

# **FINANCIAL** **COLD WAR**



**A VIEW OF SINO-US RELATIONS  
FROM THE FINANCIAL MARKETS**

**JAMES A. FOK**

**WILEY**

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# **Financial Cold War**

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Financial Markets***

**James A. Fok**

**WILEY**

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*For Peter & Harry*

## Preface

Among my earliest memories was a visit to a stockbroker's office with my father. Growing up in Hong Kong, every Chinese New Year children would receive 'red packets' containing small sums of money from relatives and family friends. Each year, my father would gather up the haul that my siblings and I had collected to invest in stocks. In the *go-go* years of Hong Kong in the 1980s, people from all walks of life seemed to hang on every fluctuation of the stock market. Although I had very little knowledge of financial markets back then, I suppose I was instilled early in life with a sense of their power.

Later, as a teenager, I struggled with my studies in classical Chinese texts. Taking pity on me, my godmother offered to tutor me, and I started going up to her office twice a week for tutorials. Auntie Sue - as she is known to me - was a successful lawyer who had co-founded a law firm with my father. However, by that stage she had become a little bored of the law and had taken up a side-line in trading stock options. I found Confucian and Mencian philosophy rather tedious and often diverted these tutorial sessions to discussions on stocks and options trading. Over time, Auntie Sue taught me the basic principles of securities valuation and options pricing that, as an adolescent with dreams of riches, I absorbed with enthusiasm.

In my first year at university, with savings from part-time work and various entrepreneurial ventures, I opened an online trading account and began investing in the markets myself. It was in the middle of the Dot-com boom and I had some initial success but, ultimately, this was to lead to one of my first great lessons in the pitfalls of overexuberance.

Nonetheless, my interest in financial markets wasn't extinguished.

As an undergraduate in Beijing in the 1990s, I got to experience first-hand how market reforms were transforming China. I witnessed the launch of Starbucks, Walmart and the trappings of American consumer culture in the country. A huge number of Chinese students aspired to post-graduate studies in the United States (US) and I was regularly asked by fellow students to help them study for the GRE English test, success in which was a prerequisite for acceptance to American colleges (although, frankly, most of them scored far higher than I would have done). At that time, it seemed to me that the 'Chinese Dream' was pretty similar to the 'American Dream' and, like many observers, I expected economic growth would ultimately lead to political reforms and a more liberal democratic society.

I also glimpsed some of the hangovers from China's traumatic past. When five US guided bombs hit the Chinese embassy in Belgrade during the Balkans conflict in 1999, people were quickly whipped up into a nationalistic frenzy. US authorities claimed that this incident, in which three Chinese citizens were killed, was due to a CIA mistake. China has never accepted this explanation. In the days that followed, angry crowds demonstrated outside the US embassy. One evening shortly afterwards, I was out with a friend from Korea. Conversing in English, we were mistaken for Americans and chased after by a mob. That certainly left an impression on me that populist nationalism is a pretty scary thing.

On completing university, I joined the graduate programme of an American investment bank in London. I rapidly specialised in advising financial services clients and

learned top-down and bottom-up about the international financial system.

For almost a decade until mid-2021, I worked at the centre of Hong Kong's financial markets at Hong Kong Exchanges and Clearing Limited (HKEX). HKEX is the sole exchange and clearing house operator in the most successful initial public offerings (IPOs) market in the world. I landed there because, back in early 2012, I found myself between jobs with time on my hands. A social acquaintance who was running Business Development for HKEX at the time asked if I might come and help out on a corporate takeover the Exchange was contemplating. I had been due to join another investment bank several months later and my wife told me I should just relax and enjoy my time off. However, although I had previously worked on transactions involving banks, insurers and asset managers, I had never seriously looked at how exchanges work, and curiosity got the better of me. The transaction turned out to be the competitive auction for the London Metal Exchange (LME), the world's leading venue for trading industrial metals, with a history tracing back over four centuries.

