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The Greatest Enemies of the West

by NORBERT F. TOFALL

Abstract

The West's biggest enemies are national debt and weak productivity. The situation is favourable for China and Russia to attack Western currency dominance and the US dollar.

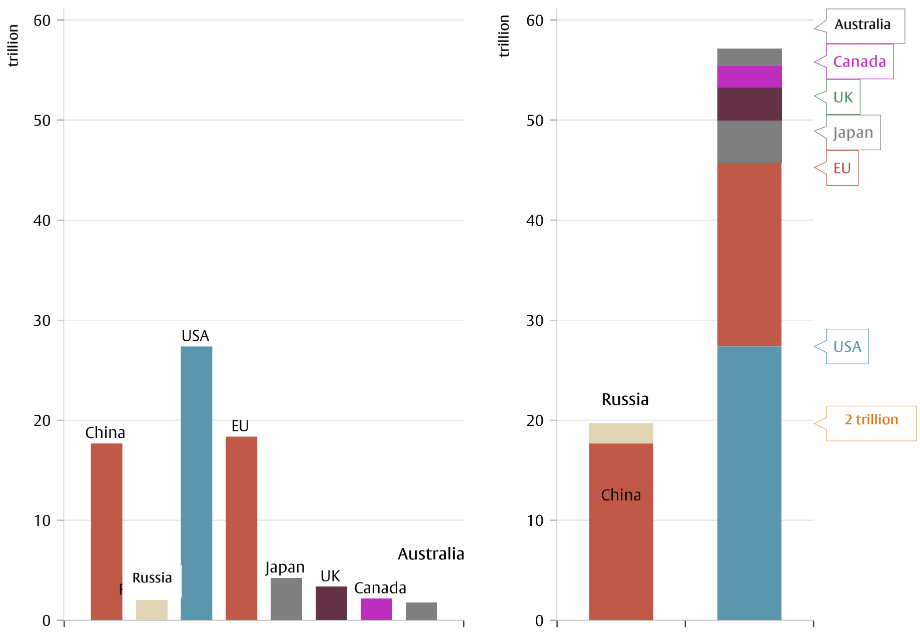
Zusammenfassung

Die größten Feinde des Westens sind die Staatsverschuldung und die Produktivitätsschwäche. Die Lage ist für China und Russland günstig, die westliche Währungsdominanz und den US-Dollar anzugreifen.

The West's biggest enemies are not China and Russia, nor are they the BRICS+. Russia and China are also great enemies of the West, but the West's greatest enemies are its own horrendous national debt, weak productivity and investment and the creeping depletion of capital. The national debt of many Western countries and the USA in particular has reached a level never seen before in peacetime. The situation is therefore favourable for China and Russia to attack Western currency dominance and the US dollar as the world's reserve currency. [1]

Moreover, the real geo-economic and geopolitical challenges still lie ahead of the West. Looking at the gross domestic products of Western countries on the one hand and China and Russia on the other (see Figure 1), the West should actually be able to overcome these challenges if it represents its economic and political interests against China and Russia in a reasonably united manner and agrees on a joint China and Russia strategy.

Figure 1: Nominal GDP in US dollars in 2023



Source: Flossbach von Storch Research Institute, Macrobond, International Monetary Fund (IMF). Data from 17 June 2024

However, due to high levels of national debt, weak productivity and investment and the creeping erosion of capital, many Western countries are being caught on the wrong foot by the geo-economic and geopolitical challenges that lie ahead. In

[1] See NORBERT F. TOFALL: *US dollar, BRICS+ and China. Is a de-dollarisation of the global economy likely?* Commentary on economics and politics by the FLOSSBACH VON STORCH RESEARCH INSTITUTE, 2 October 2023 and JOHN M. T. RYAN: "Will Geopolitics Accelerate China's Drive Towards De-Dollarisation?", in: *The Economists' Voice*, July 2024.

addition, the obstacles to growth in many Western countries, which are based on years of procrastination, are the underlying causes of the ultimately self-destructive political attempts by populist left-wing and right-wing movements to preserve or even increase their own nation's prosperity through protectionism and isolationism and to secure it through special security and economic deals with China and Russia.

