

INTERNATIONAL BESTSELLER

The Rise and Fall of an Epic Financial Bubble

# THE NEW EMPIRE OF DEBT

Second Edition

WILLIAM BONNER AND ADDISON WIGGIN

Authors of the international bestseller *Financial Reckoning Day*



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# **Praise for the First Edition of *Empire of Debt***

“[T]ells you what’s really going on” in the global economy.

—*The Economist*

“*Empire of Debt* is a wake-up call for all investors. Bonner and Wiggin masterfully illustrate why we should all take a much closer look at what our future holds.”

—*Marketwatch*

“Tells the story of how all empires are eventually undone by the same ‘vain overreaching.’”

—*Times of London*

“Read [*Empire of Debt*] and your views of the world around you will no longer be the same.”

—Nassim Nicholas Taleb Author of *The Black Swan*

“The doom mongering is leavened with some waspishly witty writing.”

—*The Daily Telegraph*

“The authors describe with sardonic humor—and no small amount of name calling—how America has become an overfed, imperial has-been and economic basket case.”



—[SmartMoney.com](http://SmartMoney.com)

“In addition to being accomplished financial analysts, Bonner and Wiggin are talented historical writers. And they put this talent to work in the cause of examining the political and economic effects of empire.”

—*The Huffington Post*

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OF  
**DEBT**

The Rise and Fall of an  
Epic Financial Bubble

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**William Bonner**  
and  
**Addison Wiggin**



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# INTRODUCTION

## The Bubble Empire

The will of Zeus is moving toward its end.

—*The Illiad*

One day in early spring 2005, we traveled by train from Poitiers to Paris and found ourselves seated next to Robert Hue, head of the French Communist Party and a senator representing Val d'Oise. He sat down and pulled out a travel magazine, just as any other traveler would. Aside from one Bolshevik manqué who stopped by to say hello, no one paid any attention. A friend reports that he was on the same train a few months ago with then Prime Minister, Jean-Pierre Raffarin, who was accompanied by only a single aide.

Many years ago, when the United States was still a modest republic, American presidents were likewise available to almost anyone who wanted to shoot them. Thomas Jefferson went for a walk down Pennsylvania Avenue, alone, and spoke to anyone who came up to him. John Adams used to swim naked in the Potomac. A woman reporter got him to talk to her by sitting on his clothes and refusing to budge.

But now anyone who wants to see the president must have a background check and pass through a metal detector. The White House staff must approve reporters

before they are allowed into press conferences. And when the U.S. head of state travels, he does so in imperial style; he moves around protected by hundreds of praetorian guards, sharpshooters on rooftops, and thousands of local centurions. When President Clinton went to China in 1998, he took with him his family, plus “5 Cabinet secretaries, 16 members of Congress, 86 senior aides, 150 civilian staff (doctors, lawyers, secretaries, valets, hairdressers, and so on), 150 military staff (drivers, baggage handlers, snipers, and so on), 150 security personnel, several bomb-sniffing dogs, and many tons of equipment, including 10 armored limousines and the ‘blue goose,’ Clinton’s bulletproof lectern.”

Getting the presidential entourage and its armada of equipment to China and back, the Air Force flew 36 airlift missions on Boeing 747, C-141, and C-5 aircraft. The Pentagon’s cost of the China trip was \$14 million. Operating Air Force One alone costs over \$34,000 an hour.

Today, the president cavalcades around Washington in an armored Cadillac. The limousine is fitted with bulletproof windows, equally sturdy tires, and a self-contained ventilation system to ward off a biological or chemical attack.

The Secret Service—the agency charged with preserving the president among the living—employs over 5,000 people: 2,100 special agents, 1,200 Uniformed Division employees, and 1,700 technical and administrative wonks. Everywhere the president goes, his security is handled—by thousands of guards and aides, secure compounds, and carefully orchestrated movements. Security was so tight during a visit to Ottawa, Canada, in 2004 that some members of Parliament were refused entry into the building for lack of a special one-time security pass, an act apparently contradictory to the laws of Canada.

