Not So Super Anymore

New Era: America is still No. 1, but no one is at the wheel of the global economy any longer. Who will run the next crisis?

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Issues 2005 - The United States is the world's leading economic power—but perhaps no longer the world's economic leader. There's a difference. No one doubts the singular wealth or position of the American economy. It's roughly 2.5 times bigger than Japan's, six times larger than Germany's and eight times bigger than China's. The dollar, the reigning currency for world trade and international investment, represents about two thirds of governments' foreign-exchange reserves. American capital markets and investment banks remain supreme. In 2003 global companies and governments sold more than $5.3 trillion worth of stocks, bonds and other debt, says Thomson Financial; 58 percent of that money was raised in the United States, and the top five underwriters were American (led by Citigroup, Morgan Stanley and Merrill Lynch). There's no end of superlatives for the U.S. economy.

But leadership is the ability to set and achieve goals, either by imposing your will or by getting others to follow. Time was when the United States could do this easily. After World War II, Europe needed reviving; the United States sent money through the Marshall Plan. From the 1960s to the 1980s, when currency values displeased Washington, the United States simply abandoned them. In 1971 Richard Nixon devalued the dollar; in 1985 the Reagan administration essentially informed Europe and Japan that they'd have to accept a big dollar depreciation. Times have changed. In its general foreign policy, the Bush administration may seem unilateralist. But on economic matters it has suffered a loss of influence that, frankly, continues a trend. Ironically, it stems partly from the success of American ideas.

By championing "globalization"—even before the term became fashionable—the United States has unwittingly weakened its own leadership. In an increasingly globalized and prosperous world, competing centers of wealth and power emerge: no longer just Europe and Japan but also Brazil, China and India. There's a fragmentation of influence. Some influence moves to markets: those impersonal crowds of buyers and sellers that governments can manage only crudely. And some moves to other countries that, in various global settings, assert their own interests and ideas. Either way, American leadership erodes.

What this means is that the second Bush administration faces inevitable limits on its economic leadership. The United States is often as much the prisoner as the master of events. This matters in at least three critical areas. One is oil; even in 2004, the rapid and unexpected price rise imperiled the worldwide recovery. America's problem is simple: its huge oil use worsens price pressures. Until 1974 the United States was the world's largest oil producer. Ample supplies tamed prices. Now imports satisfy 60 percent of U.S. needs and, with less than 5 percent of the world's population, the United States uses a quarter of global production.

A second concern involves exploding U.S. current-account deficits that—in theory, at least could shake the very stability of the global economy. In 2004 the deficit will hit a record $664 billion, or 5.7 percent of gross domestic product, estimates economist David Wyss of Standard & Poor's. Americans spend far more abroad than they earn; current-account deficits have occurred in 21 of the past 22 years. In turn, foreigners have used their huge dollar earnings to buy massive amounts of U.S. stocks, bonds, real estate and entire companies. At the end of 2003, foreign net investment in the United States totaled $2.4 trillion.

The danger is that a "crisis of confidence"—diminishing foreigners' desire for dollars—could trigger a deep
global economic slump. Here's how. For starters, U.S. stock and bond markets might crash if foreigners bought less. American consumer confidence and spending might then plummet. Simultaneously, the already-volatile dollar would drop sharply; other currencies (the euro, the yen) would rise. That would make other countries' exports less competitive. Their industrial production and confidence could decline dramatically. The result: a cascading loss of confidence, spending and global trade. Of course, a crisis isn't inevitable. But for one to start, foreigners don't have to sell dollar holdings; all they have to do is stop accumulating new holdings.

Finally, look at global trade negotiations. Since World War II there have been eight major rounds of negotiations leading to cuts in tariffs and other trade barriers. The ninth is under-way. Until the late 1990s, "the United States and Europe called the shots on world trade," says Robert Hormats of Goldman Sachs. No more. The present round almost collapsed after a negotiating session in September 2003 in Cancun, Mexico, ended in failure. Developing countries—led by Brazil and India—rejected as inadequate a U.S.-European plan to reduce agricultural protectionism. Only since the United States and the European Union made more concessions have talks resumed.

The connecting thread here is that the United States can no longer impose its will on the global economy, even with a few close allies. It can't lead on energy, because successive presidents and Congresses haven't curbed the national thirst for oil. Abroad, America is seen as an energy hog. On the trade talks, Robert Zoellick, the Bush administration's U.S. trade representative, says the Brazils and Indias will be "critical to success."

As for a "dollar crisis," the United States didn't unilaterally create those massive deficits—and couldn't cure them unilaterally. The causes include faster economic growth in the United States than in Europe and Japan, boosting U.S. imports and hurting U.S. exports. Another cause is the refusal of Asian countries, led by China, to revalue their currencies; that, too, hurts the U.S. trade balance. In theory, a rescue might occur if enough government central banks bought dollars and other countries—led by China—revalued their currencies. The United States would probably have to slow its economy to suppress its demand for imports. Each of these measures might be unpopular—and hard to adopt. Nor is it clear that they'd succeed in restoring market confidence in the dollar.

It's not just globalization that weakens American economic leadership. Gone, too, are some traditional political props. None was more important than the cold war. America's major trading partners were its major military allies. They depended on the U.S. defense shield. Trade and economic policy was part of a wider strategy to defeat communism by demonstrating that democratic capitalism produced more prosperity and popularity than the dictatorship of the proletariat. There was less room for dissent. Now the situation is reversed: America's over-seas deployments (a.k.a. Iraq) inspire fury abroad. It's actually popular to reject American leadership.

Likewise, the United States benefited from its dominance of international economic organizations: the IMF, the World Bank, the General Agreement on Tariffs and Trade (now the World Trade Organization). The United States still dominates—but less so. Worse, these organizations have lost power. In the Asian financial crisis of 1997-98, the IMF didn't have enough money to rescue teetering economies by itself. The World Bank is no longer the largest source of funds for poor countries. In 2003 private companies' direct investment in developing countries totaled $172 billion, says the United Nations. By contrast, World Bank loans now amount to about $20 billion annually.

Public opinion was another vital prop. Confident in the 1950s and 1960s, it accepted U.S. economic concessions to other countries. Now Americans are more fearful. Pure protectionism has declined, says political scientist I. M. Destler of the University of Maryland, because many industries have global operations. But there are growing worries about job loss, "offshoring" and China. Consider a recent poll on the North American Free Trade Agreement. By a 60 to 25 percent margin, respondents thought NAFTA...
bad for "job security." Presidents and Congresses have less leeway in what they can do abroad. Congress refused to grant President Bill Clinton broad trade-negotiating powers; it barely granted Bush those powers.

None of this dooms U.S. leadership. But it does mean the nature of that leadership has changed. It's no longer automatically asserted—and no longer automatically accepted. It depends increasingly on persuasion and decreasingly on raw power. If there's a model for the future, it is the Asian financial crisis. The Clinton Treasury feared that successive currency crises could destabilize the global economy. This view was not universally shared; some European officials believed that currency losses would chasten private lenders without causing a wider crisis. A different Treasury might have agreed—or failed to persuade other countries.

There's a lesson and a warning here. The lesson is that global markets do not always operate well by themselves. They require some broad political framework to provide stability, quell uncertainty and cope with crises. For a half century, the United States provided the framework. The warning is this: as much as American leadership has often been resent-ed, it might be regretted if it's no longer there. The globalized economy is a work in progress, and if it disintegrates into a melee of unsupervised markets and contentious nations, people may recall nostalgically the days when they nosily complained about Washington's overbearing leadership.

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