In view of the economic balance of power (see Figure 1), it is obvious that China and Russia are pursuing the dominant strategy of dividing the West economically, politically and culturally at all levels. The BRICS+ are only a means to an end.

The Chinese and Russian strategy can only work in view of the still existing economic proportions if the West allows itself to be divided and does not fight its greatest enemies, which are home-made.

I.

There have always been studies that analyse the rise and fall of empires and nations.[2] And in the study published last year by Peter Heather and John Rapley "Falling Empires. Rome, America and the Future of the West", which was published last year, the high level of national debt and low productivity in particular are pointed out as the causes of the current economic and political problems in the West and a connection between the two phenomena is suspected. [3]

Rapid social and technological change revolutionised the productivity of labour in the 20th century. In addition, Western economies were able to boost their growth "by accelerating borrowing on future earnings", earnings that "ultimately resulted from productive investments." Today, however, it is not easy to distinguish borrowing for productive investment from borrowing to cover outstanding expenditure. "Even apparently old-fashioned infrastructure projects are not always what they seem in the modern West." [4]

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[2] See, for example, Edward Gibbon*: Verfall und Untergang des römischen Imperiums*, (original English edition 1776-1789), 6 volumes, Munich 2004; Mancur Olson: *Aufstieg und Niedergang von Nationen. Ökonomisches Wachstum, Stagflation und soziale Starrheit,* (original American edition 1982), translated by Gerd Fleischmann, 2nd, revised edition, Tübingen 1991; Paul Kennedy: *Aufstieg und Fall der großen Mächte. Ökonomischer Wandel und militärischer Konflikt von 1500 bis 2000,* (original American edition of 1987), translated from the English by Catharina Jurisch, Frankfurt a. M. 1989; Peter Heather*: Der Untergang des Römischen Weltreiches,* (original English edition of 2005), German by Klaus Kochmann, 5th edition, Reinbek bei Hamburg 2021; Daron Acemoglu and James A. Robinson*: Warum Nationen scheitern. Die Ursprünge von Macht, Wohlstand und Armut,* (original American edition from 2012), translated from the English by Bernd Rullkötter, 3rd edition, Frankfurt a. M. 2015.

[3] See Peter Heather and John Rapley: *Falling Empires. Rome, America and the Future of the West*, (original English edition of 2023), translated from the English by Peter Andresen, 2nd edition, Stuttgart 2024.

[4] For the entire paragraph, see ibid. p. 231.

Thus, the construction of a new bridge opens up new trade routes, reduces transport costs and travelling times and thus generates new economic activities, while the repair of an old bridge merely keeps existing trade routes open and secures existing activities.[5] With Friedrich August von Hayek, one can go beyond Heather and Rapley and say that the construction of a new bridge increases the capital stock, the repair of a bridge maintains the capital stock and the destruction of a bridge leads to capital depletion. Only the construction of a new bridge counts as an investment that can increase productivity ceteris paribus.

Heather and Rapley now argue that today, large gains that could be realised through state infrastructure projects and other forms of direct state incentives have shifted further and further away from the West. Although some economists claim that this could change through new productivity revolutions, for example in information technology, and that the old overall economic growth rates of the West could be achieved again, this has now been awaited for 40 years: "Robert Solow said back in 1987 that the computer age is everywhere except in the productivity statistics. And that still seems to be the case."[6]

For some time now, productivity has been growing more and more slowly in most Western countries. In the middle of the 20th century, annual productivity growth per hour worked was almost 3 per cent. Since the 1970s, however, it has been falling continuously and currently stands at around 1 per cent.[7]

However, Heather and Rapley do not address the fact that productivity development in the western countries is different, which is most likely due to the digitalisation of the computer age, which is more pronounced in the USA than in the countries of the European Union, but also to different economic regulation and incentive systems. In the USA, productivity has actually risen more sharply since 1995 than in the period from 1950 to 1995 (see Figure 2).

