

# What the French revolution can teach America

**Dominique Moïsi**

"Eat the wealthy." The ferocity of the words used by some demonstrators in London on the eve of the Group of 20 summit evokes the worst excesses of the French revolution. Anti-capitalist anger in the west is not confined to Europe. Alexis de Tocqueville's *The Ancien Régime and the Revolution* is as relevant to understanding today's America as his deep and eye-opening thoughts on the young American republic in his *Democracy in America*.

Of course, America in 2009 is not France in 1789, the year before the fall of the Bastille (the prison that embodied the oppressive nature of the monarchical regime) and the symbolic beginning of the French revolution. The fall of Lehman Brothers in September 2008 has nothing to do with the fall of the Bastille, symbols of wealth should not be confused with symbols of oppression. There is no guillotine around the corner and it would take a lot of imagination to compare President Barack Obama to Louis XVI, or Michelle Obama to Marie-Antoinette.

Yet as a European living in America – watching news on television every night, talking to friends, colleagues or my students – I sense fear, anger and a deep feeling of injustice reminiscent of the climate on the eve of the French revolution. Just replace bread shortages with foreclosures, aristocrats with bankers, and privileges such as the right not to pay tax with stock options. Add to that support for the king but rejection of many of his ministers, and the comparison looks less far-fetched.

The explosion of populist rage that has accompanied the AIG scandal, amplified by an opportunistic Congress and by media that play to the tune of their audiences when not reinforcing their passions, reflects the depth of suffering in the US Main Street, like

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much of France at the end of the 18th century, is outraged. Fear for its own present and future is combined with anger at those it considers responsible, and who are much less affected than they are. Not senior bankers today like the aristocrats of yesterday, their privileges no longer justified by their social functions – to serve the king with their swords or to contribute to the creation and dissemination of wealth?

The problem with the economic team of the new president is that, like the court of the king of France in pre-revolutionary times, it has inherited all the bad reflexes of the *ancien régime*, mixing excessive sympathy for the out-dated logic of the world of finance, which it helped to create, with insensitivity to the emotions of the ordinary people, which it tends to ignore. This sympathy is perceived to contrast with the harsh treatment of carmakers.

Bankers and financiers have to reinvent not only their trade but also their way of life and, above all, their value system. In the Madoff scandal, just as shocking as the crime of an individual was the behaviour of many of his rich customers, who combined greed with a lack of financial common sense.

An interesting incident was reported by CNN last week. A group of protesters – very few, to be honest – rented a bus in Connecticut and stopped in front of the mansions of AIG executives to express support for those who had returned their bonuses and outrage against those who had not and were still living in grand style, in contrast with the many more who had lost nearly everything.

The greed of some was tolerated as long as most of society continued to progress. But today's combination of fear and humiliation with a deep sense of injustice leads to anger that is potentially irrepressible. The strength of the American republic has been bolstered by the popularity of its new president. This capital should not be squandered on reliance on a media-savvy communication culture. As can be seen so often in history, less is more. The president of the US simply speaks too much.

Revolution is not around the corner, at least, not in America. But there are lessons Mr Obama can learn from the French king's failure to manage dissent. He must not fall prey to populism. His goal is to save the economy, not punish the bankers. At the same time, he must not be seen to have too much sympathy for the world of finance and its excesses or to cut himself off from the suffering of his people. If he fails, the corporate laws of today will face the same fate as the *ancien régime* rights of yesterday.

World leaders' agreements, substantive or superficial, will not suffice. It is the trust of their respective citizens, translated into hope and confidence, that will make the difference.

# Credibility is key to policy success



**Martin Wolf**

The UK has followed the US and Japan into "unconventional monetary policy". Meanwhile, Mervyn King, governor of the Bank of England, warns the UK government of the dangers of further discretionary fiscal stimulus. Yet what are the implications of the policies followed by central banks? Are these not the big threat to monetary stability?

According to forecasts from the International Monetary Fund, the UK's general government deficit will be 9.5 per cent of gross domestic product this year and 11 per cent in 2010, the largest in the Group of 20. As I argued earlier this week ("Why G20 leaders will fail to deal with the big challenge"), the rise in the deficit, from 2.7 per cent of GDP in 2007, is the counterpart of the swing in the private balance, forecast at 8.9 per cent of GDP between 2007 and 2009.

