

The Long War of the 21st Century*

A former director of the Central Intelligence Agency believes we are in a "war to the death" with "Islamists from the Sunni side of Islam" whose totalitarian ideology has less in common with traditional Islam than with the fascism and communism that were the major threats of the last century. He concludes that if Americans and Europeans "help one another" using their differing (but complementary) approaches to this threat, "the forces of democracy and the rule of law will win."

I thought I would share with you in a few minutes some thoughts about how Europe and the United States will need to deal with one another in this long war in which we are engaged. I do believe it is and will be a long war; analogous in its length, and in the importance of ideology, and in some other ways to the 45-year-old Cold War.

I want to say just a word about whom the war is with, why we are in it, and what we have to keep in mind both here in Europe and in the United States as we fight it.

First of all, whom is the war with? Wars used to begin by cavalry or tanks crossing borders with flags flying, and that issue was closed; one knew whom one was at war with. The current war is different. I would suggest to you that there are really three groupings in the Middle East who have decided that they are at war, at least with the United States and in many ways with all of Western Civilization.

Secular Totalitarians

The first, and they are getting weaker rather quickly, is the secular totalitarians such as the Baathists, the Arab Nationalist Party of Khadafi and others. These are residual totalitarian parties, based essentially on the fascist party organization and structure of the '20s and '30s in Europe. The Baathists are modeled after the European fascists of that era, and the communists.

But they have, needless to say, been

dealt rather a substantial setback in Iraq. They are still there in Syria. They've been seriously weakened in Libya by Libya's decision, oddly enough just as coalition forces were moving into Iraq, to start to become honest about its weapons of mass destruction program.

But totalitarian nations of the sort that Afghanistan and Iraq used to be are terribly important in this war we are in, because they can provide refuge, where-withal, training, equipment, anthrax, whatever, to terrorist groups.

Islamist Totalitarians

Then there are two terrorist groupings that derive from Islamist philosophy. And when I say Islamist here, I am denoting a totalitarian movement masquerading as a religion. In my judgment the regime in Tehran surrounding Mr. Khamenei, and the leadership of al Qaeda (and those that support them within the Wahabi sect in Saudi Arabia) are Muslims precisely to the degree that Torquemada [the Grand Inquisitor during the Spanish Inquisition] and those around him in the late 15th and early 16th Centuries in Spain were Christians.

Torquemada was about as far as one can get from the Sermon on the Mount. And the Islamist organizations that are behind and that underpin the terrorists, whether it is Hezbollah or al Qaeda, are effectively, I believe, about that far from being true Muslims.

The Islamists from the Shiite side of the great divide within Islam, who today govern in Tehran even though they are very unpopular among their own people, are also, I think, weakening. Khamenei and his colleagues are massively unpopular with the young people of Iran, and half

of Iran is 19 or younger; massively unpopular with the women; and massively unpopular with even large numbers of Iranian Shiite clerics, because their conduct is squarely at odds with the history and tradition of Shiite Islam, which has generally been opposed to the union of mosque and state.

The Caliphate, the union of mosque and state, is a Sunni concept. The Shia have generally not favored such union. They have been, on the whole, quietists such as the Ayatollah Sistani. And the doctrine which he, I believe, is still standing behind and his fellow Iraqi Shiites are standing behind, is not totalitarian. Some aspects of it are different, certainly, than what many of us would like. But I do not believe, and I've just returned from Iraq, that the Iraqi Shiites are likely to follow those in the regime in Tehran into totalitarianism.

The third group is the Islamists from the Sunni side of the great divide: Al Qaeda and those affiliated with it. They are financially and intellectually supported by the Wahabi sect in Saudi Arabia and those who agree with them, particularly within that country and elsewhere in the Gulf region.

The Wahabis have spent since the late 1970s something like seventy billion dollars spreading the particularly hate-filled form of their doctrine into the madrasas [religious schools] of Pakistan, into the textbooks of Indonesia, and into institutes that they fund in Western Europe and the United States. And to my mind, this last group—the Islamists from the Sunni side of Islam, al Qaeda, and those who support it—are likely, unfortunately, to be with us a very long time. They are extremely wealthy, they are well organized (as well as they can be given the resistance which we in the West have put up to them), and I fear that dealing with them is going to make this a long war. A war of decades, not years.