In late 2003, when Bush deigned to visit the British Isles, an additional 5,000 British police officers were deployed to the streets of London to protect him. Parks and streets were shut down. Snipers were visible on the royal rooftop.<sup>[1](#)</sup> After Bush's stay at Buckingham Palace in London, the Queen was horrified by the damage done to the Palace grounds. They were left looking like the parking lot at a Wal-Mart two-for-one sale.<sup>[2](#)</sup>

## **THE THEME OF THIS BOOK IN A NUTSHELL**

Watching the news is a bit like watching a bad opera. You can tell from all the shrieking that something very important is supposed to be happening, but you don't quite know what it is. What you're missing is the plot.

Let us begin by noticing that this is a comic opera that seems as though it might veer into tragedy at any moment. The characters on stage are familiar to us—consumers, economists, politicians, investors, and businessmen. They are the same hustlers, clowns, rubes, and dumbbells that we always see before us. But in today's performance they are doing something extraordinary: They are the richest people on the planet, but they have come to rely on the savings of the world's poorest people just to pay their bills. They routinely spend more than they make—and think they can continue doing so indefinitely. They go deeper and deeper in debt, believing they will never have to settle up. They buy houses and then mortgage them out—room by room, until they have almost nothing left. They invade foreign countries in the belief that they are spreading freedom and democracy, and depend on lending from Communist China to pay for it.

But people come to believe whatever they must believe when they must believe it. All these conceits and illusions that we find so amusing in the Daily Reckoning ([www.dailyreckoning.com](http://www.dailyreckoning.com)), come not from thinking, but from circumstances. As they say on Wall Street, “markets make opinions,” not the other way around. The circumstance that makes sense of this strange performance is that the United States is an empire—whether we like it or not. It must play a well-known role on the world stage, just as you and I must play our roles, not because we have thought our way to



them, but simply because of who we are, where we are, and when we are. Primitive people play primitive roles. They are no less intelligent than the rest of us, but they would be out of character if they began doing calculus. They have their parts to play just as we do. Sophisticated people play sophisticated roles. They are no smarter than anyone else, but you still don't expect them to wear bones through their noses. We, citizens of the last great empire, have our roles to play too, and the empire itself, must do what an empire must do.

Institutions have a way of evolving over time—after a few years, they no longer resemble the originals. Early in the twenty-first century, the United States is no more like the America of 1776 than the Vatican under the Borgia popes was like Christianity at the time of the Last Supper, or Microsoft in 2009 is like the company Bill Gates started in his garage.

Still, while the institutions evolve, the ideas and theories about them tend to remain fixed; it is as if people hadn't noticed. In America, all the restraints, inhibitions, and modesty of the Old Republic have been blown away by the prevailing winds of the new empire. In their place has emerged a vainglorious system of conceit, deceit, debt, and delusion.

The United States Constitution is almost exactly the same document with exactly the same words it had when it was written, but the words that used to bind and chafe have been turned into soft elastic. The government that couldn't tax, couldn't spend, and couldn't regulate, can now do anything it wants. The executive has all the power he needs to do practically anything. Congress goes along, like a simpleminded stooge, insisting only that the spoils be spread around. The whole process works so well that a

member of Congress has to be found in bed “with a live boy or a dead girl” before he risks losing public office.

American businesses are still nominally capitalistic. But a recent press item reports that General Motors will never be able to compete unless it ditches its crushing health care costs. Why does it not just cut the costs? It seems to lack either the nerve or the right, but the journalist proposed a solution: Nationalize health care! Meanwhile, CEO pay has soared to the point where the average chief executive in 2000 earned compensation equal to 500 times the average hourly wage. Stockholders, whose money was being squandered, barely said a word. They were still under the illusion that the companies were working for them. They had not noticed that the whole capitalist institution had been trussed up with so many chains, wires, red tape, and complications, it no longer functioned like the freewheeling, moneymaking corporations of the nineteenth century. Meanwhile, corporations in China—a communist country—had their hands and feet free to eat our lunches and kick our derrieres.

The entire homeland economy now depends on the savings of poor people on the periphery to keep it from falling apart. Americans consume more than they earn. The difference is made up by the kindness of strangers—thrifty Asians whose savings glut is recycled into granite countertops and flat-screen TVs all over the United States.

