American National Security Interest-Undermined by Foreign Debt?

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Introduction

Throughout the Great Recession, the United States' looming fiscal deficit has increasingly been financed by foreign investors; by 2009 more than half of the federal deficit was financed by foreign capital, and the trend has grown rapidly.[1] Although accepting foreign liabilities is arguably necessary for recovering the U.S' economy from the deepest recession since the Great Depression, it has come with the potential cost of undermining American national security interests. A. S. Posen notes that "every successive year's accumulation of foreign debt [...] increases the national security risks for the United States.[2] This is supported by C. F. Bergsten, who states that "To avoid catastrophic risks stemming from soaring foreign debt, the U.S. needs a plan for long-run fiscal sustainability.[3] Is the risk of foreign debt irrelevant to national security, or is it something that U.S. policy makers have disregarded throughout the Great Recession? To answer this question, this paper will study whether foreign debt has undermined the American national security interest post-Great Recession.

In some instances, foreign debt has already had an impact on national security. One should consider as an example the United States' naval incident with China in 2009, where "the U.S. might have decided to press its case. But it would then have to face the reality that its defense is crucially supported by the very country it wanted to confront.[4] In the context of "Great Power Politics" between China and the US,[5]", the potential risks to the United States national security should be considered, while at the same time acknowledging that about 24 percent of U.S. Treasury securities belong to China,[6] the potential risks to national

1 W. M. Morrison, M. Labonte. China's Holdings of U.S. Securities: Implications for the U.S. Economy. *Congressional Research Service* 7-5700. July 2009. Also, see Graph 2: Structure of Federal Debt.

2 C. F. Bergsten. The Long-Term International Economic Position of the United States. *Peterson Institute for International Economics.* Special Report 20. May 2009, p. 65

3 C. F. Bergsten, "The Dollar and the budget deficit," in *The Great Trade Collapse: Causes. Consequences and Prospect.* ed. Richard Baldwin. (Geneva: VoxEU.org Publication, 2010), p. 17

4 D. W. Drezner. Bad Debts Assessing China's Financial Influence in Great Power Politics. *International Security.* 34(2): 7-45. Fall 2009. p. 7

5 D.W. Drezner. (Fall 2009).

6 W. M. Morrison, M. Labonte. (July 2009).

security should certainly be considered.

Aside from geopolitical struggles, the global importance of the U.S. dollar becomes challenged as budget deficits erode international trust in American fiscal responsibility. This could, in turn, undermine one of the capstones of American national security—the role of the US dollar as a global currency.[7] In the context of ongoing currency wars, as discussed further under the main body, security risks from a weakening dollar are certainly realistic. Hence, in considering both geopolitics—especially in respect to China—and currency-related national security risks, foreign debt issues require much more attention than has been the case thus far.

Herein, American policy makers are assumed to operate in the nation's best interest. Therefore, while the current policy favors an increase in federal deficits, it is expected that concern regarding foreign debt is misplaced. This would mean that foreign debt does not undermine American national security interest. On the other hand, if arguments such as those put forth by Posen and Bergsten are found to be true, the current debt policy would be flawed. Adjustments would have to be made in order to foster American national security. It is also important to note that this paper does not aim to analyze the sustainability of high deficits. Although the case of sustainability will be an implicit consideration, this paper will study foreign debt's impact on U.S. national security post-Great Recession.

Research Design

In order to allow for objective analysis, the first section—Linkages between U.S. National Security and Foreign Debt—will bring the focus closer to the primary concern of this paper; whether foreign debt has undermined the American national security interest post-Great Recession. There are two issues here: the current structure of foreign debt within the set of federal liabilities, and the primary security risks stemming from foreign debt. Two particular issues warrant significant analysis: authoritarian powers, especially China (which holds large portions of U.S. securities), and the role of the dollar as a global currency potentially being threatened. By considering these two issues, a possible answer is expected to be found regarding whether foreign debt has undermined the American national security interest post-Great Recession.

