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For over sixty years the United States has been the largest economy and most powerful country in the world. However, there is growing speculation that this era of hegemony is under threat as it faces huge trade deficits, a weaker currency, and stretched military resources. *America’s Global Advantage* argues that, despite these difficulties, the US will maintain its privileged position. In this original and important contribution to a central subject in International Relations, Carla Norrlof challenges the prevailing wisdom that other states benefit more from US hegemony than the United States itself. By analysing America’s structural advantages in trade, money, and security, and the ways in which these advantages reinforce one another, Norrlof shows how and why America benefits from being the dominant power in the world. Contrary to predictions of American decline, she argues that American hegemony will endure for the foreseeable future.

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To family and friends
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Preface

When I began inquiring about the distribution of benefits from trade, I was first looking at countries’ relative capacity for trade expansion, synergies between import and export growth, and the determinants of commercial bargaining power. After some time, I realized that evaluating countries’ relative propensity for raising imports and exports, and any advantage tied to it, required a parallel assessment of countries’ ability to absorb foreign investment and to invest in other countries. Analyzing commercial gains allocation meant getting to work on the politics of investment and monetary relations, and wading through more data than any scholar without a research assistant could possibly wish for. In the meantime, there was renewed interest in cross-border financial transactions in the economics discipline, a string of unprecedented current account deficits in the United States, euro success, and China’s rise. One moment there was talk of America as empire, the next forecasts of American decline. But just how much systemic variation is there between the account of America the indispensable power and America the weak? This led me to consider the structural features at the basis of a country’s relative standing in the world and the relationship between these features. Was there a bargaining advantage associated with being the largest power in the world, or was it better to be a free-riding smaller power, as so many scholars surmised? My research not only suggests that the United States benefits from being the most dominant power today, but that it will continue to be the greatest power for the foreseeable future. Not all gains are quantifiable in monetary terms but come in the form of an unusually wide policy autonomy window, i.e., a longer time horizon and a greater capacity for risk-taking. Because of the leverage the United States has over other states, it has considerable leeway to pursue policies that would be suicidal if undertaken by any other country. This is not to say that the United States is above all constraint or invulnerable, but rather that it is in a better
position to gain from international economic relations than are other states – not all of the time, of course, but most of the time. This claim will seem obvious to many readers but is surprisingly controversial in the International Relations and Political Economy literature, where Olson’s public goods argument has been completely internalized and where any finding that is not counterintuitive is frowned upon. While I understand that American decline is inevitable in the long run, my analysis adds a cautionary note to all the speculation about imminent decline, which is by no means restricted to our own time but goes back to the 1970s, and never quite seems to materialize in the thunderous fashion that would sound the end of the American era.

Watching the full dread of the financial crisis play itself out in the United States while waiting for reader reports added unwelcome suspense to the review process. Although clearly this is not a book about the credit crunch, it includes aspects of the crisis and fundamentals in the banking sector relevant to assessing America’s clout, its relative position, and future prospects.
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In writing this book I have benefited from the insight, kindness, and generosity of many people. My greatest debt is to Joseph Carens, who read several versions of this manuscript and offered piercing comments, along with unfailing friendship and support. The man deserves a medal for his mentoring and benevolent engagement. When few could see what I was up to, Jennifer Nedelsky took the time to sit down and talk to me about my project, gently pushing me to exhume the core of my argument. David Welch read several chapters several times and offered his expertise and enthusiasm from start to finish. David Welch and Melissa Williams opened their home and made me feel as good as I possibly could when nothing was going my way.

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his reflections on a game-theoretic model. Mark Brawley gave me extremely useful comments on a paper on the IPE of investment, and invited me to talk on the rivalry between the dollar and the euro at McGill. Csaba Nikolenyi offered useful pointers and a generous reading of a paper on America’s external liability position. Carol Bertaut sent me a dataset, and a co-authored paper, on cross-border securities, and took the time to answer a series of questions in very precise terms. Cedric Tille looked at a rough draft on external imbalances and offered valuable feedback including recommendations for further reading. In response to e-mail, Pierre-Olivier Gourinchas took the time to clarify some of the criticism that economists at the Federal Reserve Board of Governors had leveled against his work with Helene Rey. I also owe a special thanks to three political economists at the Graduate Institute of International Studies – Urs Luterbacher, Cedric Dupont, and David Sylvan – where I did my PhD. My supervisor, Urs Luterbacher, gave me what game-theoretic tools I have, and the attention and space I needed to develop my own ideas. His views on my work, his encouragement, and his friendship have been invaluable. Cedric Dupont shaped my way of thinking about international institutions and offered me an affiliation, a desk, and moral support at a critical juncture of this book project. David Sylvan taught me to question assumptions in the IPE literature, and gave me incredibly useful advice on the very first proposal for this book project.

