

THE UNITED STATES  
AND  
THE INTERNATIONAL ECONOMIC SCENE

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"It was the best of times, it was the worst of times." So wrote Charles Dickens a century ago at the start of his classic novel A Tale of Two Cities. And so might think President George Bush now at the start of his new Administration in Washington. For the United States confronting the international economic scene today, it is indeed both the best and worst of times.

It is the best of times because of the generally robust prosperity that is so evident in so many countries in the world economy today. In the United States itself, recovery from the recession of 1981-82 has now continued without interruption for more than six years. And growth is even higher in many of the other industrial nations of Western Europe and Japan, while inflation and unemployment are both down significantly. In many parts of the Third World, growth has also been strong in recent years. This is especially true of the newly industrializing countries of East and Southeastern Asia. And even in the centrally planned economies of China and the Soviet bloc, economic prospects are looking better as a result of a variety of market-oriented reforms -- perestroika. In all these respects, the international economic environment seems benign and unthreatening for

the new Administration.

In other respects, however, the environment is anything but benign. Beneath the surface of the current prosperity lurk numerous and serious policy challenges for the Administration that can be ignored only at its -- and our -- peril. In relations with the other industrial countries, the United States faces potentially hazardous problems of persistent payments imbalances, exchange-rate uncertainties, and protectionist trade pressures. In relations with the Third World, there remains the vexing and seemingly intractable problem of external debt. And in relations with the centrally planned economies, there remains the question of how best to respond to the new policies of reform and restructuring. For the United States today, the key issue is how to cope with all these challenges at a time when America's own relative position in the world economy appears to be in historic decline. How the Bush Administration reacts to all these challenges will go a long way to determining whether the current prosperity of the community of nations can be maintained or not.

## I

In relations with the other industrial countries, the new Administration's most pressing challenge is to cope with the related problems of persistent payments imbalances and exchange-rate uncertainties. At the core is America's own external deficit, which during the eight years of the Reagan Administration soared as high as \$150 billion a year, and which is still running in excess of \$100 billion annually. Deficits of this magnitude can persist only so long as the rest of the world is prepared to help finance them by acquiring claims on the United States. Between 1980 and 1988 America borrowed more than \$700 billion from the rest of the world in this fashion, shifting in the process from

being the world's largest creditor nation to being its largest debtor. The key question is whether foreign creditors will be willing to continue financing America's deficits on this scale and what happens if they are not.

The risks are clear. Any significant decline of foreign willingness to finance America's deficits could precipitate a major fall of the dollar, destabilizing exchange markets everywhere. The only way to prevent a dollar crisis would then be increase U.S. interest rates sharply, which could precipitate widespread recession. Neither prospect is especially to be desired.

What, then, can the Bush Administration do to avoid the twin risks of exchange-market instability or global recession? First and foremost, everyone recognizes, it must act effectively to reduce the domestic counterpart of the country's external imbalance the deficit in the U.S. Government's own budget. Although the exact nature of the link between America's fiscal and payments imbalances is not entirely clear, the general connection between the two is undisputed: dependence on foreign financing is a direct result of the greatly enlarged budget deficits generated by the Reagan tax cuts of the early 1980s. President Bush says that reduction of the fiscal deficit will be a priority of his Administration. But doubts persist that much can actually be accomplished so long as the new President continues to ask people to "Read my lips: No new taxes," while the Democratic-controlled Congress continues to oppose further substantial cuts in spending programs. Clearly, prolongation of the budgetary stalemate would not help to sustain the confidence of foreign creditors. Effective action to restore payments equilibrium abroad must begin with an enlightened compromise on fiscal policy at home.

In addition, the new Administration must also act to bolster the mechanisms of policy cooperation among the major industrial nations that have been set in place in

recent years. Coordinated exchange-market intervention must be continued to contain the risk of a serious dollar crisis, at the same time that appropriate adjustments of domestic policies are initiated not only in the United States but in the principal surplus countries as well, particularly West Germany and Japan. Fiscal contraction in the United States must be matched by more expansionary policies elsewhere if the risk of a serious recession is to be avoided. Imaginative economic diplomacy will be required of President Bush and his policy makers to overcome understandable hesitations at home and abroad to making individual concessions for the common good.

## II

The same is also true in the field of trade policy, where relations among the industrial nations in recent years have been especially tense and conflictual. Disputes have erupted on all sides, as protectionist trade pressures in the European Community and Japan as well as in the United States have generated increasing friction on issues ranging from agriculture and automobiles to steel and high technology. The risk, clearly, is that the spread of mercantilist impulses in individual nations could seriously erode the multilateral trading system, endangering the economic gains of all. And nowhere is this a more pressing challenge than in the United States, still the world's largest trading nation. Here too imaginative economic diplomacy will be required to reconcile the often conflicting imperatives of national interest and systematic responsibility.