After setting the focus, the next section—Recent History of US Federal Debt Policy and Politics—aims to analyze what determines the political acceptance of federal debt. One of the primary objectives is to understand why current American policy has favored federal deficits in response to the Great Recession. Another objective is to examine why the foreign dimension of federal debt has been left without sufficient attention. Overall, since policy decisions as well as politics *per se* originate largely in prior experiences and practices, the second section aims to facilitate a general understanding for how federal debt functions *vis-a-vis* the recent history of federal policy and politics.

The third subtopic—The Future of US Foreign Policy—will briefly discuss the

7 C.F. Bergsten. (2010). p. 17-20.

implications of any relevant findings. If national security is found to be undermined by authoritarian powers, currency-related risks, or both, there are potential changes necessary for U.S. foreign policy. However, if the latter is not true, or if not enough evidence is found to conclude that foreign debt has undermined national security, examination will be given to these respective implications. The first section will reason whether international policy changes are necessary to foster the American national security interest, whereas the second section will function as a base for understanding how respective policy issues could realistically be changed (given the recent history of federal debt policy and politics). Again, the necessity of a policy change would be determined by whether foreign debt is found to undermine American national security interests post-Great Recession.

Before moving to the main discussion, a concrete definition of national security is necessary regarding what exactly stands for national security. A concise definition is rather difficult to provide, considering that a comprehensive debate on what national security interest exactly stands for goes beyond the scope of this paper.[8] However, H. Lasswell 's explanation would perhaps serve as the best guideline for clarifying some of the ambiguity: "Our greatest security lies in the best balance of all instruments of foreign policy, and hence in the coordinated handling of arms, diplomacy, information, and economics; and in the proper correlation of all measures of foreign and domestic policy."[9] Since this particular paper will consider issues related to most of the aspects identified by Lasswell, perhaps some answers for the central research question will be retrieved—that is, whether foreign debt has undermined the American national security interest post-Great Recession?

Linkages Between US National Security Interest and Foreign Debt

"To avoid catastrophic risks stemming from soaring foreign debt, the US needs a plan for long-run fiscal sustainability."[10]

There appears to be a relative consensus among scholars that the share of foreign debt is projected to approximately double within the next decade.[11] Moreover, since a great majority of the foreign debt is expected to be funded by foreign officials, several potentially hostile governments may therefore have a direct say in terms of how credit is supplied.[12] Hence, in [12] In order to further analyze the connotations, this section will first look at the changes in the structure and amount of foreign debt throughout the Great Recession and, secondly, discuss the potential implications on national security which, as Bergsten was quoted as saying above, is arguably altered due to "catastrophic risks."

Until the 2000s, the share of foreign debt has been relatively minute. Starting from the beginning of the 21st century, however, foreign liabilities have expanded—especially

8 For an example of such a debate, see for instance: N., Onuf, Review: The New Culture of Security Studies. *Mershon International Studies Review.* 42 (1), p. 132-134, May 1998.

9 H.D. Lasswell, *National Security and Individual Freedom*, New York: McGraw-Hill, 1950, p. 75.

10 C.F. Bergsten. (2010). P. 17.

11 See, for example, J. Kitchen, M. Chinn, "Financing U.S. Debt: Is There Enough Money in the World-and At What Cost?" *La Follette School Working Paper.* No. 2010-015 (2010).

12 Ibid, p. 7.

during the Great Recession. If guided by A. S. Posen, who argues that "every successive year's accumulation of foreign debt [...] increases the national security risks for the United States," such a tendency seems discomforting at the very least.[13]This is mainly, as Bergsten argues, due to the dollar's global role, which "depends critically on the belief that assets held in dollars will not be subject to sustained devaluation."[14] While federal debt becomes largely financed by international capital, this belief is contradicted mainly due to the fact that in order to reduce the burden of debt, the government can use inflation-tactics and, as seen very recently, currency wars.

Another aspect that raises concerns regarding the expansion of foreign liabilities is the profile of foreign capital providers. For example, one of the major groups of "worrisome" lenders is the authoritarian regimes, which are often hidden behind sovereign wealth funds. Sovereign wealth funds are investment corporations that operate with public money. D. W. Drezner has suggested that these institutions "sit at the intersection of high finance and high politics" due to their explosive growth, which has risen "regulatory and geopolitical concerns…[15]…". For the US explicitly, the evolution of such investment vehicles raises questions due to the authoritarian regimes that may use the sovereign wealth funds "as one component of possible rival to liberal free market democracy…[16]…".