And let me be candid about one other thing. There will be no al Qaeda "Gorbachev." This will not end with an arms control agreement. This will not end any way other than as a war to the death. And we should get used to thinking in those terms when dealing with the Islamists from the Sunni side of the great di-

* This article is a transcript of a speech given in Zürich, Switzerland by R. James Woolsey to the Progress Foundation on March 11, 2004. Mr. Woolsey is Vice President of Booz Allen Hamilton. From 1993-1995 he served as Director of the Central Intelligence Agency.

vide within Islam.

If that's whom we are at war with, why? Why did they choose to be at war with us? I believe that much of the difficulty dates from the 1970s. First, the Wahabi sect in Saudi Arabia had, certainly, power and influence for decades, more with some Saudi kings than others. But the 1970s produced a huge spike in oil prices and a huge increase in revenue for Saudi Arabia. They went from earning about two billion dollars a year in overseas oil sales in the early '70s to on the order of twenty to forty billion dollars in sales in the late '70s. So the Wahabis have been willing and able to fund extremism throughout the Arab and Muslim world and elsewhere, such as in Western Europe and the U.S.

This movement has been, as I said, extremely influential for a long time within Saudi Arabia. But it particularly took off on a world-wide basis in 1979 when two events led many within Saudi Arabia to believe that something very different needed to be done. The first was the fall of the Shah and the coming to power of Khomeini and his Islamist movement within the Shiite side of Islam. The second was the seizure of the Great Mosque in Mecca, and the bloody aftermath, which convinced many in Saudi Arabia that they had a very serious problem with Islamists within their own society and that the way to resolve it was to export the anger. And as a result we have, I think, seen a union of some of the more modern and secular Islamists together with the Wahabis. And we see today the problems, the very serious problems, that have derived from that.

Are We Cowards Who Only Care About Oil?

I think another reason why we are at war with these three groups, why they chose to be at war with us, is that we have convinced the people of the Middle East—and here I speak really only as an American, my European friends can make their own judgments—over the course of the last quarter century that we care not about them, but only about their oil; that we would like for them please to be polite filling station attendants and provide the oil whereby we can fuel our SUVs; and that other than that they have no particular interest for us.

We've also convinced them, frankly, that we are cowards. If you look back over the 25 years, since the late 1970s the following has happened:

Our hostages were seized in Tehran in 1979—and we tied yellow ribbons around trees, as if we were victims.

In 1983, our embassy and our marines were blown up in Beirut—and we left.

Throughout most of the 1980s in response to terrorists' attacks—we sent the lawyers. Yes, we sent prosecutors, we prosecuted a few small fry, occasionally we dropped a bomb somewhere.

In 1991, we had half a million troops in Iraq. We had encouraged the Kurds and Shiites to rebel against Saddam—then we stopped and we watched the Kurds and Shiites be massacred after we had encouraged them to rebel; thereby sending a message that we cared, first and foremost, about the oil of Kuwait and Saudi Arabia, that once it was secure we did not give a damn about the people of the Middle East.

In 1993, Saddam tried to assassinate former President Bush in Kuwait—and we fired perhaps two dozen cruise missiles into an empty Iraqi intelligence headquarters in Baghdad in the middle of the night: Thereby being very stern, I suppose, with Iraqi cleaning women and night watchmen, but not particularly effective in dealing with Saddam Hussein.

And also in 1993, our helicopters were shot down in Mogadishu, and again we left.

Throughout the '90s there were more terrorist attacks, and we did what we did in the '80s. We sent the prosecutors, we prosecuted a few small fry, and we dropped a few bombs here and there.

If you were looking at the United States from the perspective of an adviser to Osama bin Laden or Saddam Hussein or Khomeini as of the end of the 20th century, I think you would have said the people of this spoiled, wealthy country do not like the people of the Middle East, they are only interested in its oil, and they are cowards. And the combination of those messages, I think, has helped produce the current situation in which we find ourselves.

Now, if that's whom we are at war with and why they've chosen to be at war with us, what do we have to think about in fighting it domestically and in the Middle East? Just a few words on each.

Complex Networks

Here in Europe and in the United States we are the custodians and managers of the most technologically sophisticated societies the world has ever seen. They are societies of vast networks of all kinds: oil and gas pipelines, the internet, financial transfer networks, food production and delivery, the electricity grids. All of these were put together with an eye toward ease of access, ease of maintenance, inexpensive operation, and none of them put together with a thought being given, really at all, to terrorism.