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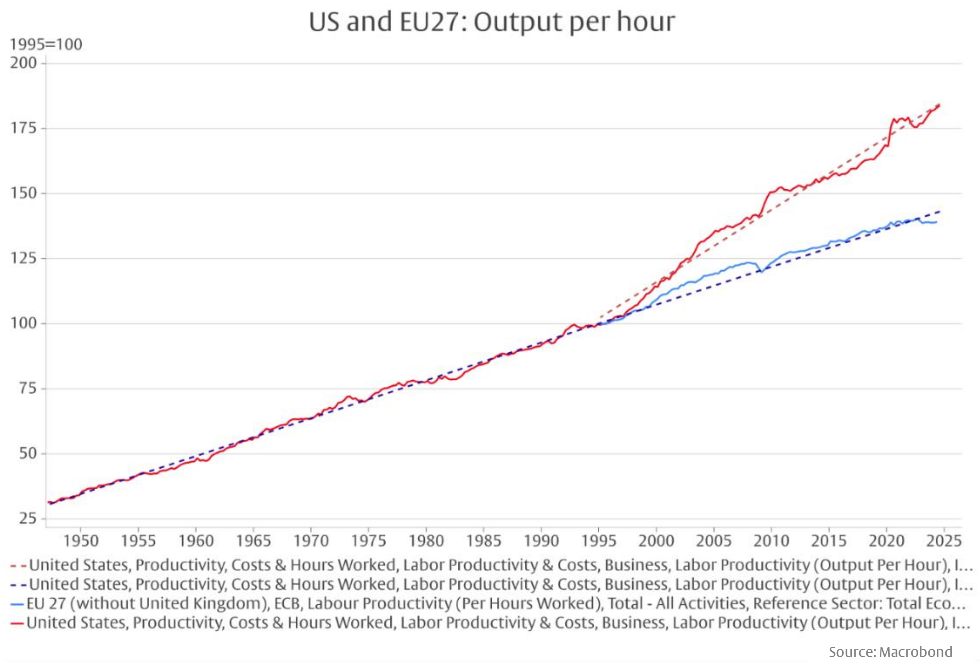
[5] Cf. ibid. p. 231-232.

[6] For the entire paragraph, see ibid., pp. 232-233.

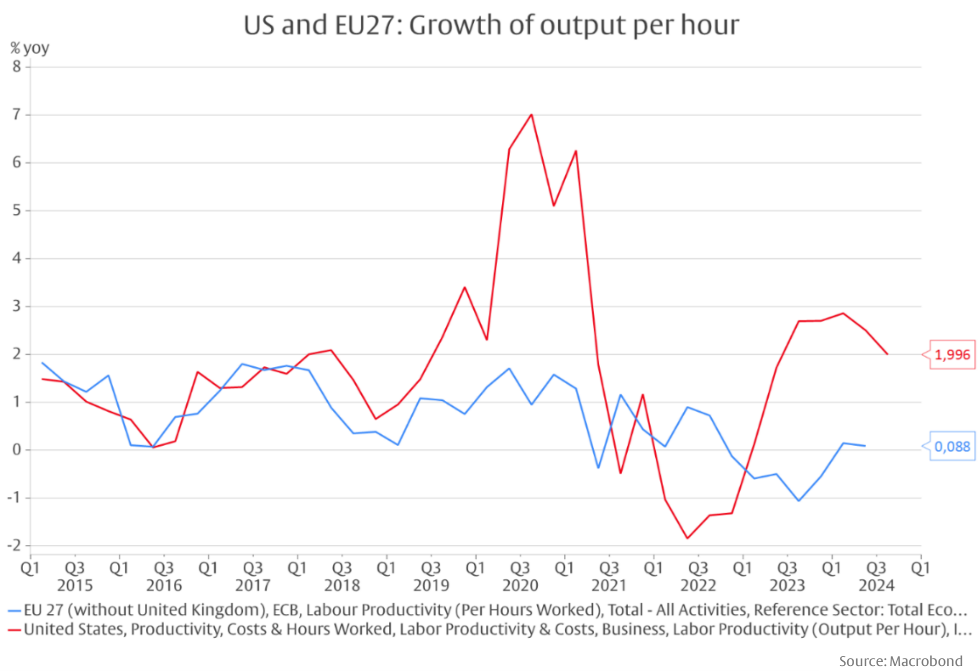
[7] Cf. ibid. p. 233.