Under the Reagan Administration, America's response to this challenge was two-fold -- on the one hand, occasionally erecting new barriers to imports at home; on the other hand, actively pursuing the reduction of old

barriers to U.S. exports abroad. The bias of policy was supposed to be in favor of more open markets, which officials sought to promote both bilaterally, through negotiations with individual trading partners, and multilaterally through the so-called Uruguay Round of GATT trade talks. In practice, however, the Reagan Administration proved to be one of the most protectionist American governments of the twentieth century, as new import restrictions were imposed on a wide range of products, from automobiles to specialty steels. Administration spokesmen argued that these were adopted mainly for the purpose of containing domestic protectionist pressures and avoiding enactment of even more stringent controls by the Congress. Their pro-trade bias, they said, was best illustrated by the successful conclusion of comprehensive free-trade agreements with both Israel and Canada. But for most of America's trading partners, the effect of Ronald Reagan's eight years in office was a rising level of tension and irritation.

The challenge for the Bush Administration will be to find some way to reduce that tension and irritation, restoring a genuinely pro-trade bias to policy, while continuing to contain domestic protectionist pressures that now seem stronger than ever. The stubbornness of the U.S. external deficit, despite a more than fifty percent depreciation of the dollar since 1985, is increasingly persuading many Americans that the game of international trade is simply not played on a "level playing field," and that the only answer to unfair trade practices abroad is a higher level of import barriers at home. Greater insularity on the part of the United States, however, is unlikely to be accepted passively by other governments, which would undoubtedly be placed under equally strong pressures to retaliate in kind. Trade war could be the final result, unless President Bush can find a way to satisfy the

demands of his own domestic constituents without unduly threatening the interests of foreign competitors.

### III

In relations with the Third World the new Administration's biggest challenge is of course the debt problem, now seemingly no closer to solution than when it began with Mexico's financial crisis back in 1982. For more than six years, debtor governments have struggled mightily to keep up interest payments to their creditors. The vain result, in most cases, has been persistent economic stagnation, as investment has dried up at home and much domestic capital has fled abroad. The risk of the situation, as recent events in Venezuela have dramatically demonstrated, is that frustrations borne of declining living standards could lead to popular resistance and political instability, perhaps even to revolutionary changes of government. The only solution, it is equally clear, is to ease the cash-flow strains on debtor countries in a context of renewed growth as well as continued stability in financial markets. Even before he formally took office in January, George Bush promised a "whole new look" at the debt problem to see if such a solution could be found.

Under the Reagan Administration, the main emphasis of policy was on limited financial accommodations by creditors (mainly in the form of debt reschedulings plus, occasionally, some new lending) coupled with the acceptance of firm policy conditions by debtors, usually in the form of an IMF stabilization program. But while that approach was highly successful in buying time for commercial lenders to reduce their vulnerability to default, thus easing the threat of a serious banking crisis, it clearly failed to restore the lost solvency of sovereign debtors.

Nonetheless, U.S. authorities remained stubbornly resistant to all calls for an alternative strategy of debt relief for as long as they possibly could.

A first break in U.S. policy came at the Toronto economic summit last year when for the first time, under pressure from some of its major allies, the American Government formally agreed to consider some mild relief measures for the sub-Saharan region of Africa, where most debts are owed to official creditors. And this trend has now been reinforced by the recent proposals of the new Administration's Treasury Secretary, Nicholas Brady, calling on banks to offer voluntary relief measures, to be supported by official guarantees, for the middle-income group of debtors located mainly in Latin America. The frustrations of debtor countries have clearly had an impact on the thinking of policy makers in Washington. It remains to be seen, however, whether the Bush Administration's first initiative on this issue can indeed suffice to keep the problem from getting out of control.

#### IV

In relations with the centrally planned economies, the new Administration's main challenge reflects an old dilemma: What attitudes toward the marxist East best serve the political and economic interests of the capitalist West? Presently many of the governments of the East, led by China and the Soviet Union, are hurriedly seeking to enact market-oriented reforms to revive their stagnant and decaying economies, opening up attractive new opportunities for trade and investment by the West. The issue for the Western alliance, led by the United States, is how best to respond to this intriguing and complex situation. Are prospects for international peace enhanced by policies of

active support for the current wave of liberalization in the East? Or would we be better off leaving the Marxist economies to continue floundering in their own self-induced decay? Much rides on how the Bush Administration eventually attempts to answer these crucial questions.

## V

Underlying all these challenges is the most fundamental issue of all for the United States: how to cope with its own historic decline in the global economy. Forty years ago, at the end of World War II, America clearly dominated every dimension of international economic relations, and Washington was relatively unconstrained in the formulation and implementation of its commercial and financial policies. But all that has changed as a result of a spectacular recovery of Western Europe and Japan and the emergence of other influential actors in an increasingly multipolar world economy. No longer can the United States exercise unquestioned authority on economic policy issues. Today other countries too occupy positions of power in the system.

Can America learn to cope with its relative decline without destabilizing the overall system? The stakes are high. Under Ronald Reagan, the U.S. Government often seemed tempted to revert to its old accustomed unilateralism --putting narrow national concerns ahead of broader systematic responsibilities-- only to find American interests threatened by the unforeseen consequences of its own actions. This was as evident in the area of monetary relations, where "voodoo economics" at home led to unprecedented payments imbalances and exchange-rate fluctuations abroad, as it was in the trade area, where trade wars with the European Community or Japan were on



several occasions only very narrowly averted. Will the Bush Administration continue to risk economic Gotterdamerung by perpetuating the illusion of U.S. dominance? Or will Washington now recognize the need for genuine compromise and cooperation with others in order to preserve global prosperity and growth? The well-being of us all rests in the balance.