The Demise of the Debt Economy

by Felix Goryunov

Felix Goryunov, a Russian economic journalist who has been observing the world economy for over 30 years, contributes his view of the potential for a change for the better in Russian-American relations—not so much because new leaders will soon take office in both countries, but because the global financial crisis demands it. "There is some hope that a new New Deal, to follow after the recession's impact changes Americans' political mind-set, will incorporate a realistic, rather than a belligerent U.S. stand in global affairs," writes Goryunov.

Even against the backdrop of a strained last meeting between Presidents Bush and Putin in Sochi on April 6, Russian Foreign Ministry official Alexander Kramarenko wrote in a similar vein, in an April 2 article for Kommersant. *As head of the ministry's Planning Department, Kramarenko said that "the change of administration in the Kremlin gives the Americans a pretext and an opportunity to review their Russia policy in a positive tone," in the direction of "a radically different approach to Russian-American relations." He added that the U.S.A. "needs to be prepared to deal with Russia as an equal, taking each other's interests into account, to the benefit of both sides."*

Our guest commentator concentrates on the role of the U.S. "military-industrial complex," whose activity has been of central concern to Soviet and Russian strategists since the same Cold War period, in which President Eisenhower warned about it as an entity within the United States. At the same time, Felix Goryunov's attention to the systemic nature of the current world economic crisis—what EIR *readers know as the handiwork of the London-centered financial oligarchy that persisted after the ostensible demise of the British Empire—and the damage it has inflicted on the U.S. economy, inclusively, points to areas of common interest between Russia and the United States.—Rachel Douglas*

Journalism is a rewarding profession for those who like to feel at home in the corridors of power. And who are happy not only to be kept informed, but also to spill the beans—when asked. This is why I have subscribed to the London *Economist* for over 30 years. No other media are better informed of what top Western politicians are doing, what they intend to do in the future, and why. So it came as no surprise when I saw the issue of Aug. 19, 1978, with President Jimmy Carter, Prime Minister Harold Wilson, and Chancellor Helmut Schmidt dancing in military uniform on the cover. It bore the title, "All the fun of rearmament," which was decoded in the lead editorial as "Rearming without tears."

The beans spilled by the *Economist* were new only in their flagrant manner of declaration of intent. Though all of NATO's big three—the United States, Britain, and Germany—are governed by left-of-center parties, the weekly wrote, they have a record of raising defense spending more than their opponents do. Since their economies are running at below capacity, reflation via rearmament could have distinct appeal for governments, because higher defense spending is a reasonably efficient, if not the most efficient, way to boost growth. But a no less important advantage of this economic policy, the *Economist* reckoned, is that a Soviet attempt to cope with the rearmament challenge will take even bigger bites out of Soviet consumers' butter. Thus, Russia could have a problem on its hands.