Figure 2: Comparison of productivity trends in the USA and EU27



Productivity growth in the European Union has fallen significantly, especially since 2015, while productivity growth in the USA first fell below the productivity growth in Europe due to the pandemic but has risen significantly above the EU level again since the end of the pandemic, see Figure 3.

Figure 3: Productivity growth per hour



Heather and Rapley argue that only a very small number of highly productive people are responsible for the 1 per cent overall economic productivity growth per hour worked in Western societies, supported by a host of less specialised, low-productivity workers such as cleaners, nannies and baristas. Heather and Rapley then link this finding directly to the debt problem. In the past, in times when productivity growth was based on many people and broad sections of society, debt would have been a way of increasing future incomes in society as a whole. This probably means that the capital resources per working hour of many people and broad sections of society could be increased by means of debt, so that the increased labour productivity led to correspondingly higher real wages. Today, however, debt in Western societies is a means of financing consumption in the present that will only be paid for in the future:[8]

"Because the old mechanism of investment and expansion has broken down, Western governments and societies have become accustomed to using new debt not so much to create future prosperity, but primarily to maintain current living standards."[9]

We can only agree with this finding. And it should have been made even clearer that this finding reflects the greatest enemies of the West - horrendous national debt, weak productivity and investment and the creeping erosion of capital. But is this entirely correct finding really based on the causal analysis that Heather and Rapley offer us? An incorrect causal analysis leads logically to incorrect therapeutic proposals.

Due to their Keynesian orientation, Heather and Rapley unfortunately do not get to the bottom of their presumed connection between weak productivity and debt and therefore completely neglect the fact that the connection between high debt and weak productivity follows from our monetary system. This is because the high level of debt in many Western countries would not have the threatening consequences of weak productivity, investment and growth as well as capital accumulation if this debt consisted of savings and thus of consumption foregone and not of credit money creation as in our current monetary system. The "mechanism of investment and expansion" has been progressively overridden since the early 1970s by ever more limitless debt created out of nothing. The connection between investment and expansion ultimately only exists

when investments are equal to savings or at least are not completely decoupled. But this is exactly what has been happening since the beginning of the 1970s as a result of the unpegging of the dollar from gold.

8 For the entire paragraph, see ibid., pp. 233-234.

9 Ibid., p. 234.

Although Heather and Rapley point to the declining productivity growth in Western societies since the 1970s and even suspect a connection with debt, they overlook the fundamental changes in the monetary and debt system of Western societies that have developed since the beginning of the 1970s as a result of the dissolution of the dollar peg to gold: The financing of present consumption through debts that only have to be paid off in the future is promoted by our monetary system because today's debt is not based precisely on the renunciation of consumption in the present, i.e. on savings.

However, this also means that the years of economic procrastination in Western societies and the weakness in productivity, investment and growth have been created by creating credit out of thin air and are based on our monetary system. Ultimately, these protracted problems can only be ended if a reform of our monetary and debt system is tackled. On the positive side, this means that the West can play out a strategic option with a possible and necessary reform of its monetary and debt system, which should not be underestimated, especially if China and Russia were to attack Western monetary dominance and the Western monetary and debt system.

II.

China, Russia and the BRICS have wanted to break the dominance of the dollar as the world's reserve currency for years and are striving to de-dollarise the global economy. Overt and covert gold purchases by many central banks around the world are likely to be attributable to this goal. The timing to attack the West on its monetary policy Achilles' heel is certainly favourable.

But will this attack be launched by a gold-backed currency that could be issued by China or the BRICS+ countries? And how likely is it that such an attack will break the dollar's dominance?

Neither the final declaration of the 15th BRICS meeting in Johannesburg in August 2023[10] nor the final declaration of the 16th BRICS meeting in Kazan in October 2024[11] mention the introduction of a common BRICS currency or even a common gold-backed currency in the near future. The dominance of the US dollar is to be pushed back simply by using their own national currencies in international trade and financial transactions between the BRICS states as well as between the BRICS states and their trading partners. To this end, the establishment of a separate clearing and settlement system beyond the SWIFT system has been sought for years, as

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10 See https://mea.gov.in/bilateral-documents.htm?dtl/37030/15th+BRICS+Summit+Johannesburg+II+Declaration or https://www.thepresidency.gov.za/content/xv-brics-summit-johannesburg-ii-declaration-24-august-2023

11 See http://static.kremlin.ru/media/events/files/en/RosOySvLzGaJtmx2wYFv0lN4NSPZploG.pdf

the SWIFT system is closely intertwined with the US dollar and the euro.