From the outside in, HKEX in those days looked like a sleepy and bureaucratic organisation. On my first day in the office, I discovered that the company did not have international direct dialling from the desktop phones. To make an overseas call, you had to find a secretary to come and input a long series of codes before being able to dial out. The first-round bids for the LME were due in a couple of weeks. When I got home that night, I told my wife that I would be able to resume my time off after that. *Famous last words...*

HKEX was then in the early stages of a transformation to broaden its focus from stock trading. Notwithstanding the company's inexperience in international takeovers, the then

Chairman and CEO were determined to win the race to acquire the LME. In the latter stages of the transaction, I was asked whether I might stay on in a full-time position. My wife was sceptical about the idea. We were thinking about starting a family and working for the Exchange would involve a meaningful pay cut. However, somehow it just felt like the right move.

Hong Kong is a small town and I already knew a number of people at HKEX. Most importantly, the Exchange was one of the few sizeable financial institutions that is Hong Kong-based. HKEX sits at the heart of Hong Kong's financial ecosystem, which is integral to the city's success and prosperity. It was attractive to me to be putting my energies towards building a company that can make a big difference to Hong Kong, and where the key decisions were made locally, rather than far away in Frankfurt, London or New York.

Hong Kong's *raison d'être* since it was ceded to the British in 1842 following the Opium War has been as a centre of trade, connecting China and Western markets. Over time, the trade in goods was supplemented by trading in securities and derivatives. Following the return of sovereignty to China in 1997, Hong Kong's role as the leading financial centre connecting China and international markets has continued to grow.

HKEX has grown alongside Hong Kong, expanding its role in the past decade from serving as the leading platform for Chinese companies to raise investment from international investors to trading in fixed income, currencies and commodities. The company has also cooperated with Mainland Chinese market infrastructure operators to expand and deepen the connections between China and international markets.

Initially, I worked as Chief of Staff to the CEO. Later I took over running Group Strategy for the organisation. Through my work on the formulation and execution of HKEX's strategy, I found myself at a fascinating intersection of global geopolitics and financial markets at what is arguably one of the most pivotal points in international relations in my generation. From this perch, I had the opportunity not only to interact with the top managements of the major global banks, corporate issuers and investors who are HKEX's customers, but also to work closely with regulators and policymakers in Hong Kong, Mainland China, and around the world. This opened my eyes to the broader geopolitical considerations surrounding financial markets policy and regulation.

In most parts of the financial services industry, the main challenges are to work out how to get something done and how to make money doing it. Due to their central position in the marketplace, exchanges and other market infrastructures that constitute the 'plumbing' of the global capital markets overlap with regulation and policy to a much greater extent than other financial organisations. For regulators and policymakers, making money is only a secondary or even tertiary concern. What they care about are the *rules of the game*. Very subtle changes in these can have a huge bearing on a wide range of national interests.

Following China's economic rise over recent decades and emergence as a global power, there has been much speculation about a 'gathering storm' in Sino-US relations. Academic and policy debate has raged over whether China and America can avoid the 'Thucydides Trap'. This is the theory first posited by the ancient Athenian historian Thucydides in his *History of the Peloponnesian War* between Athens and Sparta (431-404 BC) that the fear of a rising power challenging the leadership of an incumbent power would inevitably lead to war. Indeed, in the majority

of instances where a rising power has challenged the supremacy of the dominant power over the past five hundred years, war has followed – as in the case of Germany versus Great Britain in 1914.<sup>1</sup>

In the euphoria of the years following the end of the Cold War, such a conflict between two major powers was almost unimaginable. And yet, in the wake of the 2008 Global Financial Crisis (GFC), we have seen a return to populist and nationalist politics, including the open expression of appalling prejudices, that had previously been unknown and regarded as unthinkable to my generation in the liberal democracies of the West. Brexit and the Sino-US trade war are conspicuous examples of this phenomenon, where public opinion and government policies have been heavily influenced by economic factors. At the time of writing, the full long-term effects of the Covid-19 pandemic are yet to be known, but tensions have been escalating.

This book is an attempt to synthesise the financial and economic factors that have brought us to our current predicament, analyse the geopolitical realities underlying financial markets today, and to suggest some solutions that balance the many varying interests, so as to avert the calamities that befell earlier generations. In this attempt, I am conscious of Maslow's caution that 'It is tempting, if the only tool you have is a hammer, to treat everything as if it were a nail'. Financial markets cannot provide solutions to all the complex problems that arise in Great Power relations – indeed, policies that excessively favoured markets at the expense of communities may have contributed to many of the problems in the first place.