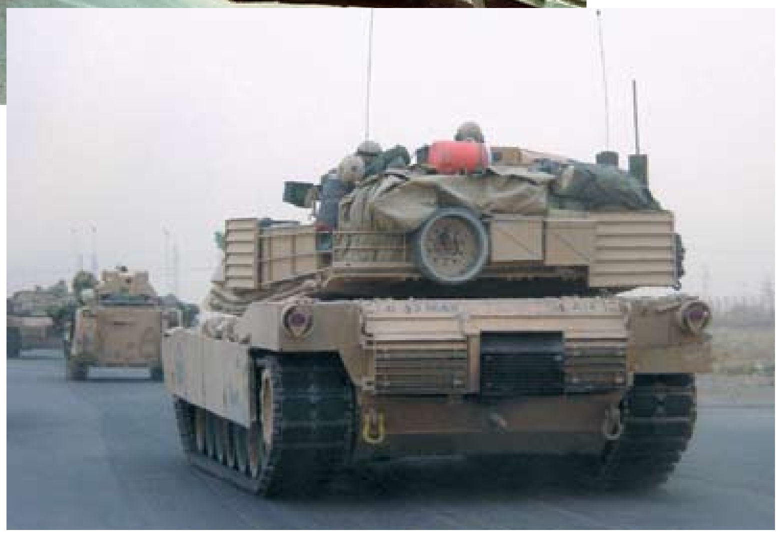
Rearmament: With and Without Tears

By that time, the Soviet Union already had the problem of declining economic growth, along with and because of the ever-mounting cost of the arms race. A new round would be a fearful menace to the sustainability of "real socialism." Nonetheless, the die-hard Stalinist Dmitry Ustinov, a Politburo member in charge of the military-industrial complex, who knew no other ways than force to settle international issues, convinced Leonid Brezhnev one year later to interfere in the Afghans' internal squabbles. The Soviet Politburo made an exceptionally expensive Christmas present to the NATO weapons industries. At the end of December 1979, the Soviet Army invaded Afghanistan. After that, the strategy of bleeding the Soviets through the arms race started to deliver at high efficiency and speed, and became a vital factor in eventual breakdown of the U.S.S.R.

The collapse of the Soviet Union, together with "The Soviet Threat," which since World War II had been the main pretense for milking the U.S. taxpayer, at first seemed to be a serious blow to the military-industrial establishment. But the loss of its best friends among Soviet generals, who were also interested parties in the arms race, was soon compensated for in the form of small wars and the enlargement of NATO to the east. There was Desert Storm in Iraq in 1991, the bombing of

Mikhail Estafiev

Above: Soviet troops withdraw from Afghanistan in 1988. Right: American forces in Iraq. "What now divides American and Russian politicians is their assessment of the lessons of history," Goryunov writes.



U.S. Army

Serbia in 1999, the NATO operation in Afghanistan since 2001, and another war in Iraq, which was launched in 2003. The gains from weapons supplies to Eastern Europe were less rewarding, but still lucrative enough to be worth the launching of orchestrated propaganda that Russia's imperial ambitions were a threat to its neighbors.

According to published figures, U.S. military spending in 2007 amounted to $548 billion, which was 19% of the total Federal budget, and equivalent to 4.4% of U.S. GDP. When compared with the Vietnam war, which was swallowing annually 9% of the GDP, the current military outlays may be considered "painless" for the U.S. economy. The problem with the American military posture, however, is that it has made the economy addicted to Washington's warmongering policies. Though the defense bill of $648.8 billion for 2008, approved by the U.S. Senate, dwarfs Russia's annual military budget of $36.8 billion, many American politicians forget the importance of being earnest, when they speak of a resurgent Russian threat.

"Since World War II, the domestic market has primarily been sustained by $2.3 trillion in military spending. These expenditures have provided an artificial and tenuous prosperity dependent on an increasing level of debt, since militarism produces neither consumer nor capital goods to generate further economic activity." This excerpt from an article subtitled "Reaganomics continues a process that Roosevelt's New Deal interrupted," was published by the *Progressive*, an American monthly, in June 1981. The magazine also confirmed the fact that, despite the blessing from top NATO leaders in 1979 for the reflation of their countries' economic capacities through rearmament, the 1981-82 recession lasted 16 months and turned out to be rather painful for the 9 million Americans who lost their jobs.

History repeats itself with fresh evidence on the severe economic impact of the Bush Administration's adventure in Iraq. In the article "War's Price Tag," published in March by the *Los Angeles Times*, Joseph Stiglitz, winner of the 2001 Nobel Prize in economics, and Linda J. Bilmes, a lecturer on public finance at Harvard University Kennedy School of Government, revealed their findings that the real cost of the Iraq War will easily reach $3 trillion in today's money. This funding, which is borrowed on international markets, will make the Federal debt still more burdensome.

Also quite relevant to the West's rearmament policies, initiated 40 years ago with the aim of weakening the Soviet Union economically, is NATO's current onslaught on its former territory and neighbors. The media hullabaloo about American ABM deployment in the Czech Republic and Poland, as well as the recent abortive attempt to drag Georgia and Ukraine into NATO, somehow misses one important point. Any former Warsaw Pact country that joins the Alliance must rearm to match its standards. That is, they have to scrap Soviet-made arms and equipment and replace them with those made by NATO-country manufacturers. This multi-billion rearmament business comes not only without tears, but with guaranteed money gains for weapons companies, as well as generous handouts to the politicians and generals in the recipient countries, who are helping to push the deals through.

