
FROM THE FOUNDER



What Will Drive Global Growth?

*In a world of
exporters, what if
the U.S. current
account vanishes?*

**"INTERNATIONAL
ECONOMY**
**THE MAGAZINE OF
INTERNATIONAL ECONOMIC POLICY**
888 16th Street, N.W.
Suite 740
Washington, D.C. 20006
Phone: 202-861-0791
Fax: 202-861-0790
www.international-economy.com

Economically speaking, most nations these days seem to have one thing in common: They all want to be the world's greatest exporter backed by a relatively weak currency. This sentiment is telling about problems ahead for the world economy.

Recently, British Prime Minister Gordon Brown proclaimed that the United Kingdom needs an "export-led" recovery. Asia's non-Chinese economic policymakers want an export-led recovery, too. They have a special problem because the Chinese link their currency to the U.S. dollar. As a result, the Asian governments have been forced to buy dollars and the renminbi aggressively, risking a financial bubble, just to keep their currencies from strengthening and hurting their own export markets.

With Germany heavily dependent on exports (46 percent of their GDP at last count), the European Central Bank is now watching foreign exchange markets like a hawk. ECB President Jean-Claude Trichet now stresses almost weekly that the euro was *not*, as popularly thought, designed to eventually become a reserve currency.

Even the U.S. Treasury's cheesy mantra about believing in the value of a "strong dollar" fails to obscure the obvious: The Administration is not about to fight an orderly decline in the greenback.

The truth is that it's not always clear why currencies behave as they do. Sometimes experts finger the widening differential between nations' interest rates. Other times, growth differentials dominate the discussion of currency movements. Sometimes they point to both interest rates and growth as the reason for currency movements. The latest explanation for the dollar's weakness points to America's rising debt. Yet America's debt-

to-GDP ratio, approaching 87 percent, is roughly the same as the combined average of the debt-to-GDP ratios of Germany, Italy, and France. These countries are the anchor for the eurozone, which is seeing its currency soar.

And anyway, if concern over debt is driving currencies, perhaps the trick is for the United States to emulate a really strong currency country, like Japan. Its debt-to-GDP ratio is approaching 217 percent. If that's the goal, Nancy Pelosi and the U.S. Congress had better get to work. Their budget austerity is killing the greenback.

The nations of the world are suddenly infatuated with exports and currencies for precisely one reason: the possibility that America's current account deficit could actually disappear as a result of a huge and permanent change in U.S. consumption patterns. Such an outcome, while hardly certain, is also not as farfetched as it sounds. The U.S. current account has already shrunk significantly, from \$215 billion in the third quarter of 2006 to \$98 billion by the second quarter of this year.

Vanishing trade surpluses would present the world with a serious problem. The non-Chinese Asian economies would particularly find it difficult, but the entire world would be forced to face this question: If there's no longer the opportunity for massive exports to a gluttonous, over-leveraged U.S. consumer, what will drive global growth in coming years? The truth is that nobody knows. In a world where most industrial economies and many emerging market nations face rapidly aging demographics, the future economic equation comes down to this: everyone wants to be a seller, not a buyer.

Perhaps government investment becomes the source of global growth. After all, we wouldn't have the Internet without an investment by the federal government. But while the standard one-liner about "new, game-changing investments in green technologies" sounds exciting, like sending a man to the moon, it is hardly a comprehensive economic game plan. Maybe the Chinese consumer proves to be the savior of the world. But with China's astonishingly fast-aging demographic and lack of a social safety net, such an outcome hardly seems certain. The notion, moreover, that Beijing's massive emergency government spending and lending exercise will never subside is probably wishful thinking. China today is simply not large enough to be the world's locomotive.

That's why everyone is keeping an eye on exports. The question now is this: When does the mad round of competitive global currency devaluations begin? Then there's this ironic thought: Will the world at some point turn to Washington,



Nanjing Road, Shanghai.

Maybe the Chinese consumer proves to be the savior of the world. But with China's astonishingly fast-aging demographic and lack of a social safety net, such an outcome hardly seems certain. The notion, moreover, that Beijing's massive emergency government spending and lending exercise will never subside is probably wishful thinking. China today is simply not large enough to be the world's locomotive.

—D. Smick

insisting that it is the responsibility of the world's reserve currency economy to run large current account deficits?

Like never before, the world needs a new Bretton Woods international agreement, an economic and financial doctrine for future stability. The mercantilists are sniffing around the edges of the global system, and mercantilism can be highly contagious. Unfortunately, the first question of the new Bretton Woods participants could be as follows: With the number of sovereign debt defaults soaring, and with the industrialized governments financially underwater, why should we be surprised that go-it-alone monetary decisions, beggar-thy-neighbor currency policies, protectionism, and fights over funding sources to finance deficits could logically define the future for the global economy? To which there is only one response: Ugh!

—DAVID M. SMICK

Mr. Smick is founder, editor, and publisher of The International Economy, and the author of The World Is Curved: Hidden Dangers to the Global Economy, now in paperback.