There's another problem with these complex networks. It is stated in the terms

used in chaos theory and network theory as the "butterfly effect." In principle, if a butterfly flutters his wings on one side of the world, it could create a tornado on the other side, because the ecology is such a complex network. That may seem fanciful, but last August a tree branch fell on a power line in Ohio in the United States, and some 50 million consumers of electricity in the eastern part of the United States and Canada were blacked out for days. Because our electricity grid is such a complex network, it can respond in strange and really almost malignant ways to a disturbance.

All of these networks that serve us can produce a malignant effect in that fashion. But what happened to us on September 11th was not an unintentional effect of a small action in a complex network. It was war. Targeting of the World Trade Center and the Pentagon for al Qaeda was possible because, among other things, we had flimsy cockpit doors on our airliners. And although the terrorists could have taken over the aircraft and killed everyone on them with relative ease, I suppose, given the security at the time, they could not have flown them into the buildings and killed thousands if we had not had flimsy cockpit doors.

That was part of the network of air transport that constituted a vulnerability to, not malignancy, but to malevolent interference. So we have two types of ways our societies can be heavily damaged in this highly interconnected world. If we look at the malignant world, the world of unintentional creation of death and destruction, we in the United States are not trying to sink Bangladesh beneath the waves of the ocean by buying SUVs that consume a great deal of gasoline. But we may be helping to do that by increasing global warming.

Similarly, you here in Europe are not trying to make AIDS worse in Africa by not having very many children. But the fact that European populations are aging very rapidly means you need a lot more health care workers, and Europe tends to hire a lot of health care workers from Africa; therefore, people with AIDS in Africa are not taken care of as well as they might be. These are malignant, unintended effects, and these types of things that can go wrong in our modern globalized society can be dealt with, in time and with good will, by good management, by good engineering, by cooperation, by public-private partnerships. We can organize to fix the electricity grid, to reduce carbon emissions, to find ways to do a better job of creating more health care workers for Africa. These things we can work on collectively and collegially, and it is impor-

tant to do that.

But the malevolent attacks on us, whether it is on commuter trains in Spain or on the World Trade Center in New York, are different. That's war. Those types of interference with our networks have to be dealt with as one fights a war. One needs to put oneself into the mind of one's enemy, understand what the enemy is likely to do, and defeat him.

Now if I were to summarize this current situation between Europe and the United States, I would not really go along with my friend Robert Kagan, who tends to say that Americans are from Mars and Europeans are from Venus.

I think it is less fundamental than that. It is that many in Europe are working harder on the malignant problems, like global warming, because these are problems that can be dealt with collectively and collegially; and Europe has now, as the result of the three Great Wars of the 20th century—two hot, one cold—become a continent (Belarus excluded) largely of democracies. These governments are able to work together and Europe is focused on that kind of an issue.

We, however, as a result of September 11th and a result of some other aspects of our history, are focused more on our side of the Atlantic on malevolent problems.

The overall point is this: as Western society in general, we do not get to choose. We have to both restructure and fight. We have to deal with both. We must both keep AIDS from getting worse in Africa and keep Bangladesh from sinking beneath the waves, and we must defeat the terrorists and those who support them.

Now, it's all right that some of us would prefer to work on one set of problems and others prefer to work on the others. We can have some kind of allocation of roles here. But if you should have an ugly and misshapen mole that you discover on your neck and you think there's a chance it might be malignant, and then that night a burglar gets into your kitchen, you don't get to say: "I'm more interested in the mole problem, I'll ignore the burglar." Nor do you get to say, "I'm interested in dealing with the burglar, whether that's with a club or by calling the police, but I'm going to ignore the mole." Both of them can kill you. You must work on both.

Now, we in North America and you here in Europe have different approaches toward dealing with problems. And over the decades, over the centuries in many ways, this has been a very useful partnership. Like a good marriage or like a good business partnership, the different partners bring different things to it. I think you will find in the years to come, whoever is in the White House, that Ameri-

cans and the American people are going to be focused rather heavily on issues related to dealing with malevolent threats against the Western world, particularly coming out of the Islamist movements of the Middle East and especially al Qaeda and its related organizations.

You here may be focused more on malignant problems. What we need to do is help one another. We have some things we can do to help with global warming and AIDS. You have some things you can do to help with fighting terrorists. And

we also have to not get in one another's way. I think as time goes on, if we focus on the threats in this century as well as we did in the last—against extraordinarily difficult challenges, whether it was imperialism, fascism, Nazism, or communism—ultimately the forces of democracy and the rule of law will win.

