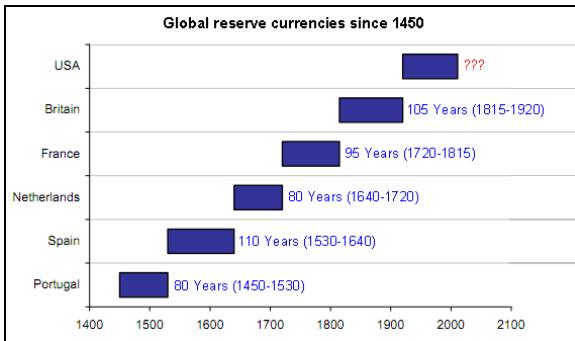
Global hegemons supply the world with two broad global public goods. The first is security. The hegemon is a dominant enough power to protect the global sea lanes for trade and maintain order by keeping small wars from evolving into large ones. The second global public good is economic; the hegemon provides the reserve currency that other nations use for trade. This requires the hegemon to run persistent trade deficits. Under a gold standard, this would eventually lead to gold shortages and undermine the hegemon's economy. Some of the early hegemons, such as Portugal and Spain, maintained this role by mining a steady flow of precious metals from the Americas.

Every European hegemon established colonies. This was done to provide precious metals (a driving force in the 1400s), a compliant labor force and allow for the expansion of power by establishing military bases on the colonial property. It also created a submissive consumer base for home nation exports and a venue for foreign investment.

¹ <https://www.publicaffairsbooks.com/titles/ivo-h-daalder/the-empty-throne/9781541773875/> and <https://www.brookings.edu/books/the-jungle-grows-back-america-and-our-imperiled-world/>

The Benevolent Hegemon

The U.S. emerged as a global superpower during WWII. A strong case could be made that Britain, the global superpower since 1815, had been waning since WWI. In fact, some scholars have argued that Britain’s inability to maintain the hegemonic role and the U.S. reluctance to accept the burden were the key causes of the Great Depression and WWII.² As WWII came to an end, President Truman worked to create a world order that would prevent WWIII. The formula that the U.S. developed for hegemony was unique in modern history. The American model shunned colonies as “Un-American.” Since the U.S. became a nation by defeating a colonial power in the War for Independence, it seemed wrong for the U.S. to then acquire colonies. That didn’t stop President Theodore Roosevelt from acquiring colonies, but there was a general unease with the decision.



(Sources: CIM, Wikipedia)

This chart shows the rough progression of hegemony since the 1400s. All but the U.S. had colonies. Instead, the U.S. created a system that shunned the coercion embedded in being a colonial power and instead designed a system to attract other nations to U.S. hegemony.

The basic elements were:

² Kindleberger, Charles. (1986). *The World in Depression, 1929-1939* (2nd ed.). Berkeley, CA: University of California Press.

Containment of communism: George Kennan’s “long telegram”³ became the key element of how U.S. hegemony was sold to the American populous. Communism was deemed to be an evil system and the U.S. had to create a coalition to surround the communist states and prevent the spread of the ideology. Instead of simply going to war against the Soviets, U.S. policy was designed to outlast them with the idea that the superiority of democracy and capitalism would eventually prevail. This meant, of course, that the U.S. would need to create superior capitalist and democratic society that would outperform the competition not only on a national level but for its citizens as well. In other words, the U.S. system would need to provide better living standards for the Free World to ensure that the majority of nations would want to be part of this Free World and reject communism.

Freeze key conflict zones: An unstated policy was the U.S. decision to freeze three conflict zones. The first was in Europe, which had never resolved “the German problem.” Germany, due to its geographic location, was destined to be a major economic power; unfortunately, its position on the Northern European Plain also meant it was vulnerable to invasion from the east and west. The inability of Europe to resolve this problem led to two world wars. To prevent a third, the U.S., through NATO, demilitarized the European nations and took over their defense. The second conflict zone was in the Far East, where Japan was a major industrialized power with few natural resources. It was always vulnerable to a naval power cutting off its access to raw material imports. In fact, fear of a U.S. oil embargo was part of the reason Imperial Japan bombed Pearl Harbor. By attacking the U.S. naval base in Hawaii, Japan hoped

³<https://nsarchive2.gwu.edu//coldwar/documents/episode-1/kennan.htm>

to gain time to attack the Dutch East Indies and acquire the oil fields available there. Much like in Europe, the U.S. demilitarized Japan after the war and secured the sea lanes, which meant Japan no longer had to project power to gain access to raw materials. Thus, Japan no longer feared losing access to critical imports and its neighbors no longer feared being invaded by Japan to gain access to raw materials.

In the third conflict zone of the Middle East, the U.S. understood that the states there were mere colonial constructs, nations in name only. The colonial powers had purposely put minority groups in charge that were dependent on the colonial governments to remain in power. But, the U.S. also knew that allowing nations to develop from self-determination would have invariably led to conflict and opened the opportunity for the Soviets to move into the region and capture the petroleum reserves in the region. Therefore, the U.S. supported the existing borders even though that meant acquiescing to brutal, autocratic governments. The Truman administration and subsequent governments never fully admitted that maintaining these three frozen conflict zones was part of American hegemony.

