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Article

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Intereconomics

Suggested Citation: Copelovitch, Mark (2024) : How the US Dollar's Dominance Negates Fears About Debt and Deficits, Intereconomics, ISSN 1613-964X, Sciendo, Warsaw, Vol. 59, Iss. 5, pp. 307-308, <https://doi.org/10.2478/ie-2024-0059>

This Version is available at:

<https://hdl.handle.net/10419/308226>

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How the US Dollar's Dominance Negates Fears About Debt and Deficits

The 2024 presidential election presents Americans with perhaps the starkest choice in our entire political history. On the one hand, Kamala Harris and the Democratic Party are running on a platform reflecting their position as a normal, pro-democracy, center-left political party. Although the Vice President has staked out some modest policy differences with Joe Biden (e.g. her trade policy seems likely to be a bit less protectionist than that of her current boss), her domestic and foreign policy positions clearly signal that a Harris presidency would effectively be a second Biden (or a fourth Obama) administration in policy, tone and governance.

On the other hand, Donald Trump and the Republican Party have now crossed one Rubicon after another, embracing levels of authoritarianism, racism, anti-Semitism and xenophobia once thought to be beyond the pale of modern political discourse. A second Trump administration would push the US further down the road of democratic backsliding, endangering the civil rights of minorities, women and immigrants, and ushering in potentially massive reversals on a range of foreign policy issues, including NATO and Ukraine, Israel-Gaza and US-China relations. Trump's return to the White House would set America on a starkly different path, on both domestic and foreign policy, than it followed under Joe Biden or would under Kamala Harris.

Yet amid these stark differences, the 2024 election also highlights a striking commonality between Democrats and Republicans. On economic policy, despite their many differences, neither party really cares about debt and deficits, even though both regularly claim they are one of America's most urgent problems.

The idea that the federal debt is a looming national crisis has been a near-permanent, bipartisan feature of US politics for decades. It was a central topic of discussion in the 1980s, when debt-to-GDP was 40%; in the 1990s, when it was 60%; and in the 2010s, when it was 100%. Panic about US national debt has returned, now that the debt-to-GDP ratio is 120% and the Congressional Budget Office's latest forecast¹ has it on track to reach 166% by 2054.

To be sure, US debt levels are historically high, surpassing even those during WWII. Yet we continue to borrow in effectively unlimited quantities at historically low interest rates. None of the deficit hawks' dire predictions – hyperinflation, default, capital flight or currency debasement – have come true. Of course, high debt levels may involve real costs (e.g. larger debt payments) and politically sensitive future tradeoffs (e.g. choices between raising taxes and reducing spending). But the idea that the US faces an imminent “sudden stop” fiscal crisis, like developing countries in the 1980s or 1990s, is a category mistake.

So why does the debt remain a central issue in American politics? One answer is that most politicians and voters view government spending through the lens of the “household analogy.” Few beliefs are more widespread in American politics than the belief that the government, like a household, should cut back spending, balance the budget and reduce debt. This was perhaps illustrated most clearly by President Barack Obama during his 2010 State of the Un-

1 The Long-Term Budget Outlook: 2024 to 2054. Congressional Budget Office. <https://www.cbo.gov/publication/59711>

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Open Access funding provided by ZBW – Leibniz Information Centre for Economics.

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ion address, at the height of the Great Recession, when he assured Americans that “families across the country are tightening their belts and making tough decisions. The federal government should do the same.”

The household analogy “feels” right and responsible. But sovereign debt is not a morality play, and we have known since the time of Keynes and the Great Depression that this is exactly the wrong way to think about fiscal policy, especially during crises. Households do not live forever. They cannot tax their neighbors, or issue bonds due decades from now. They do not issue their own currencies. And they do not (as the US does, given that the Federal Reserve and private American investors hold two-thirds of US Treasuries) owe most of their debt to themselves.

A second answer is that pretending to be a fiscal hawk is good politics. Americans regularly tell pollsters they are deeply concerned about debt and deficits, even as they also overwhelmingly favor increased spending on nearly everything in the federal budget. And voters have repeatedly rewarded the politicians responsible for the massive tax cuts and large spending increases that are the main drivers of the debt. Consequently, it is not surprising that both parties love to claim concerns about the debt and offer promises of reducing it without imposing any real costs – either tax increases or budget cuts – on the public. Indeed, we are seeing this once again in the 2024 campaign. Kamala Harris has reiterated Joe Biden’s promise not to raise taxes on those earning less than \$400,000, while Donald Trump promises further massive tax cuts, in line with Republican policies popular since the Reagan era. Neither of these positions is consistent with sincere philosophical concerns about debt and deficits, nor will they reduce America’s debt levels over the next four or eight years.

However, a deeper and more convincing answer is that neither Democrats nor Republicans act as if they were sincerely concerned about debt because it simply is not a major concern for the country issuing the world’s dominant international currency. The dollar remains king not only because of the size of the US economy, but because of America’s unparalleled deep, liquid private financial markets, international investors’ almost insatiable demand for “safe assets” in an era of unprecedentedly large global financial flows, the US government’s willingness to act as the lender of last resort in global crises, and the fact that neither the euro nor the renminbi are remotely likely to challenge the dollar anytime soon, if ever, for global dominance.

The truth is that dollar hegemony enables the US to finance itself with fewer constraints than any other country in the world. There is surely some level of debt that would be such a hard constraint, but we are nowhere near it now, and the idea that we are is an entirely political argument, not serious macroeconomics. Indeed, the very idea that US debt is “unsustainable” or at crisis levels is a category error. Japan has a debt-to-GDP ratio of 250% — more than twice that of the US — and borrows at lower interest rates. If the country issuing the world’s third international currency can sustain these numbers for decades, why do we fret over America’s ability to sustain a level less than half of that? This, of course, is not to say that we should abandon responsible fiscal policy, or that the future may eventually be different. It is merely to point out that the actual fiscal constraint for the US is not even visible on the horizon.

Ultimately, politicians respond to incentives, and both Democrats and Republicans are doing so once again in the 2024 election, using debt and deficits as political cudgels and girding themselves in the robes of fiscal responsibility by making vague but unserious promises to do something about them. The dollar’s unchallenged and overwhelming dominance in the global economy gives us this luxury. America’s real “exorbitant privilege,” to borrow the famous phrase of former French President Valéry Giscard d’Estaing, is the ability to make arguing about debt and deficits our national pastime without ever having to really face their consequences. Given the lack of any serious challenger to the dollar on the horizon, we are almost certain to keep doing this for decades to come, regardless of who wins the White House in November.