That said, I haven't yet come across an analysis that considers fully, from both a top-down and bottom-up perspective, how the global financial system as we know it today is contributing to geopolitical tensions. Even less

attention is paid to the diverse range of policies, regulations, infrastructures and conventions that support it. Without an appreciation of these and the history of how the system has come about, it is difficult to understand the full scope of the systemic financial challenges facing the world's two leading powers, much less devise effective strategies for navigating the treacherous waters we're in.

A number of leading authorities from different fields have recommended a variety of paths that could lead to a peaceful rebalancing of the Sino-US relationship. This book does not try to usurp those, but to supplement their specific perspectives with a practical perspective from the field of financial markets. What I can say with confidence though is that, without addressing the sources of financial and economic tensions, it is unlikely that other sources of conflict can be eliminated. I hope this book might help increase mutual understanding and offer some insights to assist policymakers in both the East and the West in the extremely difficult task of smoothing the course of China's integration into the international financial system during a tricky period of geopolitical adjustment.

However, the book is not only targeted at policymakers. Be it in a liberal democracy or any other political system, leaders govern on behalf of their people. Every citizen has an interest in understanding the issues his or her country faces, so as to help ensure that leaders act in the best interests of society as a whole. The book has therefore been written in a way to make it accessible, without shying away from complexity. I hope it will be helpful in particular to those with an interest in international relations, finance, economic history, sociology and political science.

Being of mixed Chinese and British heritage, I owe my very existence to globalisation and to the particularly tempestuous period of history that created China and Hong

Kong as they are today. This has undeniably influenced my viewpoints. Another stroke of serendipity that has enriched my outlook – and my life more generally – was to have met my wife Yeone, an American with a love of her country. Through her, I have had the opportunity to better understand the US and re-examine some of my preconceptions. Having had the privilege of experiencing the best – and, on occasions, the worst – of contemporary China and America, I have a deep affection for both countries. Moreover, our two young sons will grow up both Chinese and American and, if for no other reason, this alone gives me an enormous vested interest in seeing the two nations thrive in harmony with each other. Yet, putting sentimentality aside, I believe that setting the right policies depends on making objective assessments of the facts.

At this point, readers should note that I held positions of influence in Hong Kong's financial markets strategy and policymaking between 2012 and mid-2021. Through this, I was directly involved in certain Chinese policy steps towards financial markets internationalisation that are discussed in this book. While I have made every effort to maintain objectivity, where there are failings in this regard, I hope that readers will be compensated through the insights afforded by a first-hand perspective.

Over the course of human history, extreme inequality in the distribution of resources has tended to lead to conflict. The evolution of international trade and investment has, when conducted on the basis of sound rules and with the object of mutual benefit, raised humanity's collective standard of living and contributed to more peaceful coexistence between societies. Listening to the political rhetoric of late, it seems that some of our leaders may need a reminder of the lessons of history. This is my small contribution to that cause and I hope that readers will find this book entertaining, informative and thought-provoking.

That all said, I am an optimist and believe firmly that, if we can successfully navigate the next steps of global financial integration, we can all look forward to a bright era of greater prosperity and security. We have no choice. The alternative is simply not something we want to contemplate.

-James A. Fok  
Hong Kong  
10 September 2021

## **Note**

[1.](#) See (Allison, 2017).

# Acknowledgements

My first thanks must go to my wife Yeone, who initially encouraged me to write this book as a way of passing some spare time while stuck at home during the Covid-19 pandemic. She probably hadn't imagined that it would become such an engrossing diversion as to cause me to neglect most of my familial duties for many subsequent months. As I disappeared (at least mentally) into the research and writing, she only very occasionally complained about having to shoulder most of the burden of looking after our five-year-old twins. On top of that, Yeone reviewed the first draft of each section, asked a ton of questions, and pushed me to add colour to illustrate my arguments. I hope that the final work at least partially justifies her sacrifices.

My next thanks go to Mark Bentley. Mark gave me my first job in financial services and has been a consistent friend and mentor ever since. While working on this book, I spent countless hours in conversation with him discussing many of the ideas contained in it. Mark and I have very different perspectives (he is an ardent free marketeer who talks of Milton Friedman in the same reverent tones reserved for saints of the church), but his impressive ability to dissect arguments and challenge the flaws in them undoubtedly improved the final work considerably.