But these ironies, contradictions, and paradoxes hardly disturbed the sleep of the imperial race. They permitted themselves to believe so many absurd things that they will now believe anything. In the fall of 2001, people in Des Moines and Duluth were buying duct tape to protect themselves from terrorist “sleeper cells ready to attack the Midwest.” In the fall of 2004, they believed the Chinese were manipulating their currency by pegging it to the dollar

for nearly 10 years! Like Alice, they were expected to believe six impossible things before breakfast and another half dozen before tea: Real estate never goes down! You can get rich by spending! Savings don't matter! Deficits don't matter! Let them sweat, *we'll* think!

We can't help but wonder how it will turn out.

In this book, we turn once again to the dusty pages of history. We find ourselves often tracing the footsteps of the West's greatest empire—Rome—searching for clues. In Rome, too, the institutions evolved and degraded faster than people's ideas about them. Romans remembered their Old Republic with its rules and customs. They still thought that was the way the system was supposed to work long after a new system of *consuetudo fraudium*—habitual cheating—had taken hold.

Rome's system of imperial finance was far more solid than America's. Rome made its empire pay by exacting a tribute of about 10 percent of output from its vassal states. There were few illusions about how the system worked. Rome brought the benefits of *Pax Romana*, and subject peoples were expected to pay for it. Most paid without much prompting. In fact, the cost of running the empire was greatly reduced by the cooperation of citizens and subjects. Local notables, who benefited from imperial rule, but who were not directly on the emperor's payroll, performed many costly functions. Many functions were "privatized," says Ramsay MacMullen in his *Corruption and the Decline of Rome*.

This was accomplished in a variety of ways. Many officials, and even the soldiers stationed in periphery areas, used their positions to extort money out of the locals. In this way, the cost of administration and protection was pushed more directly onto the private sector. *Commoda* was the word

given to this practice, which apparently became more and more widespread as the empire aged.

MacMullen recalls a typical event:

From Milan, a certain Palladius, tribune and notary, left for Carthage in 367. He was charged with investigating accusations of criminal negligence—"if you don't pay me, I won't help you"—brought against Romanus, military commandant in Africa. Because of Romanus's inaction, the area around Tripoli had suffered attacks by local tribes, without defense from the empire. But the accused was ready for the inquisitor, and when Palladius arrived unexpectedly at military headquarters in the African capital—carrying the officers' pay—he was offered . . . under the table . . . a considerable bribe. Palladius . . . accepted it. But he continued his investigations, accompanied by two of the local notables whose complaints had launched the inquiry. He prepared his report to the emperor, telling him that the charges against Romanus were confirmed. But the latter threatened to reveal the bribes he had accepted. So Palladius reported to the emperor that the accusations were pure inventions. Romanus was safe. The emperor ordered that the two accusers' tongues be torn out.<sup>3</sup>

As time went on, the empire came to resemble less and less the Old Republic that had given it birth. The old virtues were replaced with new vices. Gradually, the troops on the frontier had to depend more and more on their own devices for their support. They had to take up agriculture. "The effectiveness of the troops was diminished as they became part-time farmers," says MacMullen.

Gradually, the empire had fewer and fewer reliable troops. In Trajan's time, the emperor could count on hundreds of thousand of soldiers for his campaigns in Dacia. But by the

fourth century, battles were fought with only a few thousand. By the fifth century, these few troops could no longer hold off the barbarians.

The corruption of the empire was complete.

If you deny that the United States is now an empire, you are as big a fool as we were. For a very long time we resisted the concept. We did not want the United States to be an empire. We thought it was a political choice. We liked the old republic of Jefferson, Washington, the U.S. Constitution . . . the humble nation of hard money and soft heads; we didn't want to give it up. We thought that if the United States acted as though it were an empire it was making an error.

What morons we were. We missed the point completely. It didn't matter what we wanted. There was no more choice in the matter than a caterpillar has a choice about whether to become a butterfly.

This was an important insight for us. Until then, all of the blustering and slapstick pratfalls on stage seemed like "mistakes." Why would the United States run such huge trade deficits, we wondered. It was obviously a bad idea, the nation was ruining itself. And why would it launch an invasion of Iraq or begin a war on terror—both of which were almost certain to be costly blunders. It was as if the United States wanted to destroy itself—first by bankrupting its economy, and second by creating enemies all over the globe.

Then, we realized, that of course, that is exactly what it must do.