As my colleague, Samuel Brittan, asked last week, why should such a temporary increase in the fiscal deficit be terrifying? UK net public debt – forecast at 61 per cent of GDP this year – remains well below the average of advanced country members of the G20. At the end of the Napoleonic and second world wars, UK public debt was close to 2.7 times GDP.

Yet even this triggered none of the hyperinflationary consequences now widely feared. As the IMF also notes, even a 100 percentage point increase in the debt ratio should require an offsetting shift in the primary fiscal balance (with interest payments removed from spending) of no more than 1 per cent of GDP, provided fiscal credibility is maintained.

The condition for this is evident in his Budget, the chancellor of the exchequer should lay out fiscal measures to go into effect, automatically, once the economy recovers. In short, what is needed is a far more credible fiscal regime.

Yet it is very peculiar to be agitated about the inflationary impact of fiscal deficits, yet relaxed about monetary expansion by central banks. Is the latter not the true danger? Or are these not just two sides of one coin, the ultimate inflationary risk being the central bank financing of deficits?

Yet, even before reaching that point, reliance on aggressive expansion of the balance sheet of the central bank has dangers, including for the fiscal position, as my colleague Willem Buiter has noted in his *Maverecon* column. Unconventional monetary policies work by expanding the money supply ("quantitative easing"), by easing credit constraints ("credit easing") and by altering relative yields on assets, particularly through direct purchases of longer-term assets. The Bank of Japan focused on the first, the Federal Reserve has concentrated on the second, and the Bank of England has now initiated the last, with direct purchases of gilts.

Carried out with sufficient single-mindedness, such programmes will "work". At the limit, a modern central bank can drown an economy in infinite quantities of fiat (or man-made) money. The question is the obverse: it is whether the longer-term inflationary impact of monetary expansion can be reversed in time. To this, again, two answers exist: one concerns feasibility, and the other concerns credibility.

On the former, the broad answer is that a central bank's unconventional monetary operations are reversible: if it buys bonds, it can resell them; if it

**The ability to navigate through the crisis depends on the sincerity of the authorities' commitment to stability**

buys short-dated paper, it can allow it to expire, if it directly finances government deficits, it can sell the public debt to the public, and even if it sends cheques directly to every citizen, which would be closest to a purely fiscal operation, the government can always sterilise the monetary effects by issuing new bonds. So, if and when economies and, as important, financial systems, recover, aggressive action by the authorities would unwind the inflationary impact of even these unconventional policies.

So, as over fiscal policy, the

fundamental question – as Spencer Dale, the Bank's new chief economist, notes in an important recent speech – is the credibility of the commitment to stability.\* If, for example, the central bank takes very large credit risk and the public doubts the willingness of the fiscal authorities to reimburse resulting losses, it will expect these losses to be monetised.

Similarly, the public may well doubt whether the huge expansion in central bank balance sheets – as is evident in the US – would be reversed in time. Inflationary expectations may then gain a firm hold, driving inflation-risk premia up and the exchange rates down. This would greatly increase the costs of restoring credibility on the inflationary upside, thereby further undermining the central banks' ability to do so when the time comes.

The conclusion is straightforward: the ability to navigate through the crisis, using either fiscal or monetary measures effectively and at modest overall cost, depends in both of these cases on the credibility of the authorities' commitment to long-term monetary stability. Neither huge fiscal deficits nor massive monetary expansions are themselves an unmanageable threat, provided the regime itself remains credible. This is crucial even for a country as indispensable to the global economy as the US. For the UK, it is close to a matter of economic life and death.

\* Tough times, unconventional measures, [www.bankofengland.co.uk](http://www.bankofengland.co.uk)

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# A summit success that reflects a different global landscape



**Philip Stephens**

The London summit was not, after all, a flop. More than that, the gathering of 20-something world leaders was a substantial success. It is true that, for all his diligent diplomacy, Britain's Gordon Brown could not claim to have saved the planet. Yet historians will record the summit as the moment when a world in the throes of economic and geopolitical upheaval took a first, hard look in the mirror.