This book also owes a huge debt to the work of the many authors and writers whose books, research papers and articles are listed in the bibliography. I now realise what an enormous amount of effort goes into all of this, and I am extremely grateful to each of them.

Along the way, I have had a lot of help. Much of what I have learned about financial markets has come from former colleagues, business partners, professional advisors, regulators and clients. There are far too many to name each of them here, but I am deeply grateful to all those who have shared the highs and supported me through the lows of my career thus far, and to each and every one who has made my work so much fun over the years.

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Jonathan Chow provided insightful feedback on the structure of the book and editing advice, which put better

focus on the key arguments. He also gave me some helpful suggestions on the title of the book and various sections.

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After I thought I had a near-final draft of the manuscript, a mutual friend suggested that I ask Henny Sender to take a look at it for me. I had met Henny a number of years before and knew her to be very thoughtful and knowledgeable about China's financial markets. I was incredibly fortunate that Henny not only *looked* at the draft for me, but drilled into the manuscript, pushing me to clarify each passage with a sort of nurturing iron discipline I had not encountered since visits to the school matron's surgery at boarding school. Without a doubt, this resulted in a far more polished work than I could ever have accomplished on my own.

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That all said, any errors, omissions or other failings in this final work (of which I am sure there are many) are my responsibility. I must also stress that the views expressed herein are mine alone, and do not claim to represent those of any of the individuals who have provided advice or support. Nor do they represent the views of any of my former employers or other organisations with which I am associated.

- James A. Fok  
Hong Kong  
4 October 2021

# Abbreviations

<b>9/11</b>	11 September 2001
<b>AIDS</b>	Acquired Immunodeficiency Syndrome
<b>AIIB</b>	Asian Infrastructure Investment Bank
<b>ANZUS</b>	Australia, New Zealand, United States Security Treaty
<b>ASEAN</b>	Association of Southeast Asian Nations
<b>B2B</b>	Business-to-Business
<b>B2C</b>	Business-to-Consumer
<b>BCCL</b>	Bond Connect Company Limited
<b>BIS</b>	Bank for International Settlements
<b>BRI</b>	Belt and Road Initiative
<b>CBDC</b>	Central Bank Digital Currency
<b>CBOE</b>	Chicago Board Options Exchange
<b>CBOT</b>	Chicago Board of Trade
<b>CCDC</b>	China Central Depository and Clearing
<b>CCP</b>	Chinese Communist Party
<b>CDS</b>	Credit Default Swap
<b>CEO</b>	Chief Executive Officer
<b>CFA</b>	Court of Final Appeal (of the Hong Kong Special Administrative Region)
<b>CFETS</b>	China Foreign Exchange Trading System
<b>CFEX</b>	China Financial Futures Exchange
<b>CFIUS</b>	Committee on Foreign Investment in the United States
<b>CGB</b>	Chinese Government Bond
<b>CIA</b>	Central Intelligence Agency
<b>CIPS</b>	Cross-Border Interbank Payment System
<b>CME</b>	Chicago Mercantile Exchange
<b>CMU</b>	Central Moneymarkets Unit (of the Hong Kong

	Monetary Authority)
<b>CNH</b>	Offshore Chinese Yuan
<b>CNY</b>	Onshore Chinese Yuan
<b>CSRC</b>	China Securities Regulatory Commission
<b>DTC</b>	The Depository Trust Company
<b>e-CNY</b>	Digital Yuan
<b>ECB</b>	European Central Bank
<b>EEC</b>	European Economic Community
<b>ETF</b>	Exchange-traded Fund
<b>EU</b>	European Union
<b>FATCA</b>	Foreign Account Tax Compliance Act (of the United States)
<b>FCC</b>	Federal Communications Commission (of the United States)
<b>FDI</b>	Foreign Direct Investment
<b>FDIC</b>	Federal Deposit Insurance Corporation (of the United States)
<b>FDR</b>	Franklin Delano Roosevelt
<b>Fed</b>	Federal Reserve (of the United States)
<b>FINSIDER</b>	Società Finanziaria Siderugica
<b>FSTB</b>	Financial Services and Treasury Bureau (of the Hong Kong Special Administrative Region)
<b>G-10</b>	Group of 10
<b>G-7</b>	Group of 7
<b>GATT</b>	General Agreement on Trade and Tariffs
<b>GDP</b>	Gross Domestic Product
<b>GFC</b>	Global Financial Crisis
<b>GNP</b>	Gross National Product
<b>GPS</b>	Global Positioning System