We repeat: People come to believe what they need to believe when they need to believe it. America is an empire; its people must think like imperialists. In order to fulfill their mission, the homeland citizens had to become what George

Orwell called “hollow dummies.” An imperial people must believe that they deserve to be the imperial power—that is, they must believe they have the right to tell other people what to do. In order to do so, they must believe what isn’t true—that their own culture, society, economy, political system, or they themselves are superior to others. It is a vain conceit, but it is so bright and so big it exercises a kind of gravitational pull over the entire society. Soon, it has set in motion a whole system of shiny vanities and illusions as distant from the truth as Pluto and as bizarre as Saturn. Americans believed they could get rich by spending someone else’s money. They believed that foreign countries actually wanted to be invaded and taken over. They believed they could run up debt forever, and that their debt-laden houses were as good as money in the bank. That is what makes the study of contemporary economics so entertaining. We sit at our telescopes and laugh like a divorce lawyer looking at photos of a rich man in flagrante delicto; we know there’s money to be made.

Things that are unusual usually return to normal. If they did not, there would be no “normal” to return to. That is why you can expect stocks to become more expensive when they are cheap and cheaper when they are expensive. Houses usually go up at a rate roughly equal to the rate of inflation, income, or GDP growth—no more. For the 10 years prior to 2006, however, they went up three to five times as fast. House prices cannot grow faster than income for very long; people have to be able to pay the prices in order to live in them. So, you could expect houses to revert to their mean too.

These simple reversions to mean are hardly controversial. We didn’t know when they would happen or how, but that they would come about was practically guaranteed.

More interesting to us are the reversions to other, bigger means. An empire itself is a rare thing. It is normal, but unusual. Nature abhors a monopoly. An empire is a monopoly on force. Nature will tolerate it for a while, but sooner or later, the imperial people must revert to being normal people, and the preposterous beliefs that the imperial people cherish, also must pass away. They must go up to a kind of humbug heaven, where absurd ideas and idle flatteries strut around while the gods point, snicker, and roll around on the floor clutching their stomachs as if the humor of it was going to kill them.

The dollar is an extraordinary thing too. Do you know what the long-term mean value of paper currency is? Well, it is zero. That is what the average paper currency is worth most of the time . . . and it is the black hole into which all paper currencies in the past have gone. There could be something magic about the dollar that makes it unlike any paper currency in the past—that is, something that makes it non-mean reverting. But if anyone knows what it is, he is not working on this book. For the last hundred years, the dollar has lost value faster than the decline of the roman-era Dinarius after the reign of Nero. This is not surprising. Roman coins had silver or gold in them. In order to make the coins less valuable, they had to reduce the precious metal content. People didn't like it. The dollar, by contrast, contains no precious metal. Not even any base metal. It is just paper. It has no inherent value. There is nothing to take out, because there was never anything there in the first place. Over time, the dollar is almost certain to revert to its real value—which is as empty as deep space.

In the big picture of things, it is also unusual for one civilized nation to earn far more per capita than another. In the thousands of years of history, some groups were poor . . . others were rich. But extreme differences had a way of working themselves out—by trade, war, pestilence, and

degeneracy. By the year 1700, a man in India, China, Arabie, or Europe had about the same standard of living, which was not very high anywhere. But along came the industrial revolution, which threw incomes out of balance and changed the way people think. Europe stole a march on the rest of the world's industries, with huge gains in output coming in a relatively short period of time. Soon, Europeans were the world's leading imperialists, convinced that they had its best economic system, its finest scholars, its highest morals, and its most splendid armies.

But if the world works the way we think it does, you can expect the incomes of Europeans—and their American cousins—to revert to their historic means. The process could take several generations. It could stall. There could be countertrends. But there is no reason to think a man's labor is inherently worth more in France than in Bangladesh, or that a plumber with stars and stripes on his overalls should earn more than one with a crescent moon.

If there is a mean, things will regress to it. You can expect, relatively speaking, Asian incomes to rise and American incomes to fall. That is, of course, just what is happening now. In India, for example, real incomes have more than doubled in the last 10 years. In America there is some dispute about the numbers, but if there has been any income growth at all it has been slight.

Just to introduce a gloomy remark, we note that we are personally and individually regressing to the mean. The mean for a human being is death—or non-existence. A person walks the earth for only three-score and ten, as it says in the Bible. The rest of the time, he is only a potential person . . . or a former person. For millions of years, he is either in the future . . . or in the grave.

