CURRENT ACCOUNT

A Dinner Conversation

"We're into a new regime," said an economist friend during a dinner conversation about prospects for the U.S. dollar. "After five years of buying up all kinds of assets here, the Europeans and Japanese now have a vested interest in keeping the dollar strong. They have no choice but to acquiesce in U.S. policies. America's power position in international affairs has been transformed for the indefinite future."

A beguiling picture—and not at all illogical, given the premises on which it is based. If foreigners do care about avoiding depreciation in the value of their now mountainous claims on the United States, they will indeed have to mute their objections to the huge federal budget deficits that, by promoting both domestic growth and high interest rates, have been so instrumental in attracting investments here. And that, in turn, would indeed give the U.S. government an extra degree of freedom in pursuing policy objectives both at home and abroad. His reasoning was impeccable, I told my friend—and in my opinion dead wrong.

In the first place, foreigners might not place highest priority on protecting the value of their dollar assets. There are other things on their minds too, such as the drainage of a large part of their savings to finance America's yawning fiscal and trade deficits, or the skyscraper heights to which their own interest rates were driven by the efforts of their governments to keep capital at home. A strong dollar also inflated the price of many of their key imports, especially energy products, that are normally invoiced in terms of the greenback. Few Europeans or Japanese I know seem to doubt that our currency has been overvalued in recent years. For them, the question is not *whether* the dollar should come down, but only *when*—via the proverbial "soft landing" or with a loud thump.

In any event, even if foreigners do acquiesce in U.S. policies, Washington's extra degree of freedom is not bought without cost. The flood of investment from abroad has turned the United States, for the first time since World War I, into a net debtor economy. Ronald Reagan used to criticize Democrats as the party of "tax tax, spend spend." So what did he do? He cut taxes, making us a nation of "*borrow borrow*, spend spend" instead. Those fiscal and trade deficits have been financed by the greatest accumulation of foreign debt in history, all of which will still have to be serviced long after Ronald Reagan is gone from the scene. Funds will have to be found to pay interest to foreign claimants. And that is bound to act as a constraint on U.S. policymakers, whatever the level of our exchange rate.

"We appreciate your quotations from Plato, Simpkins, however, they do not apply to this little takeover."

Finally, I asked my friend, what do we mean by a new regime? It seems to me that we have heard that sort of thing before—many times, in fact. During the Carter administration, for instance, when foreigners were selling dollars instead of buying them, ominous warnings were heard about America's presumably irreversible decline in the world economy. "The dollar is dead as international money," announced one prominent economist (who now happens to be president of the American Economics Association). America's economic hegemony is finished, mourned others. Power in international trade or finance could no longer be exercised unilaterally, as it had been so often in the halcyon years after World War II. From now on we would have to learn to live cooperatively, within the narrowing limits of our own national resources.

Similarly, just a few years earlier it was the rise of the Arabs that dominated all futurist scenarios. OPEC's quadrupling of oil prices had given Middle Eastern governments a stranglehold on the global economy, we were told. With their hundreds of billions of "petrodollars," they were expected to buy up everything in sight. Hair-raising predictions of global depression or worse resulting from the Arab world's manipulation of its newfound wealth were being featured in best-selling novels like Paul Erdman's *The Crash of '79* and in popular films like Jane Fonda's high-finance romance *Rollover* (a pun if ever there was one). The oil cartel, it seemed, had changed forever the balance of power in economic affairs.

A few years earlier it was the U.S. multinational corporation that was supposed to be taking over the world. Jean-Jacques Servan-Schreiber wrote his famous *The American Challenge* and Charles de Gaulle threatened to retaliate by closing off the European market to U.S. investments. And just a few years before that it was the Europeans who were supposed to be taking over as a result of their "miracle" growth in the 1950s. A quarter-century ago many thought that the symbol of the future was the Volkswagen "beetle."

Yet none of these developments turned out as expected, as we now know. The dollar is not dead as international money, and we certainly are not living within our means. The oil cartel is in disarray, U.S. multinationals are on the defensive, and the Europeans are mired in "Europessimism." The trouble with casual predictions of "new regimes," I insisted to my friend, is that they often tend to mistake temporary permutations for permanent transformations—in effect, to extrapolate short-term events along a straight line directly into the long-term future. They may be "trendy," but they are not always right about trends.

Granted, responded my friend sensibly, but who can be sure? These are matters of judgment on which sincere people may sincerely disagree—good examples of why there is so rarely consensus among economists. Perhaps his premises were wrong, perhaps not. Perhaps his prediction was inaccurate, perhaps not. Only time will tell. So we agreed to disagree. And we agreed to have dinner again in another quarter-century to find out who was right.

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