<b>GRE</b>	Graduate Record Examination
<b>GSE</b>	Government-sponsored Enterprise
<b>HFT</b>	High Frequency Trader
<b>HIV</b>	Human Immunodeficiency Virus
<b>HKEX</b>	Hong Kong Exchanges and Clearing Limited
<b>HKMA</b>	Hong Kong Monetary Authority
<b>HKSCC</b>	Hong Kong Securities Clearing Corporation
<b>ICB</b>	International Clearing Bank
<b>ICE</b>	Intercontinental Exchange
<b>ICSD</b>	International Central Securities Depository
<b>IET</b>	Interest Equalisation Tax (of the United States)
<b>IMF</b>	International Monetary Fund
<b>IMM</b>	International Monetary Market
<b>INSTEX</b>	Instrument in Support of Trade Exchanges
<b>IPE</b>	International Petroleum Exchange
<b>IPO</b>	Initial Public Offering
<b>IRI</b>	Istituto per la Ricostruzione Industriale
<b>IRS</b>	Internal Revenue Service (of the United States)
<b>JCPOA</b>	Joint Comprehensive Plan of Action
<b>JFK</b>	John Fitzgerald Kennedy
<b>LBJ</b>	Lyndon Baines Johnson
<b>LCH</b>	London Clearing House
<b>LDC</b>	Less Developed Country
<b>Legco</b>	Legislative Council (of the Hong Kong Special Administrative Region)
<b>LME</b>	London Metal Exchange
<b>LTCM</b>	Long-Term Capital Management
<b>M&amp;A</b>	Mergers and Acquisitions

<b>MAD</b>	Mutually Assured Destruction
<b>MBS</b>	Mortgage Backed Security
<b>MFN</b>	Most Favoured Nation
<b>MMF</b>	Money Market Fund
<b>MMT</b>	Modern Monetary Theory
<b>MOU</b>	Memorandum of Understanding
<b>MPT</b>	Ministry of Posts and Telecommunications (of the People's Republic of China)
<b>MTN</b>	Medium-term Note
<b>NAFMII</b>	National Association of Financial Markets Institutional Investors (of the People's Republic of China)
<b>NASD</b>	National Association of Securities Dealers
<b>NATO</b>	North Atlantic Treaty Organisation
<b>NAV</b>	Net Asset Value
<b>NEO</b>	Net Errors and Omissions
<b>NGO</b>	Non-governmental Organisation
<b>NPC</b>	National People's Congress (of the People's Republic of China)
<b>NPL</b>	Non-performing Loan
<b>NSL</b>	National Security Law (of the Hong Kong Special Administrative Region)
<b>NYMEX</b>	New York Mercantile Exchange
<b>NYSE</b>	New York Stock Exchange
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>OPEC</b>	Organisation of Petroleum Exporting Countries
<b>PAC</b>	Political Action Committee
<b>PBOC</b>	People's Bank of China
<b>PhD</b>	Doctor(ate) of Philosophy