Maintain global security: In addition to keeping the above conflict zones “frozen,” the U.S., in its hegemonic role, provided general security to prevent small conflicts from becoming major wars. There were two elements of this role. First, the U.S. built a global system of air and naval bases in Allied nations. Not only did this keep the conflict zones from becoming problems, but it allowed the U.S. to project power and maintain order. It is important to note that these allies allowed American troops to be placed in their nations in part because they wanted to participate in the U.S.-supported global trading system (see below). Unlike

earlier hegemony, the U.S. didn't acquire colonies for this purpose. Second, the bases gave the U.S. the ability to influence various regions of the world, which included preventing hostile governments from holding power in the Western Hemisphere to supporting jihadists who opposed the Soviet invasion of Afghanistan.

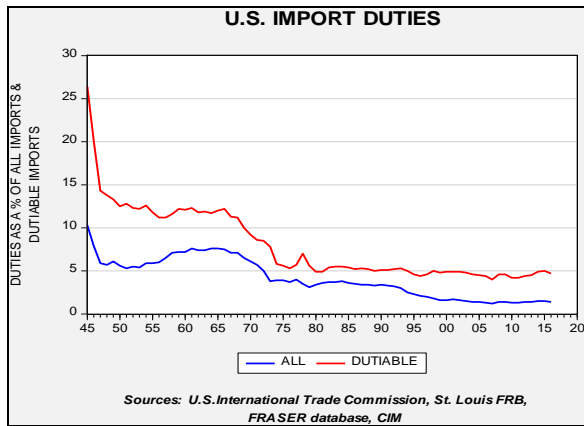
Maintain global sea lanes: The U.S. built a significant navy that is designed to project power anywhere in the world. By providing safe passage through the world's maritime choke points, global trade could flourish.

Provide the reserve currency: At Bretton Woods in 1944, the U.S. created a dollar/gold reserve system that gave the Free World a source of steady demand while recovering from the devastation of WWII. The U.S. became the global importer of last resort and ensured that the best road to development was export promotion, relying on American consumption to rebuild and grow. The nations that recovered (Japan and much of Western Europe) or developed (Taiwan and South Korea) did so through selling goods to the U.S. consumer. This system required the U.S. to accept trade deficits. The relative size difference between the U.S. and the rest of the world was initially so large that the impact of supplying the reserve currency was miniscule. However, by the late 1960s, dollar supply in Europe had become so great that European governments, notably the French, began demanding gold in lieu of dollars. Facing the potential of gold depletion, the Nixon administration abandoned the gold standard in 1971. Although it was unclear whether the global financial system would survive, the dollar remained the reserve currency and the reserve system evolved into a dollar/Treasury arrangement. Instead of holding gold, foreign nations that ran trade surpluses

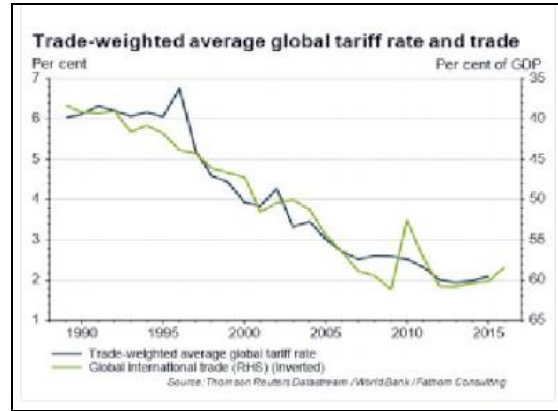
with the U.S. would hold dollars in Treasuries which, in theory, have no production limits.

Multilateral trade arrangements: The U.S. began a process soon after the war to open the Free World trading system. The General Agreement on Tariffs and Trade (GATT) eventually became the World Trade Organization (WTO). The U.S. could have exercised more leverage with bilateral arrangements. However, by purposely reducing American power and accepting the rules of a multilateral system, other nations had an incentive to join the Free World trading system on an equal footing with the U.S.

The story of the postwar world has been one of falling tariff rates. The chart below shows the U.S. rates.



World tariff rates have generally declined as well.



(Source: World Bank)

Although multilateral trade arrangements tended to weaken U.S. sovereignty, they created a system that tied the Free World together and isolated the communist world. The combination of multilateral trade arrangements and the dollar bloc put the communist bloc at a significant disadvantage. The majority of trade among the communist states was done by bartering as the Soviets didn't have a financial system to manage a ruble reserve currency.

The Truman plan worked. The Cold War ended without triggering World War III as the U.S. and its allied system outlasted the Soviet model. The U.S. did so by creating a global arrangement that encouraged nations to join it. The Soviets struggled to attract countries to communism; the only major success outside the Sino-Soviet-Eastern European bloc was Cuba and, frankly, that outpost became more of a burden than a benefit. Essentially, the U.S. used "carrots" to attract nations to the Free World. That doesn't mean that America avoided hard power; the wars in Korea and Vietnam and the interference in South America are examples of times when the U.S. acted directly when soft power wasn't adequate to the task. But, overall, especially compared to the behavior of past hegemony, the U.S. was less coercive than its predecessors.

Accordingly, this is why we view the U.S. as a “benevolent hegemon.”

Part II

Next week, we will examine the costs of hegemony and why many Americans have concluded that the superpower role creates

an undue burden. In Part III, we will analyze what we see as a new emerging model of hegemony.

Bill O’Grady
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