According to Gat[17], modern China and Russia "represent a return of economically successful authoritarian capitalist powers, which have been absent since the defeat of Germany and Japan in 1945, but they are much larger than the latter two countries ever were…"[18]. If Gat's observations are true, this would indicate that the new competitors to the U.S.-led liberal democratic world are rapidly on the rise. Due to reasons such as China being "the largest player in the international system in terms of population and [...] spectacular economic growth", the challenges to American dominance could potentially become greater than they were during the Cold War or World War II. Moreover, since "the United States, and its alliance with Europe, stands as the single most important hope for the future of liberal democracy [19]", it would be shortsighted of American leaders to disregard the potential threats stemming from these authoritarian nations—wherein financial dependence would classify as one such risk.

Along similar lines, M. Glosny from MIT has elaborated on the rise of BRICs (Brazil, Russia, India, China), and asked if they will "unite to challenge the United States collectively.[20]". Moreover, while studying China's particular impact on BRIC nations'

13 C. F. Bergsten (May 2009), p. 65

14 Ibid, p. 65.

15 D. W. Drezner, Sovereign Wealth Funds and the (In)security of Global Finance. Journal of International Affairs. 62 (1): 115-130. Fall/Winter 2008, 115.

16 Ibid, p. 119

17 A. Gat, The Return of Authoritarian Great Powers. *Foreign Affairs.* July/August 2007, p. 1.

18 Ibid, p. 4.

19 Ibid, p. 4

20 M. A. Glosny. China and the BRICs: A Real (but Limited) Partnership in a Unipolar World. *Policy.* 42:100-129. 2009.

policies, Glosny has asked whether China is motivated to advocate for a new international world order, such that American dominance would be overcome by a Chinese-led emerging world. On the one hand, he points out that "BRICs have recently undermined the dollar as the reserve currency and pressured the western powers to make the international order more inclusive and representative." Such actions would imply that the BRICs, largely consisting of authoritarian powers, could indeed force the decline of U.S. dominance. On the other hand, however, Glosny does not see a "grand plan to overthrow the order that the BRICs will implement as they grow stronger."[21]

From this perspective, perhaps the rise of authoritarian powers does not pose a direct national security threat to the United States. Although their growing geopolitical influence is rather imminent[22], no clear evidence exists that they would use the power to undermine American national security. Furthermore, even if the U.S. power decline is a reality next to the rise of the emerging world, this does not necessarily imply that the American national security interest would be threatened. However, another question is whether the U.S.' own perception of national security interest includes the status of a super power. If this is true, the motives of the emerging world would become secondary. Instead, the a priori concern in this case would be the fact that due to the rise of authoritarian states and a subsequent decline of the United States, Americans would no longer be able to grant the super power-posed prerequisites for ensuring national security interest.

From such a lens, the decline of American economic power, in concurrence with financial indebtedness to other world powers—particularly China—suggests that American economic interests post-Great Recession have been undermined. This approach is supported by W. Lee, who argues that "economic power is far more critical [than military power *per se*] in maintaining our global power and influence."[23] More precisely, according to Lee, the inability to properly recognize economic power as the foremost determinant for national security interest puts the US in "danger of becoming a regional power in the next [21st] century," which in turn would mean that America "will lack the economic strength to fulfill [...] global military commitments and exercise diplomatic influence…[24]."

In considering that the US is $12.25 trillion in debt to China [25] who, which is also the most probable competitor for American status as a superpower, the connection between foreign debt and national security becomes explicit. Given rising American criticism

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21 Ibid, p. 19.

22 See, for example: A. Virmani. A tripolar century: USA. China and India. *Indian Council for Research on Economic Relations.* March 2005. Retrieved From: http://www.icrier.org/pdflwp160.pdf(accessed on 12/03/2010).

23 W. T. Lee, National Power and a National Economic Strategy. *Strategy Research Project. US Army War College.* 1996. Retrieved from: http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA308661&Location=U2&doc=GetTRDoc.pdf. (accessed on 12/03/2010.

