

report PUBLIC JUSTICE

Third Quarter, 2006

Vol. 29, No. 3

Pay-Back Time for the United States?

by
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The time is drawing near, it would seem, when the United States' international debt will produce a large adjustment in the world economy. Over the last 20 years the accumulated sum that the U.S. owes the rest of the world has grown to some \$5 trillion or five thousand billion dollars, and it is growing ever more rapidly. In 2005, \$726 billion was added to the deficit and most commentators do not see it quickly abating.

The debt is no immediate problem as long as other countries are prepared to hold it. Thus far, foreign economies have been happy to invest funds in the United States to meet this gap. Japan and Europe have been heavy investors for a while, but now China, Russia, and Saudi Arabia are also big contributors. Initially the holdings were mainly of government bonds, helping fund the federal government's debt. It also seems that many of us hold dollars—there may be about a trillion dollars in cash, in wallets, and under beds around the world, a kind of permanent free-interest loan to the American economy. More recently, investors have been buying U.S. companies and are beginning to own a substantial amount of American real estate. Maybe, say some economists, this pattern will just carry on. There are many worldwide who do not want the dollar to fall and they will continue to carry the debt.

Yet borrowing on this scale tends in the end to come home to roost. Export earnings would need to increase by 57 percent for the U.S. trading position to be in balance. No country can readily increase its exports by half, and so this is a dangerous gap. The gap also amounts to 5.8 percent of the U.S. Gross Domestic Product. Put another way, for every \$17 that an American spends, one dollar of that sum is borrowed from other countries. We are used to the poor being in debt, but here we have the longest, greatest spending bonanza in human history, partly funded from abroad. It is made up from public and private sources. U.S. military costs since the end of the Cold War have been surprisingly high, and we know Americans like foreign cars and Middle East oil. Thus, the history of this superpower is partly built on weakness.

Sooner or later the dollar will fall. Commentators discuss whether there will be a soft or a hard landing, that is, whether the dollar will slide or drop. Since many long-term investors have good reasons for keeping their capital in the States, the fall may be gentle. But given both the vast amount of short-term capital moving around the world and a likely fall of the dollar of 20-30 percent, even a gentle slide could be quite bumpy. Short-term currency movements are so big that any currency the market does not want could dip sharply. In these circumstances, the Federal Reserve Board would probably be forced to raise interest rates substantially, and with a fall in domestic expenditure the preconditions are present for quite a sudden recession.

Strangely, the United States will not suffer loss as much as other countries, because the dollar has been the reserve currency for the world's markets. Whereas poorer countries have to pay back their debts in western currencies when they devalue, the lenders in this case (countries other than the United States) will carry the reduced value of the dollar. Foreign holders of dollars will find the value of their assets fall against their own currencies. Further, there are vast areas of expenditure where U.S. citizens and their government are able to economize, like taxing gasoline rather more. The U.S. economy will not face penury.

Yet the world will look different after this event. The profligacy of the Bush administration will be evident to all, including Republican voters, and the idea that Americans can spend as if there is no tomorrow will be economically, if not ecologically, challenged. Thrift will become a required virtue.

Further, the idea of the superpower will be punctured. That idea distorted the rule of law during the Cold War and also while the U.S. has appeared to be the only superpower. Yet, military might is very costly, as the U.S.S.R. discovered two decades back, and its attractiveness should begin to wane as somber economic realities set in.

At another level, Americans who worship God and the Dollar will have some adjustments to make in their thinking. Currencies reflect economic relationships and the mighty dollar will prove to be a god with clay feet. The significance of choosing between God and Mammon may once again become evident.

Yet, the final change is the most subtle and may be the most important. For decades the West has been able to commandeer the goods and services of the world at the cheapest of prices. It has been able to invest in poor countries for sums which are peanuts. Soon, perhaps, we will begin to see the reversal of this pattern in the U.S. and elsewhere. Markets will not instantly become fair, and the upheaval will cause suffering, but in the longer term, the meek may inherit a bit more of the earth as western economic colonialism begins to lose its grip.

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Politics: Confronting the Powers (Baker Books, 2005). This article was first published in the *Church Times* and has been edited slightly for publication here.]