You, dear reader, are enjoying that ever-so-brief period of exaggeration . . . of hyperbole . . . of extraordinary, mean-



busting usualness we call “life.” It is not for us to know the time or place when it comes to an end. But like all mean-reverting phenomena, only a fool would bet against it. (For our own part, we do not particularly care when or how we meet our end. We just wish to know where, so we can avoid the place.)

But until recently betting against the end is just what most Americans were doing. They were borrowing and spending as if there were no tomorrow, and they were investing as though there were no yesterday. If they’d only looked at the patterns of the past, they would have seen that it doesn’t make sense to buy at high prices—you can’t make money that way. The way people have always made money is by buying low and selling high. Doing it the other way around doesn’t work. Nor does borrowing and spending make you rich. Tomorrow always comes—at least it always has up until now—and you have to pay your debts.

Over time, prices go up and down. Many other things ebb and flow as well, boom and bust or bloom and wither. All of these phenomena go through predictable cycles that can be roughly modeled. Analysts study the cycles to try to figure out where we are currently located in the habitual pattern. It is often frustrating work, because the patterns are rarely quite as regular and well-defined in the present as they appear to have been in the past. Still, it is a question worth asking: Where in the cycle are we?

One of the ways you can tell where you are in the cycle is to look at what your friends and neighbors believe. When people you know are all of the opinion that stocks will rise 15 percent per year—for an indefinite amount of time—you can be sure you are nearer to a top than a bottom. When people believe the opposite—that stocks will never go up—most likely, you are near a bottom.

Beliefs give us a clue to the larger cycles as well. People must play the roles that have been thrust upon them. They are bullish near the end of a bull market; they are bearish near the end of the bear market. If it were otherwise, the market could never fully express itself. If investors grew suddenly cautious while nearing an epic bull market peak, they would sell their stocks, and the peak would never be reached. Or suppose that after several years of soaring house prices homeowners came to believe that housing prices would fall? How could you have a proper housing bubble? How can you have a rip-roaring party without anyone getting drunk, in other words? How can people make fools of themselves if they are unwilling to get up on the tables and dance?

These are deep philosophical questions. But they help us recognize where we may be in the cycle. As prices reach a loony excess, peoples' ideas grow loony too. Ergo, the loonier the ideas, the more likely it is that a turning point is near; the wilder the party, the more likely someone will call the gendarmes.

We also suspect that attitudes evolve similarly in an imperial cycle, during which a country's economic, financial, and military power runs up over several generations and then declines. At the peak, the imperial people come to believe that their system is superior, that their values are universal, and that their way of life will inevitably dominate the entire world.

Readers will recognize these attitudes in a famous article by Francis Fukayama, written after the fall of the Soviet Union, in which he suggested that the world may have reached the "End of History." It was the end of history because the American system had triumphed—no improvement seemed possible. Fukayama's idea was not original. Hegel and Marxist intellectuals had proposed the

same thing more than a hundred years earlier. With the victory of the proletariat, no further advance could be made. History had to stop.

Hegel stopped ticking. Marx died, too. History continued.

But when people feel they are on top of the world, they begin to take things for granted that they previously took for absurd. As we mentioned earlier, Americans came to depend on the savings of Communist China in order to pay for their lifestyles . . . and their wars to make the world safe for democracy. They did so without thinking. Subconsciously, they came to believe what imperial people always seem to believe—that their society is so superior, that the rest of the world longs to be just like them or is inevitably drawn to become like them, whether they like it or not. That was the premise behind the billions of dollars Americans were investing in China. A few years ago if someone had suggested that they invest in a communist country, they would have thought the person mad. China is still run by veterans of various “great leaps forward,” but Americans were convinced that they were all leaping to become just like us—capitalists and democrats at heart! So vain are we that we can’t imagine anyone wanting to be anything else.

And of course, the invasion of Iraq was based on the same sort of thinking : that even the grubby desert tribes want to be just like us. All we had to do was to get the dictator off their backs and the men would start building shopping malls and the women would all start dressing like Britney Spears.

Those are the sort of delusions you get at the top of an imperial cycle.

But culture, political systems, and economies are never as universal and eternal as we think. Instead, everything evolves. Even in France, our closest cousins do not share

our American attitudes. In the United States, we all seek to maximize our incomes. We work long hours. We start enterprises. We invest. In France, people do not seek to maximize their incomes. Instead, what they want to maximize is their leisure, and the quality of their lives. They spend more time talking about how to cook the bacon than they do about how to bring it home.