I think it will be a difficult 21st century, but if we can persevere now as well as we did in the 20th century against very different threats, ultimately our partnership will prevail. □

THE FED RAISES RATES AT LAST

Because borrowing at extraordinarily low interest rates has financed much of the recent growth of consumer spending, many have concluded that the economy is more vulnerable to increasing interest rates than it was at similar stages of previous business cycle expansions. Maybe so, but negative "real" interest rates (which make it cheaper to buy now on credit) would seem to be a greater threat.

The Federal Reserve recently increased its "target" rate for Federal Funds and its discount rate by 0.25 percentage point to 1.25 percent and 2.25 percent, respectively. These increases were the first since before the last recession. They followed a long string of decreases, which had brought interest rates to their lowest levels in over half a century.

The move by the Fed was widely anticipated and further increases are expected.

The Fed heavily influences the market rate for Federal Funds with its open market operations. Federal Funds are the deposits at the Federal Reserve that member banks lend among themselves, typically on an overnight basis. The member banks need to hold such funds as reserves. When the Fed purchases Treasury securities the payment comes out of "thin air"—it simply credits the account of the member bank receiving the payment. When the Fed adds to the total of such deposits it puts downward pressure on the Federal Funds rate, and vice-versa when the Fed sells Treasury securities.

The other way a member bank can obtain needed reserves is to borrow from the Fed, which "discounts" the assets the member bank puts up as collateral (*i.e.*, the Fed lends somewhat less than the value of the assets). The discount rate is the rate charged on such loans, and it is simply set by the Fed.

On the other hand, longer-term rates are determined by the supply and demand for loanable funds of a given maturity. The longer the maturity, the less influence the Fed has on rates. The accompanying chart includes the Federal Funds rate and the average rates charged on new

30-year fixed-rate mortgages. As is evident in the chart, the relation between these rates has been variable, but if the rates that the Fed can control are headed upward then long-term rates can be expected to move in the same direction. In fact, longer-term interest rates had been increasing for several months before the recent move by the Fed, because it has been widely perceived that rates had reached their lows for this cycle and that the future trend would be upward.

Some analysts believe that the economy is more vulnerable to increasing interest rates than it was at similar stages of previous business cycle expansions, because borrowing at extraordinarily low interest rates has financed much of the recent growth of consumer spending.

Refinancing

Refinancing home mortgages at lower rates can reduce a homeowner's monthly payment, making more available for other spending. Alternatively, lower interest rates can enable a homeowner to borrow more with the same monthly payment, thereby "cashing out" a portion of the equity in the home, which can be spent immediately.

Refinancings have been commonplace for nearly 20 years, ever since mortgage rates began to decrease from record levels of the early 1980s. Presumably, nearly everyone with a mortgage who could benefit from refinancing has done so by now. Indeed, refinancing activity reportedly has decreased markedly during the recent upturn in long-term interest rates.

A related concern has been an increase in adjustable rate mortgages (ARMs) on both new and refinanced mortgages. The

chart shows the rate on five-year Treasury securities plus one percent. This is a proxy for the rates on ARMs, but it should be realized that the terms on ARMs vary greatly. Nevertheless, the rates on ARMs are generally somewhat below those on new fixed-rate mortgages, as indicated in the chart. The worry is that higher interest rates will drain purchasing power from homeowners whose mortgage interest rates are adjusted upward.

This is bound to occur if rates continue to increase, but it should be recognized that it will be a gradual process. The rate adjustments on ARMs are relatively infrequent (only once a year at a minimum and perhaps as long as every five years at a maximum). This means that the impact of rate adjustments when it comes will be quite gradual and much smaller than other factors that impact disposable income (such as employment trends, taxes, or petroleum prices).