24 Ibid, p.1.

25 F.V. Washington, To Lose China Is to Lose Superpower Status. *Strategy Research Questions. U.S. Army War College.* 2010. Retrieved from: http://dtic.mil/egi-bin/GetTRDoc?AD=ADA530517&Location=U2&doc=GetTRDoc.pdf.

towards China for engaging in currency protectionism—and hence significantly harming the United States' economic recovery from the Great Recession— the issue of indebtedness increasingly strains American policy options.[26] In fact, the American Treasury Secretary has openly accused China of manipulating its currency, whereas at the same time threatening that "protectionist policies" might have to be implemented as counter measures[27] in the US. Such rhetoric from the United States has lost leverage as indebtedness to China has continually increased.

From this perspective, the inability to effectively respond to China's harmful currency manipulations could indicate that the national security interest is directly in danger. This is supported by F. V. Washington, who argues that due to both the American budgetary and trade imbalances, "the U.S. must maintain good relations with China to retain its superpower status," which in turn is crucial for successfully fighting the War on Terror and honoring "its commitments to the allied nations around the world for various reasons to include domestic, humanitarian, and military operations other than war."[28] Herein, if Washington is correct, this would mean that the U.S.' federal debt to China has created a situation where the authoritarian power has an unacceptable influence over the US' status as a superpower. At the same time, since both American military power and U.S. ability to meet global obligations (e.g. enforcing democratization) depend on the US' status as a superpower, China's authoritarian practices could indeed seek to weaken America in that regard.

While considering the fact that China is not the only power holding the looming foreign liabilities, it might just become irrelevant whether BRICs or other authoritarian nations have a clear cut plan for contesting U.S. global power. From this perspective, what becomes relevant instead is the fact that the authoritarian countries—foremost among them China—gradually buy their influence over U.S. national security as federally held foreign debt increases. Subsequently, regardless of whether they choose to exercise their power, as long as they have the option to contradict the American national security interest, it should be unacceptable for the United States' political elite.

In this respect, the aforementioned naval incident with China is just a minor example of how the US could become threatened. Herein, once the thought of authoritarian nations destabilizing the American position for placing demands on the U.S.' counterparts is considered, the true security risks are revealed. As already briefly discussed, the American inability to decisively tackle China's currency manipulations is an example of much larger implications. Because of the financial dependence on China, it would be extremely costly for the American policy makers to counteract with, for example, protectionist measures. This is especially so because the U.S. would risk losing the source

26 About accusing China in currency protectionism, see for example: M. P. Dooly D. Forets-Landau, and P. M. Garber, Bretton Woods II Still Defines the International Monetary System. *NBER Working Paper Series.* Working Paper 14731. 2009.

27 Ibid, p.3.

28 F.V. Washington, (2010).

of vast Chinese foreign reserves for refinancing the extremely high federal debt. If this were to happen, given that about 24 percent of the foreign liabilities are held by China, the US would have to replace the Chinese share either by taking money from the domestic economy (which would have a devastating impact on the already fragile economic recovery, since it would mean taking funds away from the private market), or finding new foreign investors. Neither of the two would even remotely support a U.S. recovery from the Great Recession.

Now, the question remains-how exactly do foreign government lenders gain influence over U.S. national security interests? One of the primary answers lies within Sovereign Wealth Funds (SWFs), which, in short, are investment firms run on public finances (mostly standing on excess reserves accumulated from export revenues). While Drezner was already quoted as arguing that SWFs present “geopolitical concerns”, B. J. Cohen goes even further by pointing out that “SWFs could be used instrumentally to seek control of strategically important industries, to extract technology or other proprietary knowledge, or to achieve a degree of direct or indirect influence over host governments.”[29]. Moreover, according to Cohen, the issue of sovereign wealth funds is a very recent problem. Initially, when small nations such as Kuwait or Kiribati formed investment vehicles to earn revenues from foreign financial markets, the possible national security implications were minute. However, after China and Russia created SWFs in 2007—each worth hundreds of billions of dollars—it is no surprise “that political discourse might now begin to take national security concerns more seriously.”[30]