In order to limit currency fluctuations in their own national currencies, the BRICS launched the Contingency Reserve Agreement (CRA) back in 2014. The purpose of the CRA is to provide credit lines that enable the participating central banks to stabilise currency fluctuations without risking depletion of their currency reserves.[12] The aim was to create a kind of alternative to the International Monetary Fund (IMF), but this has not even been remotely achieved to date. Moreover, the basic structure of the CRA already stands in the way of the de-dollarisation that was actually intended. As the BRICS countries have strong trade links with the dollar bloc, the CRA's currency stabilisation mechanism is based on the US dollar.[13]

The lack of clarity in terms of monetary policy is obvious and is not reduced by considerations to switch the CRA mechanism from US dollars to gold in order to initiate the introduction of a common gold-backed currency. Why would China, which wants to promote the global use of the renminbi, agree to such a proposal and impose monetary policy restrictions on itself through a gold currency?

Accordingly, the BRICS final declaration of Johannesburg in August 2023 makes no mention of a gold-backed BRICS common currency. Instead, it states under point 45:

"We task our Finance Ministers and/or Central Bank Governors, as appropriate, to consider the issue of local currencies, payment instruments and platforms and report back to us by the next Summit."

In the run-up to the Kazan Summit in October 2024, Russia tried to promote a Russian-designed clearing and settlement system called the "BRICS Bridge Payment System". The Russian proposal for a new payment system was based on a network of commercial banks linked via the central banks of the BRICS countries. The system would utilise blockchain technology to store and transfer digital tokens backed by national currencies. This in turn would allow these currencies to be exchanged easily and securely, bypassing the need for dollar transactions. Russia sees this as a way to solve the increasing problems in processing trade payments, even with friendly countries such as China, where local banks fear they could be affected by secondary sanctions from the United States. However, Yaroslav Lissovolik, founder of the think tank BRICS+ Analytics, admitted that the creation of such a system, while technically feasible, would take time.

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[12] See "Treaty for the Establishment of a BRICS Coningent Reserve Arrangement", July 2014, online: http://www.brics.utoronto.ca/docs/140715-treaty.html

[13] Ibid.

However, no finance ministers or central bank governors from the other BRICS countries travelled to a preparatory meeting in Russia 14 days before the BRICS summit in Kazan, which is why the Russian proposal was thwarted in advance. No monetary policy clarifications were agreed in Kazan itself.

The uncertainties regarding monetary policy do not exclusively, but primarily reflect China's ambivalent interests. Due to its export-orientation, China is firmly integrated into the global dollar system. A rapid and complete withdrawal of China from the global dollar system would be associated with considerable damage to the Chinese economy,[14] which is likely to significantly exceed the damage caused by the coronavirus crisis.

On the other hand, China has stated that it would like the renminbi to gain greater global significance and to this end has agreed oil exports against renminbi with Iran, which is subject to international financial sanctions, among others. As important oil-exporting countries belong to the BRICS+, the use of the renminbi as a means of payment could well increase if the BRICS+ were to conduct their oil trade with each other as well as with their trading partners only in renminbi. However, this presupposes the full convertibility of the renminbi. After all, what should a country do with non-convertible renminbi? Only buy goods from China?

Although the BRICS+ could install a kind of transfer ruble system based on the renminbi, as in the former Warsaw Pact, the negative economic consequences of such a payment and clearing system should actually be enough of a deterrent.

Furthermore, India, which is currently allowed to pay for its oil supplies from Russia in rupees, is likely to ask itself why trade should be conducted in renminbi and not in rupees. And why should renminbi be used at all to bring about de-dollarisation if China itself is sticking to its integration in the global dollar system?

In the event of far-reaching financial sanctions,[15] which exclude a country from the US dollar system, China does have an advantage. Its digital renminbi (eRMB) could, under certain circumstances, partially undermine the effect of financial sanctions without the need to set up a clearing and settlement system independent of SWIFT.