<b>PIIGS</b>	Portugal, Italy, Ireland, Greece and Spain
<b>PLA</b>	People's Liberation Army
<b>PNP</b>	Pacific Newport Partners
<b>PRC</b>	People's Republic of China
<b>QDII</b>	Qualified Domestic Institutional Investor
<b>QDII2</b>	Qualified Domestic Individual Investor
<b>QFII</b>	Qualified Foreign Institutional Investor
<b>R&amp;D</b>	Research and Development
<b>RQFII</b>	Renminbi Qualified Foreign Institutional Investor
<b>S&amp;P</b>	Standard and Poor's
<b>SARS</b>	Severe Acute Respiratory Syndrome
<b>SASAC</b>	State-owned Asset Supervision and Administration Commission (of the People's Republic of China)
<b>SAT</b>	State Administration of Taxation (of the People's Republic of China)
<b>SCH</b>	Shanghai Clearing House
<b>SDR</b>	Special Drawing Right
<b>SEATO</b>	Southeast Asian Treaty Organisation
<b>SEC</b>	Securities and Exchange Commission (of the United States)
<b>SEHK</b>	Stock Exchange of Hong Kong
<b>SEZ</b>	Special Economic Zone
<b>SFC</b>	Securities and Futures Commission (of the Hong Kong Special Administrative Region)
<b>SNB</b>	Swiss National Bank
<b>SOE</b>	State-owned Enterprise
<b>SWF</b>	Sovereign Wealth Fund
<b>SWIFT</b>	Society for Worldwide Interbank Financial

	Telecommunication
<b>TAF</b>	Term Auction Facility
<b>TARP</b>	Troubled Asset Relief Programme
<b>TPS</b>	Transactions Per Second
<b>TVE</b>	Township and Village Enterprise
<b>TWh</b>	TeraWatt Hour(s)
<b>UCITS</b>	Undertakings for Collective Investment in Transferable Securities
<b>UK</b>	United Kingdom
<b>UN</b>	United Nations
<b>US</b>	United States (of America)
<b>USSR</b>	Union of Soviet Socialist Republics
<b>WMD</b>	Weapons of Mass Destruction
<b>WTI</b>	West Texas Intermediate
<b>WTO</b>	World Trade Organisation
<b>WW1</b>	World War I
<b>WW2</b>	World War II

# Chapter 1

## Introduction

今天，我主要讲一个问题，就是解放思想，开动脑筋，实事求是，团结一致向前看。

- 邓小平，1978 年中共中央工作会议

Today, I mainly want to discuss one question, namely, how to emancipate our minds, use our heads, seek truth from the facts and unite as one in looking to the future.

- Deng Xiaoping, Central Party Work Conference 1978

On Christmas Day 1991, the hammer and sickle flag was lowered over the Kremlin for the last time. It was a dry, still Wednesday morning and the temperature hovered around one degree above freezing, mild by Moscow standards for that time of year. With that, the Cold War had ended.

History would go on to record it as a triumph of capitalism over communism, and of liberal democracy over dictatorship. The euphoria of the period was famously captured in Francis Fukuyama's 1989 essay and subsequent book, declaring 'The End of History', with America's brand of capitalist democracy standing as 'The Last Man'.<sup>1</sup> Indeed, the US had become the sole superpower and the world basked in the glow of the *Pax Americana*. Even as the US was at the apex of its power, however, the seeds of future crises had been sown.

'Free market' ideology had been a major factor in America's victory in the Cold War and, by the fall of the Soviet Union (USSR), US financial markets, with the dollar at their core, had long since attained global leadership. The

whole world had become dependent on an American-dominated financial system.

The victory of free market capitalism over communism was so convincing that political parties of the left had to become more centrist - if not outright *right-wing* - in order to win power. The epochal phrase 'It's the economy, stupid' was coined by campaign strategist James Carville during Bill Clinton's successful 1992 presidential campaign and summed up the prevailing mood in the US. Across the Atlantic, in 1995 Tony Blair's Labour Party in Great Britain abandoned Clause IV of the party's constitution, which had previously committed Labour to 'common ownership of the means of production'. This was seen as a decisive step on the path towards Blair's election victory in 1997.

A significant outgrowth of this free market ideology were the monetarist economic policies advocated by Milton Friedman and economists of the Chicago school. Their popularisation was, in many ways, a reaction against the dominance of redistributive Keynesian economics that had prevailed since the end of World War II (WW2) but which had failed to meet economic challenges faced in the 1970s. The influence of monetarist economics was to have a profound impact on government and central bank policies around the world. The increased role for central banks in managing the money supply within economies de-emphasised fiscal policy and governments' role in economic management.

Of course, the impact of the collapse of the Soviet Union was not just felt in economic and financial policy. As the sole superpower, the US was much freer to pursue and implement its strategic objectives across many spheres. When Saddam Hussein invaded Kuwait in August 1990, President George H.W. Bush took painstaking care to build broad international support through the United Nations