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Dollar Crisis: Economic Pearl Harbor?

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If China abandons the dollar for the euro, Americans will surely suffer. So far, that prospect has sparked mainly U. S. indignation

by Gabor Steingart

What do Brazilian supermodel Gisele Bündchen and the People's Republic of China have in common? The answer, as of last week, is that both distrust the dollar.

Patricia Bündchen, the twin sister and manager of the world's top model, announced that Gisele now prefers to be paid in euros rather than dollars. Almost simultaneously, the Chinese central bank predicted that the dollar is

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likely to lose its status as the world's leading currency.

One could easily overlook a supermodel's currency preferences, but China is a different story. It's the beast breathing down America's neck.

The most important country in the world for the United States isn't Great Britain, Germany, Saudi Arabia, Russia or Iraq. China holds that dubious distinction, because it is also the country the US can least do without. Without its willingness to buy an almost unlimited supply of US treasury bonds, there would be no American spending miracle. Without a spending miracle there would be no economic growth. In other words, without China the US superpower would lose a significant share of its economic clout.

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So far Beijing has behaved like the benevolent shopkeeper who willingly extends credit to his customers. The Americans receive shipments of Chinese-made television sets, toys and underwear, but the Chinese do not import a comparable volume of US goods. The gap between buying and selling amounts to about $5 billion every week.

The Chinese are satisfied with buying US treasury bonds, partly to keep their most important customer afloat. The central bank in Beijing already holds currency reserves of $1.4 trillion.

The Chinese have looked on with great patience as their best customer has gradually lost its ability to supply goods.

But the men in power in Beijing cannot be indifferent to the dollar's decline. It devalues their central bank's dollar reserves, the monetary embodiment of some of the fruits of China's export machine.

For the United States, a Chinese decision to abandon the dollar would be tantamount to Pearl Harbor without the war. It would represent a challenge to the world's biggest economy by the world's fastest growing economy. Millions of people would see their standard of living suffer as a result, and American self-confidence, already shaky, would crumble even further. The United States would suffer a serious blow on its very own turf, the economy.

Americans can hardly blame Beijing for their troubles. The Chinese aren't exactly kamikaze politicians, concocting some secret plan to attack the dollar. On the contrary, the preparations are taking place in full view. Translated into Texan, what the Chinese politely told the Americans last week simply means: Unless something happens, all hell will break loose.

For years the US economy has suffered one dramatic setback after another. A historic trend reversal began with the rise of the Asian economies -- first Japan, then China and now India. The United States, a once-proud exporting nation, became the world's biggest importer. In only 15 years, from 1992 to 2007, the US balance of trade deficit has surged from $84 billion to $700 billion.

Within a single generation, the world's biggest lender has become its biggest borrower, a circumstance the United States has made no serious attempts to change. And what has been Washington's standard take on the shift? The dollar is our currency, but it's your problem.

Thus, the tone of the US government's callous and thick-skinned reaction to China's announcement last week came as no surprise. There was a reason the dollar became the world's reserve currency, US Treasury Secretary Hank Paulson said in a slightly offended tone.

But the truth is that the United States would be better off if Paulson and the administration of President George W. Bush would take decisive action instead of sulking. The US's ability to deliver goods should be increased and its industrial base should be reinvigorated. Government and consumer spending, which in reality is doing nothing but eating away at the country's future, should be curbed. Although growth would decline as a result, it would be a more sustainable form of growth.

Last week's remark by a Chinese central bank official should be interpreted as a warning, not a threat. Indeed, China has no choice but to respond, given the dollar's ongoing weakness.

For these reasons, an attack on the US economy is probably the most easily predictable event of the coming years. And if it happens, the attacker will even be able to justify its actions as self-defense.

What is the difference between the US government in 1941 and the