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[14] Cf. Steffen Murau: "Competition for the dollar?", in: *ipg-online* from 21 August 2023, online: https://www.ipg-journal.de/rubriken/wirtschaft-und-oekologie/artikel/konkurrenz-fuer-den-dollar-6929/?utm_campaign=de_40_20230822&utm_medium=email&utm_source=newsletter

[15] On the question of whether sanctions and geopolitical risks could end U.S.dollar dominance, Colin Weiss: *Geopolitics and the U.S. Dollar's Future as a Reserve Currency,* Board of Governors of the Federal Reserve System, International Finance Discussion Papers, Number 1359, October 2022, p. 25: "Although the sanctions imposed on Russia' FX reserves by the U.S. and its allies may have increased the salience of sanctions risk, I find that geopolitics alone are unlikely to end the U.S. dollar's dominance as a reserve currency. Most government holdings of U.S. assets belong to those with close military ties to the U.S. and countries without these ties have strong economic incentives to hold dollar-denominated reserves. Even a geopolitically-motivated move away from the U.S. dollar in trade invoicing would only diminish the dollar's role as a reserve currency and not destroy it."

But even in such a case, the question immediately arises of what to do with eRMB if the renminbi is not convertible. Within a group of countries affected by financial sanctions, the eRMB could be used more widely; however, in order to be used more widely beyond this group, convertibility would at least have to be established. Furthermore, the eRMB is not a distributed ledger-based and self-managing cryptocurrency, but is based on a centralised ledger and can therefore be switched off by the Chinese central bank at the push of a button. This results in further dependencies on China.

Overall, the highly divergent interests of the BRICS member states and, in particular, the highly ambivalent pursuit of interests by China currently mean that the BRICS+ are unlikely to be able to significantly weaken the importance of the US dollar for the time being. This does not mean that the importance of the US dollar cannot decline in the future for other reasons. However, the most likely scenario at present is that the US dollar will continue to dominate. [16]

Until further notice:

1. The US dollar is freely convertible.
2. SWIFT is an efficient international payment system.
3. The American financial markets are the deepest and broadest in the world.
4. In the USA, there is legal certainty and
5. By and large, the Federal Reserve fulfils its statutory task of ensuring the stability of the value of the currency.

None of the BRICS+ countries, not even China, nor the group of countries as a whole can currently even come close to equalling the US dollar in this respect.

And it cannot be emphasised enough that the dominance of the US dollar, as it developed after the Second World War, was not based solely on the Bretton Woods system, but was only permanently accepted because the USA shared prosperity advantages with other nations through the Marshall Plan on the one hand and free trade on the other. Without these advantages for many nations, the US dollar would not have been able to maintain its role. The US dollar maintained its role as the world's reserve currency even after Richard Nixon announced in 1971 that the USA would no longer exchange US dollars for gold, thus ending the gold-dollar standard. The so-called "exorbitant privilege" of the USA is ultimately based on these globally distributed advantages for others who buy the dollar or dollar-denominated bonds for their own advantages and not to do the USA a favour. Only when these advantages no longer outweigh the disadvantages will the USA's exorbitant privilege disappear.

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[16] See also Steffen Murau, Joe Rini and Armin Haas: "The evolution of the Offshore US Dollar System: past, present and four possible futures", in: *Journal of Institutional Economics* (2020), 16, p. 767-783, p. 776.

Applied to BRICS+ and China, this means that only when the BRICS+ succeed in creating sufficient economic advantages for other nations worldwide in a credible and sustainable manner will there be a chance that the US dollar will be used less worldwide or even that its dominance can be broken. In addition, China would have to be prepared to share prosperity benefits with other nations. The former is unlikely due to the increased potential for conflict that the BRICS expansion entails,[17] the latter is very unlikely due to China's excessive desire for hegemony. China does not want cooperation for mutual benefit. China wants hegemony. And the gold price trend suggests that something is up.

III.

