

A QUESTION OF SOLVENCY

by James Chace

Two decades ago, America's power to control events abroad had been sharply reduced. The nation's economy was deeply troubled. Inflation had reached near 20 percent, and to strengthen the dollar the Federal Reserve had raised interest rates to 20 percent and above. Unemployment rose as high as 10 percent, as jobs in the private sector were being driven out by high taxes and low productivity. Business investment in the United States, as a share of gross national product, was two-thirds the rate in West Germany, less than half the rate in Japan. Worse yet, we were a profligate people. We continued to buy vast amounts of goods and resources abroad, increasing our imports of foreign oil by a staggering 42 percent between 1973 and 1978, until they ran to about 50 percent of our needs at the end of the decade. To finance the growing trade deficit, the government simply created more credit—IOWs that were becoming worth less and less to whomever held them. We just went on printing money and importing oil and running shoes because the alternative—to live within our diminished means—seemed unthinkable.

That was then. This is now. America's economic situation has changed dramatically. Hyperinflation is a distant memory. In the past 20 years the United States has created 35 million new jobs. Interest rates for the past few years have been low. An economic downturn, which gained momentum with the attack on the World Trade Center on September 11, 2001, is on the wane, despite the gyrations of the stock market, which has clearly frightened investors into moving more of their assets into safe havens. The dot-com bubble of the 1990s has been wisely pricked. At the same time, at this writing in midsummer, the financial community has been racked by scandal. Big businesses, such as Enron, Tyco, Global Crossing, Adelphia, and Xerox—and that's for starters—have wildly overstated their earnings. (Medco, a subsidiary of Merck, counted \$14.1 billion in copayments to pharmacies as revenue.) Accounting firms aided and abetted these criminal financial scams. The stock market responded to this crisis of confidence by plunging.

In addition, America's current account deficit of around 4 percent of gross domestic product is deepening. With business investment floundering, foreigners are largely

financing the rising federal budget deficit, due in no small part of President Bush's mania for tax cutting.¹ In an about-face, the dollar has weakened as the euro strengthens. It is becoming more likely than ever that foreigners are losing their infatuation with the American economic "miracle."

If the dollar were to weaken too severely and the Federal Reserve felt called upon to raise interest rates to curb a resulting inflation, this would hobble the sputtering U.S. economic recovery and we could find ourselves back in the bad old days of the 1970s and "stagflation."

In this summer of our discontent, faced with a federal deficit that may well reach \$160 billion this fiscal year with no possibility of a balanced budget in sight, the Bush administration nonetheless remains committed to an enormous defense buildup.

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ing to \$451 billion over the next five years. This is greater than the military expenditures of all the rest of the world combined. (The \$48-billion increase in defense spending alone, requested for the coming fiscal year, is more than any other nation's total defense budget.) In order to uproot terrorism across the globe, the United States is now sending its soldiers to Afghanistan, the Philippines, Yemen, and Colombia. A leak from the Pentagon also spelled out the administration's commitment to use military force of up to 250,000 troops to overthrow the regime of Iraq's Saddam Hussein.

In my book *Solvency*, published over 20 years ago,² I cited the advice of America's leading political commentator, Walter Lippmann, writing in the middle of World War II. Lippmann then warned:

"For nations, as for families, the level may vary at which a solvent balance is struck. If its expenditures are safely within its assured means, a family is solvent when it is poor, or is well to do, or is rich. The same principle holds true of nations. The statesman of a strong country may balance its commitments at a high level or at a low. But whether he is conducting the affairs of Germany, which has had dynamic ambitions, or the affairs of Switzerland, which seeks to hold what it already has, or the United States, he must still bring his ends and means into balance. If he does not, he will follow a course that leads to disaster."

In foreign policy, solvency consists "in bringing into balance, with a comfortable surplus of power in reserve, the nation's commitment and the nation's power."³

At first glance, the issue of insolvency is surely behind us. Or is it? With all its travails, the United States still possesses by far the strongest and most dynamic economy in the world. It would seem that America has justified Dean Acheson's comment over half a century ago that America was the economic locomotive and the rest of the world the

caboose. The notion, once widely held, that Japan might overtake the United States as Number One seems ludicrous now, as Japan has remained mired in a stalled economy for over a decade. The American economy is now twice as large as Japan's, its closest competitor. While the European economy is robust, in the global hangover at the end of the 1990s binge Europe has suffered in the wake of the American downturn rather than demonstrating the economic prowess to buoy up the rest of the world. A European common currency will likely provide Europe with a new economic dynamism, but the Europeans are in no mood to sacrifice their social programs for a bout of relatively unrestrained capitalism.

As long as the American people are willing to put up with inadequate health care and poor schooling, public expenditures on defense will go unchallenged. But even under this scenario, the question that lies before us is whether the United States will be willing to continue to play the role of global policeman if this entails ever deepening involvement in savage wars with little or no support from its putative allies.

Of course, any administration is likely to gain public support in response to an act of terrorism that strikes the United States territory. But it is quite another matter to engage in a preventive war, as now seems possible with Iraq, especially if a military intervention ties down American troops with no end in sight.

True, the American people have been willing to support for a very long time America's wars in the last century, even when they were unpopular, as in Korea, or seemed to violate moral norms, as in Vietnam. It is simply a myth that Americans have no staying power.

But if we get bogged down in multiple interventions, with little or no support from our traditional allies, the consequences are all but predictable. It is doubtful NATO could survive under these circumstances. It is also likely that there would be a strong reaction in the country that would call for a retreat from any further interventions unless the American national interest was directly threatened. The case for using American might solely to defend our homeland—including the development and deployment of a national missile defense system—could easily be a seductive response to an ungrateful and hostile world.

In this respect, the dangers of imperial overstretch could bring forth a new crisis of solvency, especially if social programs at home are sacrificed to the quixotic effort to impose a global Pax Americana.

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1 See The Economist, June 22, 2002.

2 James Chace, *Solvency: The Price of Survival* (New York: Random House, 1981).

3 Walter Lippmann, *U.S. Foreign Policy: Shield of the Republic* (Boston: Little Brown, 1943), p. 9.