Those who view politics as an event rather than a process will have been disappointed. So also will those expecting, or pretending to expect, that the summit would fix the global economy. The world is too complex for the instant gratification demanded by 24-hour rolling news channels.

The final communiqué was replete with the linguistic fudges that speak to a difference of diagnosis and remedy for the world's economic ills. The grandstanding of France's Nicolas Sarkozy and the no-nonsense fiscal conservatism of Germany's Angela Merkel handed ammunition to anyone in search of discord.

To have expected anything other than this of the summit, however, was to misunderstand the nature of politics and the scale of the challenge. Ms Merkel was stating the obvious when she said each of the leaders was determined to defend his or her own national interest. It was ever thus.

The summiters had their own historical and cultural reference points. Many of the differences defined the obvious boundaries between west and east, between old and rising powers.

Thus, in considering measures to

promote recovery, Germany recalls the ruinous consequences of the inflation of the Weimar Republic. The US looks back to the same era, but uppermost in President Barack Obama's mind is the human misery of the Great Depression.

These gatherings cannot erase such differences. The purpose is to align, as far as possible, national and mutual interests. In hauling the leaders some way in this direction, Mr Brown is due his plaudits.

I cannot claim an inside track on the course of the international economy. But for the short term everyone agrees things will be bad – not least in the world's poorest economies. On the other hand, I am unpersuaded by the prophets of doom who think we are rushing headlong towards economic Armageddon.

The banking system still needs to be fixed. As Dominique Strauss-Kahn, managing director of the International Monetary Fund, has warned, many banks are still hiding toxic assets. The Fund is warning, too, of a potential financial crisis in eastern and central Europe. The collapse in world trade is a measure of how quickly bad news ricochets around the global system.

Measured by what was "brand new", the summit's achievements were modest. Yet the proper gauge of success was how far the leaders had travelled during the past few months. The answer is quite a distance.

Mr Strauss-Kahn observed that in spite of recent spats the leading economies had, by and large, met the Fund's call for a fiscal boost of 2 per cent of global output. Alongside it, the world has seen an unprecedented monetary stimulus, with interest rates as close as it matters to zero. More stimulus may be needed, but for now that argument is an artificial one.

The communiqué also includes a huge injection of funds to increase the firepower of the international financial institutions so that they can prop up emerging economies and

support trade. The numbers here were higher than even some optimists had hoped for. I leave to the accountants an assessment of the statements on bank regulation and tax havens. Something on those issues needed to be done, if only for politics' sake. But a clampdown on bank accounts in Liechtenstein is not the most urgent task.

Those who dismiss the summit have to consider how much of the convergence would have occurred without the focus of this week's meeting. Not much, I suspect.

The summit's deeper significance, though, lay in its unspoken recognition of the remaking of the geopolitical landscape. Not so long ago, this would have been a gathering of the Group of Eight rich nations, perhaps with cameo roles for China,

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India and a few others. Now, Hu Jintao, Manmohan Singh and the rest take their places as of right. The world, in other words, is at last catching a true reflection of itself.

Mr Obama has been more alert than most to this shift. Europe speaks the language of inclusiveness but is genuinely fearful of giving ground to the rising powers. Mr Sarkozy's petulance is more a cry of pain than a measure of confidence.

By contrast, the US president has grasped that if America is to hold on to its pre-eminent role in the world it will be within a system in which others have a stake. Mr Obama shows wisdom beyond his years in realising that to understand the extent of US power – and it is still unrivalled – a

president must also map its limits.

The road ahead will be bumpy. Whatever Mr Obama's intentions it will be hard for the US to break the unilateralist habit, not least because many of those who demand that Washington share power also expect it to pick up the tab for global security. The hesitation of many of the old powers to cede power is matched by the reluctance of the rising nations to assume the burdens. China wants recognition of its great power status through a bigger say in international institutions. But while this week saw Beijing in more assertive mood, it is still minded more to say what it dislikes than to offer its own answers. India is even less inclined to accept that prestige carries responsibilities.

The so-called Group of 20 – I counted 29 delegation heads round the dining table in 10 Downing Street – is a cumbersome grouping. Its reach gives it legitimacy, but at the price of operational efficiency. A smaller grouping – say, of 15 – might yet be a better answer.