In the event of an attack on the exorbitant privilege of the dollar, it should not be expected that the USA will stand idly by and watch such an attack. In the early 1970s, the USA proved that it was capable of monetary reform within a matter of days. Today, the possibilities of digitalisation and distributed ledger technology can be used for monetary reform. And the former fear of contact between Silicon Valley and the US government no longer exists. In a currency war situation, it is unlikely that the USA, should its exorbitant privilege of the dollar be attacked by China and Russia, would set up a digital dollar modelled on the ECB's digital euro and thus merely digitally copy the current dysfunctional monetary system.

And it is unlikely that Europe will be able to decouple itself from monetary reform in the USA. Perhaps a monetary reform in the USA could lead to both the USA and Europe ending or having to end the economic procrastination of the last few decades and thus achieve new productivity growth. The West's greatest enemies are not China, Russia and the BRICS+. The West's biggest enemies are horrendous national debt, weak productivity and investment and the creeping depletion of capital.

Ceterum censeo: The pivotal point is the national debt. National debt must be reduced and our monetary and fiscal order must be reorganised. The West needs a kind of new "Bretton Woods" - a reorganisation of our monetary, money and debt order: Following the so-called Chicago Plan of 1933[18] , the central banks of Western countries should *firstly* take the national debt of their respective countries onto their balance sheets and *secondly* enable citizens to make secure bank deposits through full cover with central bank money and create digital central bank money

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[17] See NORBERT F. TOFALL: *G20, BRICS+ and China. Global economic and political minefields,* commentary on economics and politics by the FLOSSBACH VON STORCH RESEARCH INSTITUTE, 11 September 2023.

[18] See IRVING FISHER: *100% Money and the Public Debt*, Economic Forum April-June 1936, pp. 406-420 and JAROMIR BENES and MICHAEL KUMHOF: *The Chicago Plan Revisted,* IMF-Working Paper, WP/12/202, August 2012. Among the proponents of a 100 per cent reserve requirement for commercial banks, alongside Irving Fisher, was Milton Friedman, see MILTON FRIEDMAN: *A Program for Monetary Stability, Volume 3: The Millar Lectures,* New York (Fordham University Press) 1961.

as full money,[19] which makes political manipulation of interest rates more difficult. In addition, thirdly

by allowing competing private currencies[20] "market pressure to migrate", which stabilises the Western currencies through the practical possibility of migrating out of them.[21]

Although it seems utopian at the moment for the Western states to agree on a new currency, monetary and debt order at a new Bretton Woods Conference, the political pressure to face up to this challenge could grow faster than desired due to geopolitical crises and new wars. The new East-West conflict makes it necessary to strengthen the economic foundations of the West. The greatest enemies of the West are not China, Russia and the BRICS+, but the horrendous national debt, the weakness of productivity and investment and the creeping erosion of capital. These enemies must be fought. In the current global political situation, situations can quickly arise in which the alternative outlined above must be chosen because it enables swift and decisive action and because gradual debt relief has so far been unsuccessful or is no longer possible. Bretton Woods did not fall from the sky in 1944 either. But Bretton Woods already set the course for geopolitics, sovereign debt and financial markets after 1945 in 1944.

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[19] See THOMAS MAYER: *Ein digitaler Euro zur Rettung der EWU*, study by the FLOSSBACH VON STORCH RESEARCH INSTITUTE from 24 October 2019 and THOMAS MAYER: *Das Inflationsgespenst,* Salzburg (Ecowin) 2022.

[20] See FRIEDRICH A. VON HAYEK: *Entnationalisierung des Geldes. An analysis of the theory and practice of competing means of circulation,* Tübingen (Mohr) 1977

[21] See already FRANK SCHÄFFLER and NORBERT F. TOFALL: "Euro-Stabilität durch konkurrierende Privatwährungen", in: DIRK MEYER (ed.): *Die Zukunft der Währungsunion. Chancen und Risiken des Euros,* with contributions by Helmut Schmidt, Václav Klaus, Arnulf Baring, Roland Vaubel, Wolf Schäfer, Hans-Olaf Henkel, Charles B. Blankart and others, Berlin (LIT) 2012, pp. 275 - 288 and NORBERT F. TOFALL: *Währungsverfassungsfragen sind Freiheitsfragen. Towards a market-based monetary order with cryptocurrencies?,* study on economics and politics by the FLOSSBACH VON STORCH RESEARCH INSTITUTE, 15 January 2018.

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