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I would also like to officially acknowledge previous publications. Parts of chapters 4 and 5 appeared earlier, in different form, in the Canadian Journal of Political Science, and parts of chapter 7 in Cooperation & Conflict.

Finally, special thanks to my family, Eva-Carin, Claes, Sofia, and Håkan, as well as Karl and other members of my extended family for love and support, and to Isabelle and Marwa for feedback on these chapters and impeccable friendship. This book is for you.
1

Introduction

Short on cash before his ship comes in, Antonio seals a bond with Shylock to sustain the profligacy of loyal, dear Bassanio. Cunningly, Shylock extends the credit with the proviso that, should Antonio fail to honor the bond, Shylock is entitled to a pound of Antonio’s flesh. Predictably, Antonio’s fortune is not homeward bound. With unmitigated glee, Shylock claims the bond. But enforcing the bond proves difficult. The rules of the game are interpreted in such a way that Shylock must forego his bond unless he claims it in a way which spills no Christian blood – a way which is clearly impossible. All ends well except for Shylock. Antonio is richer by Shylock’s misfortune and so, indirectly, is Bassanio, having used the loan to conquer princess Portia, who is as good a catch as anyone ever was.

The main themes of Shakespeare’s play, *The Merchant of Venice*, are familiar. Friendship juxtaposed to love, greed to sacrifice. But it is literally a story of debt, and figuratively an account of the possibility of taking advantage of debt when being in debt is as fluid and deceptive as the Seas of Venice.

In sixteenth-century Venice, Christian rules favored Christian borrowers over Jewish lenders. Shylock tried to bring that order down by funding the untenable spending habits of Bassanio, whom Antonio felt obliged to protect. Much by way of commercial and financial interactions has changed in the course of half a millennium yet there are striking parallels to mull over. This book argues that American liabilities are strategic because the prevailing order in trade, money, and security makes it possible for the American people – the Bassanios of this world – to enjoy a cornucopia of foreign goods. Alarmist bells notwithstanding, if, by financing American consumption, China is banking on the demise of American hegemony, it is betting on the same terrible odds that sealed the fate of poor Shylock.

The United States has been the most powerful country in the world for more than sixty years. Throughout this period, it has had the
world’s largest economy and the world’s most important currency. For most of this time, it had the world’s most powerful military as well – and its military supremacy today is beyond question. We are truly in an era of US hegemony, a unipolar moment, a Pax Americana, which has enabled Americans to enjoy the highest standard of living in human history.

Is this privileged position being undercut by serial trade deficits? The pessimists are growing more numerous by the day. They see the country’s spendthrift ways as a disaster waiting to happen. They warn that the cavernous gap in merchandise trade, well above 6 percent in 2006, is an ominous sign of competitive slippage. In 2008, the liabilities acquired to finance the shortfall in exports reached an amazing 29 percent of GDP. A falling dollar, military overstretch, the rise of the euro, the rise of China, and progressively deeper integration in East Asia are among the factors that many believe herald the imminent decline of American hegemony.

In my view, the doomsayers are mistaken. I argue that American hegemony is stable and sustainable. While the United States certainly does face a number of challenges, an analysis of the linkages between trade, money, and security shows that American power is robust.

This book is a story about why and how American hegemony works, and what other states would have to do to emulate or, on other grounds, thwart, America’s power base. As I will show, the United States benefits from running persistent trade deficits as a result of its special position in the international system. I will argue that any comparably situated country would choose to pursue the same cyclical deficit policy as the one encouraged by the US government. A series of size advantages cut across trade, money, and security: the size of the American market, the role of the dollar, and American military power interact to make a trade deficit policy rewarding and buffer the United States from the extreme consequences that a sustained deficit policy would otherwise have.

Based on new research in economics on valuation adjustments (i.e., capital and exchange rate gains), and data analysis of my own, this study draws attention to the economic advantages for the United States of having the key currency. In addition to benefits in the form of seigniorage, the United States gains substantially from valuation adjustments, reinforcing policy autonomy and the gains derived from the asymmetry in the structure of borrowing and lending. I also lean on new economic