The Danger of Reagan's "Imperial Circle"

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Without intending it, or even being aware of it, the Reagan administration has developed a few form of economic imperialism which allows it to finance a high budget deficit at the expense of the debtor nations. The policy is likely to appeal to the voters but it is bound to have disastrous consequences.

The budget deficit is not deliberate. It is the unintended consequence of irreconcilable policy objectives: a desire to it public spending while maintaining a strong military posture and reducing taxation. When government spending could not be cut sufficiently the deficit soared. Fortunately for Reagan, the budget deficit set in motion a self-reinforcing process which is beneficial for the U.S. Unfortunately for the debtor countries, what is a benign circle for the U.S. is a vicious circle for them.

The budget deficit keeps interest rates higher than they would be otherwise. High interest rates coupled with financial deregulations suck in funds from all over the world, political considerations also play part: a strong defense posture in a world fraught with conflicts tends to attract foreign capital.

The budget deficit stimulates the economy. Without it, the recovery could not have been as fast and vigorous as it turned out to be. The recovery, combined with high interest rates and the influx of foreign capital, tends to keep the dollar strong. The recovery, combined with a high exchange rate, tends to suck in imports and create a trade deficit. The trade deficit combined with a high exchange rate tends to moderate inflation, as a consequence, the U.S. enjoys the best of all possible worlds: strong economic growth combined with low inflation and budget deficit financed by the influx of foreign goods and foreign capital. I shall call this benign circle the "Imperial Circle."

The strength of the U.S. economy helps debtor countries build up their trade surplus. For the rest, the "Imperial Circle" acts as a vice which squeezes them dry. Both interest rates and the dollar are much higher than they were when the debts were incurred. Like other self-reinforcing, self-validating connections, the Imperial Circle is liable to be broken. Countries like Brazil enjoyed a period of unprecedented prosperity while they were amassing debt, but when the music stopped the piper had to be paid. It is only a question of time before the same thing happens to the U.S. budget deficit. When capital inflows cease to exceed the new rising trade deficit, the dollar will decline and the Imperial Circle will be turned upside down. With foreign capital seeking refuge elsewhere even a shrinking budget deficit will be more difficult to finance. With the dollar weakening, interest rates and the rate of inflation may rise when it ought to be falling.

President Reagan seems to understand the workings of the Imperial Circle better than his economic advisers. That is why he has been so adamantly opposed to raising taxes. Political and economic pressures will oblige him to do so after the elections. Nineteen-eighty-five may therefore turn out to be a year of economic crisis.

The tension between the collective of commercial banks and the debtor countries is also likely to reach a climax around that time. Countries like Argentina, Brazil and Mexico will have built up significant trade surpluses; yet they will be suffering from continued high unemployment and recession.

Debtor countries may choose to stimulate their domestic economy rather than service their foreign obligations. If they continue to abide by the IMF prescription, discontent may well find expression in direct action. It will be all too easy to interpret political developments in an East- West context and to combat Communism all over Latin America, not to mention the Philippines or Tunisia or Kenya. A slowdown in the U.S. economy would then coincide with a debt crisis and/or political turmoil in Latin America and other parts of the Third World.

Is there no alternative to economic and political calamity in 1985? I believe there is, but it would require a thorough revision of U.S. economic and foreign policy.

To bring the budget into better balance it is essential to reduce military expenditures. But that is not enough. The U.S. budget deficit is the last remaining engine of inflation in the world; if it is reduced, deflationary forces will predominate and the world economy is going to crash. The heavily indebted countries will be unwilling and unable to pay their debt. That is a problem that needs to be resolved. It cannot be resolved between the banks and the debtor countries for the simple reason that the banks' commitments far exceed their own resources. Any viable arrangement will require some additional commitments from the industrialized nations both to underwrite the banks and to ensure a flow of new lending.

Military spending can be reduced only if there is a relaxation in political tensions. Anti- Communism as it is professed and practiced by the Reagan administration runs a great risk. If we interfere in the internal politics of countries within our orbit in order to prevent them from falling into the Communist orbit, we must deny them the privilege of choosing their own form of government.

Since under the present arrangements we are also denying them economic prosperity, we are obliged to rely on increasingly oppressive regimes in order to maintain our dominion. That is already happening in Central America, but if we continue on our present path, the rest of Latin America is likely to follow.

If we did a better job in assuring the freedom and prosperity of the countries at the periphery of our economic empire, we would have less need to depend on our military might. The way to do it is not by regional handouts to repressive regimes but by tackling the international debt problem.

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