Such deals would hardly be scrutinized, although the U.S. Foreign Corrupt Practices Act of 1977 contains many provisions that prohibit the bribery of foreign officials for greasing arms purchases. The Congressional committee that discussed the Act before its adoption specified that there could be "perfectly legal payments, such as for promotional purposes and sales commissions." See the difference with bribes? No? Neither do I.

Living Beyond One's Means

The United States could afford to reinforce its military muscle because it was not the only one paying for it. Since the middle of the 1970s, the U.S. capital markets were flooded with foreign cash by international investors in businesses and real estate, thus allowing weapons manufacturers to borrow cheaply. But a real bonanza for the American military-industrial complex came in 1978, when the Carter Administration initiated and enacted the Exchange Stabilization Fund. The fund started to issue series of Treasury bonds to be sold overseas, in order to prevent a fall of the dollar on international markets. Named Carter bonds, these securities soon became a major funding vehicle for covering U.S. Federal budget deficits.

Now, the degree of America's international indebtedness is staggering. Of the $9.2 trillion in total Federal government debt outstanding at the end of 2007, $5.1 billion was sold to the public in the form of Treasury bonds or Treasury bills. About $2.4 trillion of the latter sum is owned by foreigners. Foreign interests have more control over the U.S. economy than Americans, said David Walker, the U.S. Comptroller General. The huge holdings of American government debt by countries such as China and Saudi Arabia could leave a powerful financial weapon in the hands of countries that may be hostile to U.S. corporate and diplomatic interests, he reckoned.

As a matter of fact, the Treasury's indebtedness is only part of the picture. According to Gillespie Research/Federal Reserve, foreign interests own about $9 trillion of U.S. financial assets, including 13 percent of all stock, 13 percent of agencies, and 27 percent of corporate bonds. The major provider of money for home mortgages, Fannie Mae, borrows about a third of its investment funds from outside of the United States. (Aleksei Kudrin, Russia's Finance Minister, recently disclosed that some money from the country's Stabilization Fund, may be invested in a Fannie Mae or Freddie Mac facility.) So it is no wonder that the Grandfather Economic Reports, which compile and popularize data on U.S. indebtedness, admit: we have become a nation of debt-junkies, living beyond our means more than ever before.

It is not only the U.S. Treasury that is vulnerable to foreign indebtedness (the largest holders of T-bonds are Japan, with $581 billion, and China at $477 billion), but also the U.S. Federal Reserve. Hoards of dollar reserves overseas are a constant threat to the U.S. global financial position as owner of the world's major reserve currency. The list of biggest dollar holders in February 2008 was topped by China ($1.6 trillion), Japan ($1 trillion), Russia ($502 billion), and India ($306 billion). At the end of 2007, 63.7% of official currency reserves were held in greenbacks and 26.4 percent in euros. But, with the steep depreciation of the dollar after the U.S Federal Reserve started to cut interest rates last Autumn, the ratio is changing in favor of the euro and, to a smaller degree, such currencies as the British pound sterling and the Chinese yuan.

The cheaper dollar is arousing concern among such big holders as the Arab members of OPEC, who manage the world's largest sovereign wealth funds. Last Summer, Gulfnews.com reported from Dubai that the Gulf sovereign funds may change the pricing of oil from the dollar to another currency, while Qatar already cut its exposure to the dollar by 40% of its foreign reserves portfolio. Although Arab OPEC members later announced that they would stay with the greenback for a while, the danger of their withdrawal remains real.

According to IMF estimates, government-managed investment funds now have $2.5 trillion at their disposal. The investment bank Merrill Lynch forecasts that, by 2011, this total will grow to $7.9 trillion. Thus sovereign wealth funds may become an alternative wielder of leverage in world finance and reduce the exorbitant privilege of the United States, which finances large current account deficits in its own currency.

About a dozen leaders of center-left ruling parties from around the world, brought together by British Prime Minister Gordon Brown in Watford on April 5, called for the urgent reform of global financial institutions, to prevent a recurrence of the credit crisis. There was general agreement among them on the need for new rules for disclosure and transparency of financial institutions. They also pressed for global, rather than national supervision of financial markets and development of an effective early warning system to guard against financial risks to the global economy. It can be presumed that this so-far tacit recognition of the fact that global finance must not be controlled by national interests and policies, is just a beginning of a wide debate about the necessity of a new international monetary order.