Whatever the imperfections, the process promises to embed the habit of multilateralism in a multipolar world. History reminds us that big shifts in global power, such as we are witnessing, often end in war as rising states challenge the status quo. A few arguments about tax havens or bank regulation are a small price to pay for a peaceful transition.

Managing the Sino-American relationship during the next decade will require extraordinary statesmanship on both sides. Europe still has to find a path out of its present state of denial. The rising nations will not easily shed their suspicions of the west. So, yes, there will be fissures and fractures. It will take more than a summit or three to conjure a new global order. But looking hard in the mirror is as good a place as any for the leaders to start.

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# Comment

## Obama's message on security should be candid

**George Robertson**

President Barack Obama will this weekend head to the 60th anniversary summit of Nato, held symbolically on the borders of Germany and France. His visit comes a week after the 10th anniversary of the Nato assault on the former Yugoslavia over Kosovo. The week also marks the re-integration of France into the Nato military command that it left 43 years ago. But amid all these military anniversaries what should Mr Obama's message be for the Europeans and what will he get in response?

He should ask the Europeans to do more in terms of security in return for a grand bargain – the US will remain connected to Europe's security and prosperity, Europe's part should be to step up to the plate on guaranteeing our collective safety from the new global risks. We have seen the chaos inflicted by the flutter of a butterfly wing in subprime housing loans, fallout could be just as severe from problems such as disease, climate change, resource wars and the proliferation of weapons of mass destruction.

With the rare backdrop of European goodwill that has been largely absent for a US president since the fall of the Berlin Wall, Mr Obama's message to Europe should be candid and sharp. The first priority is Afghanistan, where Europe's safety from infectious chaos is on the line. Mr Obama can underline with force that failure will hit hardest in Europe's backyard and Europeans are not doing enough. Afghanistan may be the front line for Europe's defence but we seem to lack the political will and modern capabilities to deal with enemies to our democratic way of life.

Second, Mr Obama, while taking a radical knife to his own defence budget and reaching out to Russia as a pragmatic ally (just as the Europeans asked), can look with dismay at the

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state of Europe's defence capabilities. The vast money that Europe spends on defence translates into so little. We are still largely configured, with some honourable exceptions, for a cold war that is long gone. Europe is pathetically ill-equipped for the world we foresee.

Today, Europe's usable deployable troops amount to just 2 per cent of the 2.5m who are in uniform. It has little or no airlift means to get troops to where they need to be. It has only a fraction of the helicopters that are urgently needed in battle zones, but thousands suited only for recreational flying. There is a scandalous shortage of crucial enablers – the logistical staff, engineers, cooks and medics. Without them no soldiers can be deployed. This lack makes a mockery of the ambition for a European pillar in the alliance.

So, Mr Obama should not ask for European defence budgets to be increased. That is not going to happen. Instead he should demand that existing budgets be redirected towards the threats of today. The millions in military budgets should be spent on 21st-century capabilities, not on cold war museum armies. He should point out that the newly re-integrated France will be taking over Nato's transformation command based in Norfolk, Virginia. This is where a massive transformation of European forces and capabilities should start immediately.

I hope Mr Obama will also tell us what is staring us in the face – that a European Security and Defence Policy is good for the US as well as Europe but that it must not be about glitzy headquarters and flags on posts, but about a real ability to act in a crisis. That depends on tackling issues, such as why the European Rapid Reaction Force still only exists on paper, and why 10 years on only a fraction of the headline goals on capabilities have been achieved. Too many people in Europe cling to the notion that if there is trouble in its backyard they need only call Washington, as they did for Kosovo and Bosnia. Mr Obama should tell them that the line will be busy.

Europe's leaders are far too silent, culpably so, about our new vulnerabilities. Just as Mr Obama tells Americans the hard truth about what faces them, it is time Europe's politicians got the message over what needs to be done. I give this solemn warning to Europe's political leadership. If you do not use budgets on real defence needs, you will risk some of the anger that is focused on bankers. Spending scarce taxpayers' money on heavy metal armies, undeployable troops or the wrong helicopters is a potentially blood-boiling scandal. Nato, as President Nicolas Sarkozy has said, is an alliance of European states as well as of North American and European nations. It is time for Europe to wake up if it is to show up on the day. Only then can it face the new president with its head held high.

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