France once had a European Empire that reached from Spain to Moscow. Later, it had a worldwide empire, with subject countries and colonies in Africa, the West Indies, and the South Pacific. From the time of Richelieu to the time of Leon Blum, France had one of the most powerful armies on earth. Even at the beginning of World War II, France had the largest army in Europe—on paper. But there never was a cycle that didn't want to turn. And the imperial cycle turns along with the rest of them. For many generations, the French believed they had the finest culture, the best schools, the most advanced scientists, and the most dynamic builders in the world. France saw its mission as bringing the benefits of its civilization—of vin rouge and the Rights of Man—to the rest of the globe. But now it's our turn. It is we Americans who think we have the best culture, the best economy, the best government, and the best army the world has ever seen. Now, it is we who have the burden of the "mission civilisatrice." It is our duty to bring freedom and democracy to this tattered old ball; our president said so.

How did America become an empire? We don't recall the question ever coming up. There was never a debate on the subject. There was never a national referendum. No presidential candidate ever suggested it. Nobody ever said, "Hey, let's be an empire!" People do not choose to have an empire; it chooses them. Gradually and unconsciously, their thoughts, beliefs, and institutions are refashioned to the imperial agenda.

While there has been no discussion of whether America should be an empire, there has been much public clucking on the specific points of the imperial agenda. Should we attack Iran or Iraq? Should we have national identity cards? Should we suspend the Bill of Rights in order to combat terrorists more effectively?

Many people wondered, including your author, what was the point of the war against Iraq. The country had no part in terrorist attacks. Au contraire, Saddam's Iraq was a bulwark of secular pragmatism in an area unsettled by religious fanaticism. It was the religious fanatics who posed a danger, said the papers, not the ruthless dictators who suppressed them. Others wondered if an attack on Iraq would make the world safer or more dangerous. Or if the United States had committed enough troops to get the job done.

But the big question had already been settled without ever having been raised. Why should Americans care what happened in the mideast? Or anywhere else? Did the Swiss wonder what kind of government Iraq should have? Did the Swiss try to make the rest of the world more like Switzerland, or allow themselves the vain fantasy of imagining that everyone on the planet secretly yearned to be more like the Swiss themselves?

While no one noticed, the imperial weed put down roots deep in the soil of North America. By the early twenty-first century, hardly anything else grew; it had completely crowded out the delicate flowers planted by the Founding Fathers. The debate surrounding the invasion of Iraq was an imperial debate—about means and methods, not about right and wrong or national interest. No one from either major political party bothered to suggest that the United States should not be nosing around in other peoples' business. Both parties recognized that Iraq was not a matter of national interest—it was a matter of imperial interest. No

business, no where, was too small or too remote not to be of interest to the empire. From its military bases all over the globe, and its sensors orbiting the planet, the American imperium watched everyone, everywhere, all the time. In the year 2005, no sparrow fell anywhere in the world without triggering a monitoring device in the Pentagon.

This marked what may be the peak of a trend that began more than one hundred years ago. Just about the turn of the century, the United States became the world's largest economy—and its fastest growing one. Near the same time, Theodore Roosevelt began riding rough over small, poor nations. America's fat proto-imperialist rarely saw a fight he didn't want to get into. It was at his urging (he had threatened to raise his own army to do the job) that Wilson announced his readiness to join the war in Europe in 1917. Wilson said he was doing it to "make the world safe for democracy." This is the stated goal of nearly all U.S. foreign policy ever since: to improve the planet with more democracy. Of course, almost all empire builders think they are improving the planet. Even Alexander the Great thought he was doing it a favor by spreading Greek culture.

But when Wilson sent troops to Europe, people wondered then what the real point was. America had no interest in the war and no particular reason to favor one side over the other. But there too, they missed the point. America was quickly becoming an empire. Empires are almost always at war—for their role is to "make the world safe."

President Truman clarified the imperial modus operandus when he sent the United States into battle in Korea with no declaration of war. He didn't even tell Congress until after the army was engaged and Americans were dying. Then, President Johnson followed up with another war in a far-off place that made no difference to Americans—Vietnam. What was the point? The Swiss army was nowhere to be found.