The End of Empire?

Surprising as it may seem, one more challenge to U.S. financial supremacy now comes from the U.S. multinational companies.

"Multinationals: Are They Good for America?" The answers to the question posed last February by *Business Week* were largely unenthusiastic. Unlike the U.S. economy, the weekly wrote, multinational companies have plenty of cash and soaring profits from overseas operations. They are more productive and innovative than domestic companies. And, unlike American consumers, banks, and smaller companies, the multinationals are not constrained by the credit crunch. In short, the magazine reckons, they are the go-to guys right now for the ailing American economy. It is far from certain, however, that they are going to oblige.

Politicians can't help to reverse the trend, even if they wanted to, because powerful capitalist motives underlie this corporate exodus. Multinationals go where growth and profits are high. By official estimates, U.S. multinationals' share of domestic output shrank from 21.8% of GDP in 2000 to 18% in 2005, and continues to decline. In the same period, these multinationals cut more than 2 million jobs. While the sales of foreign subsidiaries of U.S.-based multinationals have skyrocketed, American exports in 2007 retained the same share of GDP as in 1997.

The overseas earnings of American companies in emerging markets are a lot higher than at home, not only because of the larger sales volume, but predominately thanks to the big gap in labor costs. Last year, for example, a factory worker in Mexico cost his employer $2-3 an hour; in China, $1.40; in India, $1.00—whereas in America and Europe, this cost is more than $20-$30. The annual rate of profit growth in the BRIC countries (Brazil, Russia, China, India) is triple or quadruple that in the developed countries.

Multinationals enjoy profit-generating advantages in the emerging markets also thanks to their technological prowess. It is not only sales of machinery and equipment that are riding the wave of investment-driven growth. No less important is the distribution of value added between a multinational company and its counterpart in an emerging market. For example, it is estimated that only 15% of the value of China's electronics and information technology exports is added by its manufacturers. The rest—i.e., sophisticated units and components—is imported by China, both for exports and for domestic consumption. It will take years before the BRIC members upgrade their R&D capability to bridge the gap.

Even this, so-far unequal division of labor has brought radical changes to the world economy. It has become truly global and has thrown off its former dependence on U.S. economic performance and financial strength. History so disposed that the United States became the capitalist world's leader in the 20th Century by replacing the British Empire. Now, America's international position is largely being eroded as a result of the arrogant and belligerent international policy of its leadership.

The alarm bells began to toll even before U.S. troops invaded Iraq. On Sept. 23, 2002, the *Nation*, a popular political weekly, published an eye-opening article, which to this day makes die-hard neoconservatives clench their fists and curse. The article, entitled "The End of Empire," foretold all that is now happening to the American supremacy in actual fact. That the imperial ambitions of the Bush Administration are founded on quicksand, and its main vulnerability has to do with money. That Bush's open-ended claims for U.S. power and its unilateral right to invade and occupy "failed states" to execute "regime change," offending international law, are prerogatives associated only with empire. And that Bush-led America is ignorant of the humiliating lesson of Great Britain, whose empire met its demise under the pressure of global changes.

Now, when it becomes clear that financial reckoning for the foolhardy policies may be around the corner, American political winds are blowing against President Bush and his men. As usual, the *Economist* is among the first to forecast a change of course. In an article called "After Bush," the weekly's Washington Bureau Chief, Adrian Wooldridge, describes how both Democratic contenders oppose the most disastrous foreign policy in American history, because the public has turned sharply against military assertiveness. America's foreign policy may change under the next President, the *Economist* writes, but confusion over Iraq, worries about overstretching, and divisions over the country's role in the world will remain.

A 'New' New Deal?

In 1961, President Dwight Eisenhower said that the United States had created a permanent armaments industry of vast proportions, whose influence was felt in every city, every state house, every office of government. Since those faraway times, the posture of the military business in the American establishment has only strengthened. To the extent that even Senator Obama, who makes a lot of his anti-Iraq-war stand in winning the electorate, can't afford to disregard the interests of Pentagon contractors. The *Progressive* magazine noted that Mr. Obama is forsaking the position of most African-Americans in favor of "butter" by supporting the expansion of U.S. ground forces by nearly 100,000 additional soldiers.