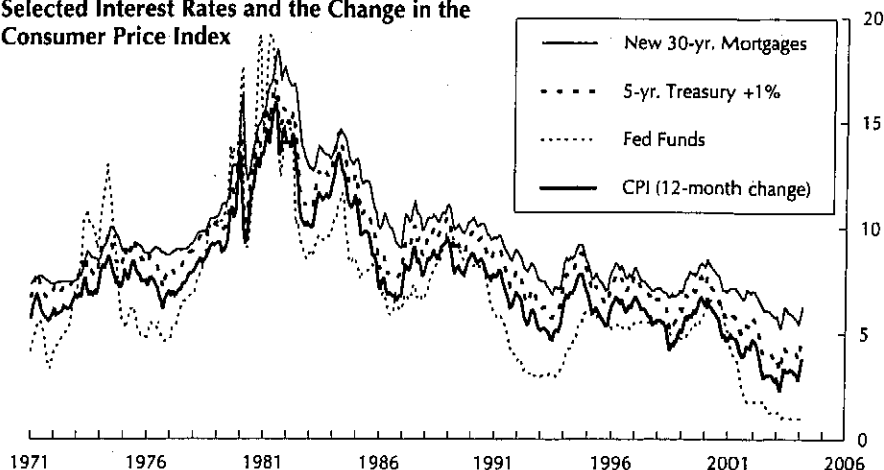
Home equity loans (HELs) could be a larger factor. The interest rate on these loans is directly linked to a short-term rate such as the bank's prime rate. They have no fixed repayment schedule. Higher rates on HELs would have an immediate effect. HELs were developed after the tax deduction for interest on consumer loans was disallowed. Because mortgage interest remained deductible, HELs have been used instead of car loans or revolving credit (charge account and credit card debt), and it is unclear how a higher rate on HELs would affect consumer spending.

The Housing Bubble

A related concern has been the potential effect of higher mortgage interest rates on the "housing bubble." It is said that, because homes have appreciated even as the stock market has disappointed and mortgage money has been available at historically low rates, consumers have been over-investing (or over-paying) for housing. In this regard it may be noted that home buyers and home sellers often have different perspectives on price. Purchasers tend to think in terms of the prospective monthly payment, while sellers tend to focus on the cash they will receive on a sale.

If higher rates mean that the buyers can borrow less, then prices could level off or even decrease. Those who have been viewing their homes more as investments than as places to live could be hurt. But despite episodic "horror stories" (such as "McMansions" purchased with what amount to short-term borrowings) there is little evidence that this is a pervasive phenomenon. Moreover, it should be noted that the increases in home prices have been much greater in some areas

Selected Interest Rates and the Change in the Consumer Price Index



(Boston, New York City, and Los Angeles, to name a few) than others.

In any event, we would note that the markets have a way of resolving such issues far more expeditiously than analysts. People have to live somewhere. If they cannot afford to stay where they are, prices will adjust. And it is far from certain the dire consequences foreseen by many analysts will come to pass.

Inflation: Too Little, Too Late?

In an era of fiat currency, with little certainty of the long-term value of the dollar, some portion of interest payments is compensation for the diminishing purchasing power of the dollar. The "real" interest rate is the nominal rate less the rate of price inflation. However, it is impossible to calculate this in advance and, even after the fact, there are many possible ways to calculate the "real" interest rate.

This means that inflationary expectations are a major determinant of long-term interest rates, regardless of what the Fed is doing to influence short-term rates. Inflationary expectations in turn mainly reflect recent and current experience.* The chart shows the rate of change of the Consumer Price Index over the preceding 12-month span. The fluctuations of this series generally parallel those of the longer

* Investors "put their money on the line," and it is often noted that this aid to clear thinking is not available to mere commentators no matter how expert. However, there is little evidence that the "inflation premium" in long-term rates is a reliable guide to future price inflation.

term rates shown in the chart. But the correlation of the rate of price inflation with the Federal Funds rate is much smaller.

At present, the Federal Funds rate is well below the rate of price inflation we have shown, which is for the "all-items" index; and the latter's rate of increase, although still quite low by the standards of the past 50 years or so, has recently accelerated. Some analysts think the reported rate of increase of the all-items index overstates the underlying rate of price inflation because it includes the very volatile prices of food and fuel. Others think that the current index understates the rate of price inflation because of spurious "quality adjustments" and/or the fact that housing costs in the CPI are based on rents rather than home prices. A third oft-repeated complaint is that politicians somehow manipulate the index. In our view this is highly unlikely, inasmuch as it would require the complicity of such a huge number of people that it would be impossible to keep secret.

The Fed has apparently waited to begin increasing rates until well after inflation began to accelerate. The worry is that the Fed is "behind the curve" and will find itself unable to increase rates sufficiently to thwart accelerating price inflation, especially during a Presidential election campaign. This could mean not only more price inflation, but also an eventual "hard landing" if the Fed is forced to tighten in earnest in the event it becomes cheaper to buy now on credit than to buy later at a higher price. □

PRICE OF GOLD

	2002 Jul. 11	2003 Jul. 10	2004	
			Jul. 1	Jul. 8
Final fixing in London	\$314.15	\$343.40	\$394.80	\$405.35

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