3. US Power Seen from an Economic Perspective

Although economics is fundamentally interdependent, with no winners or losers in principle, trade deficits exist as a source of problems. Why do trade frictions and trade imbalances pose problems? In calculating GDP, exports are added and imports are subtracted. When a country has a trade deficit, its economy scales back because its imports are subtracted from its domestic product without any exports being added. On the other hand, in an export economy, exports are added without any imports being subtracted, thus expanding the economy. All together, income is shifted from an import economy to an export economy. This type of trade imbalance is a problem because countries cannot adjust it amongst themselves.

To address this imbalance, a mechanism has been in place for some time; currency exchange rates move to adjust for occurrences of trade imbalance. However, because of drastic economic changes in the past two decades, this adjustment mechanism no longer functions sufficiently. Added to that is the liberalization of capital in each economy since the 1980s, which has intensified the investment in higher-rate, US dollar bonds, thus resulting in a stronger dollar, indifferent to trade imbalances. These phenomena have further ruled out weaker US companies, making it as if deficit economies had lost and surplus ones had won, thus creating a political issue.

Among businesses, the greater the surplus is, the bigger the chance to win. But among states, it is often on the contrary; the greater the deficit, the bigger the market the state in the red provides. A buyer has greater bargaining power than a seller. In fact, the US sees its huge deficit as a source of power in international politics. The US imports the greatest amount in the world, which thus serves as a huge global market. Many economies in Asia, including Japan and China, rely on the US market for their existence. That means that the greater the surplus against the US an economy holds, the stronger the dependency it has on the US.

It is China that has the potential to challenge the huge influence the US holds over the whole world and break down the order the US has created. China's GDP, in nominal terms, was still half of Japan's and one-fifth of the US's in 2005. However, in terms of purchasing power parity, China had already exceeded Japan and was nearing the US. In terms of global market share, China will likely exceed the US in a few more years. While China's total imports are about 45% of those of the US, it is just a matter of time for China to come to the US's level, based on the rapid growth China will likely achieve in the future. When the Chinese market becomes the biggest in the world, it will drastically change the power balance between China and the US. Moreover, by that time, Japanese businesses may likely be generating more sales in China than in Japan or the US, which would explosively enhance China's influence over Japan. If China becomes Japan's largest buyer in the future, Japan and other Asian countries will likely find it difficult to ignore Beijing's intentions to follow the US. Afterward, if India also grows to be a huge market, the political/economic centers will further move away from the US.

The US has long maintained its political power by offering markets and producing trade deficits. But this has expatriated the US dollar. If this flow lasts for some time, huge dollar assets will accumulate in the recipient countries. In recent publicized data, Japan holds USD 582.2 billion in US Treasuries, while China holds USD 396.7 billion. Foreign holders account for 45%

of the holders of totally issued US Treasuries. Should these dollar bond holders move to free the dollar, US financial markets would fall into a state of chaos. In particular, a sell-off of bonds would raise the interest rate, causing huge impacts on the US economy.

While there cannot be any solid prediction about the possibility of a dollar sell-off by foreign players, a source of concern is recent movements in the Middle East. The dollar has fallen sharply, renewing its low against the euro and being near a state of collapse. Investors in Europe and the Middle East are stepping up their flight from the dollar, seeing the recent subprime problems and other failures exposed in the US economy. In the Middle East, countries such as Kuwait, Abu Dhabi, and Qatar are moving toward stopping their dollar-peg systems, while Saudi Arabia, too, is seen to likely do so. If Saudi Arabia stopped its dollar peg, it would lose its reason to sell oil in dollars, increasing the possibility that oil will be sold in euros. If, furthermore, oil producing countries as a whole stopped selling oil in dollars, it could trigger a crash of the dollar.

The United States is very vulnerable to energy prices in another respect, as well. The energy efficiency of the United States is significantly lower than that of Japan and Europe. It is even lower than China on the basis of purchasing power parity. Energy prices are rising due to the emergence of the Chinese and Indian economies. This will likely wreak the biggest havoc on the US, a poor energy efficiency economy.

Finally, what are left in the US are its sovereign lands and seas, and these will play crucial roles. The US investment in research and development, including the share of military expenditures in the investment, is far greater than any other country's. Furthermore, US universities are of far greater quality than those in other countries. Being traditionally tolerant of immigrants, the US draws brains from all over the world, including China and India, who in turn help sustain America's leading-edge technologies. Given that future advanced economies must largely depend on intellect for innovations, the US apparently secures a highly advantageous position.

Now, the US has reached a limit in its traditional tactics of gushing out trade deficits to sustain the world economy in return for political power. The US needs to lower the dollar and expand its exports to balance its external accounts. But this will help China increase its economy to the level suggested by its purchasing power parity, thus helping to increase its influence as well. In the predictions of the IMF and others, China's economy will account for 22.6% of global GDP in 2015 in terms of purchasing power parity. The overwhelming influence now held by the US will likely be overshadowed by the emergence of China, an increase in the US trade deficit and thus a weaker dollar.