As we know, the Clinton family never hesitated to please the military when it had a chance: The bombing of Belgrade in 1999 is just an outstanding example. This is all the more so for Senator McCain, whose manifesto, related by the *Washington Post* on March 30, was hawkish by definition. He called for further increases in U.S. military spending, and for making clear that "the solidarity of NATO, from the Baltic to the Black Sea, is indivisible" in order to counter "Russia's nuclear blackmail or cyber attacks." So it looks as if all U.S. Presidential candidates are playing the Russophobia card to reassure the weapons industry establishment of their allegiance to the "bullets before butter" policies.

It is also becoming evident that, whoever occupies the White House next year, he or she will not be in a position to withdraw troops from Iraq overnight. In a time of recession, it would be unsafe to curtail spending on military procurement and add new factories to the list of redundant businesses, not to mention reductions in military personnel. During a critical time, however, a declaration of intent is no less important than a deed. President Roosevelt calmed American workers by announcing his New Deal, months before it began to bear its fruit of unemployment and welfare benefits. Thus, corrections of course among Presidential contenders are possible, if the economy gets out of hand before the November elections. The more so, that more and more Americans are feeling change-hungry. A *New York Times*/CBS poll released on April 3 found that 81% of respondents felt that "things have pretty seriously gotten off on the wrong track."

Pragmatic We Can Be

Nowadays, it is not only Americans who need assurances of the good intent of America's powers-that-be. Millions of people all over the globe expect that the U.S. recession, which is starting to spread to some parts of the globe, must be taken care of at its source. American multinationals, which in recent decades expanded their operations to new overseas markets, are also interested parties in a coherent policy of ensuring international stability instead of creating new tensions. This is a pressing demand of critical economic circumstances and of pure common sense. Global stability and economic development must not be sacrificed to the vested interests of one industry cluster of one country, no matter how politically powerful they may be.

The political rift between Washington and Moscow, which has not abated during the last four years, is a result of artificially instigated tensions. There are a lot of heated discussions about what can be done to mend our relationship. What has been missing so far in the debate is one encouraging fact. In current U.S.-Russia economic relations, things are not business as usual, as happened even in Soviet times, but with every passing year such business is a lot better than before.

A survey of American companies carried out by Ernst & Young, a consultancy, from October 2006 to February 2007 discovered that 89% of them projected continued growth in sales, and 79% intended to make investments through 2008. The profitability of 79% of the companies surveyed in 2001-05 was on or above target. The survey also recorded that 90% of the American companies operating in Russia believe that continued commercial engagement with Russia is positive for American business. According to information released by the Association of European Businesses in Russia, CEOs of EU companies in Russia think the same. They also believe that 2007, when there was a setback in EU-Russia relations, was a year of political losses against economic gain.

There is little doubt that the thousands of American residents working and living in Russia will confirm that this country has never been and is not "America's natural enemy," as is claimed by some U.S. right-wing politicians. Moreover, our countries have a record of mutually advantageous trade in the time of the Great Depression, and brotherly relations against a common enemy in World War II. And, once we are no longer ideologically divided, it is foolish to settle the scores over international or domestic issues that can well be resolved without diplomatic or propaganda wrangles, as often happened in the past. The history of our two nations has known confrontations and detentes, partnership and quarrels.

What now divides American and Russian politicians is their assessment of the lessons of history. The Soviet defeat in Afghanistan became such a lesson for the Russian elite. The American defeat in Vietnam did not change belligerent U.S. strategies. It is also worth remembering the whim of history that taught Germany and Japan that a defeat in war might be a blessing. Defying such experience, the United States went on building up a superpower's military muscle and dragged its economy into the debt trap. To the contrary, Russia's refusal to continue the Cold War, largely motivated by economic exhaustion, may now prove to be an economic achievement. (Well, thanks to abundance of natural resources.)

In any event, despite the cooling of relations with the West and American provocative policies in Eastern Europe, Georgia, and Ukraine that raise Russians' concern, the Kremlin is set to continue a pragmatic and conciliatory foreign policy. Now, when America is in economic distress comparable to that of 70 years ago, it may be the right time for a New Deal not only in U.S. domestic policies, but in America's relations with the outside world, Russia included.