For example, while understanding the growing security concerns with regard to SWFs, “the European Commission issued a formal statement calling for new scrutiny on SWF operations.” Furthermore, as Cohen points out, this was also noted by some of the American political elite. For instance, Cohen quotes John McConnell, the director of US national intelligence in 2008, who stated, “Concerns about the financial capabilities of Russia, China, and OPEC countries and the potential use of their market access to exert financial leverage to achieving political ends represents a major national security issue.[31]”. On top of that. and perhaps most importantly, Joe Biden, who was then the chair of the Senate Foreign Relations Committee, spoke along the same lines (sic!), “There is a subtle impact on our conduct of foreign policy when investments are made, for them to determine and put impact on the Congress and the president to curtail and/or enhance a certain foreign policy action.”[32]

Herein, although the latter applied to a broader form of investments than just the purchases of federal debt, this still proves that the political elite has been absolutely conscious throughout the Great Recession, and that a drastic growth in foreign debt levels

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29 . J. Cohen, Sovereign wealth funds and national security: the Great Tradeoff. *International Affairs*.85(4) : 713-731. 2009.

30 Ibid, p. 719.

31 Ibid, p. 720.

32 Ibid p. 720.

directly risks the American national security interest. On first glance, since the central goal of this paper is to determine whether foreign debt has undermined the American national security interest post-Great Recession, finding that this has in fact been implicitly admitted on almost the highest level of government—by the current Vice President of the US—it almost appears as if the paper does not need to go further. If both the former director of the US national intelligence and the current Vice President admitted that national security is altered due to the nation's financial dependency on authoritarian powers, what other evidence is needed to retrieve a credible conclusion?

Nevertheless, while this perhaps indeed proves that the current policy makers have not acted upon the nation's best interest, as they have potentially allowed for an undermining of American national security interests, this does not mean that the risks will come true. This in turn might prove that, perhaps, the policy makers had to choose the lesser of two evils in deciding whether to save the economy from a free fall by taking on foreign debt—and hoping that the authoritarian powers will not exercise their excess power—versus standing by while the economy runs into a depression. For example, J. Kirshner argues that the concerns regarding sovereign wealth funds, and the involvement of foreign governments in lending funds to deficit nations, are overstated.[33] This is especially so, according to Kirshner, due to the lack of clear linkages between "high politics" and sovereign wealth funds. Instead, the SWFs are "intervening variables-manifestations of other pathologies, rather than the root causes of the potential trouble."[34]Therefore, since SWFs are one of the main vehicles used to provide foreign official loans, the potential risks stemming from the fact that a substantial amount of federal debt is held by foreign governments, may not be as straight-forward as perhaps argued by scholars such as Bergsten, Drezner, or Cohen.

Therefore, in deciding whether authoritarian powers purchasing access in order to directly influence American policy decisions (and hold the power of undermining national security interest) is a true threat, the answer remains somewhat inconclusive. On the one hand, the American political elite have certainly disregarded the potential risks stemming from the financial dependency on authoritarian powers, especially China. This has been shown to constrain American policy options in tackling several national security-related issues, including responding to Chinese currency manipulations, which risk the American economic recovery from the Great Recession, and therefore weaken the U.S.' position as a global super power. Furthermore, given that the U.S.' political elite has been completely aware of the potential dangers, it is somewhat astonishing that they have recklessly continued the current path of increasing federal deficits.

However, in considering that the U.S. economy has been facing the worst economic crisis since the Great Depression, it could be argued that the policy makers have chosen the least harmful option. Moreover, if supporting this with arguments such as

33 J. Kirshner, Sovereign Wealth Funds and National Security: The Dog that Will Refuse to Bark. *Geopolitics.* 14: 305-3J6. 2009.

34 Ibid, p. 306.

Kirshner's regarding overstated worries on SWFs conducting "high politics", the current policy of increased foreign debt might indeed be supported. This in turn would mean that the decline of U.S. superpower status has been seen inevitable by the political elite, just as accepting the financial indebtedness to the authoritarian powers, especially since the evidence suggests that they have no hostile ambitions.

Although the issue regarding authoritarian powers, especially China, holding substantial amounts of the US' foreign debt did not entirely clarify whether the American national security interest has been undermined, the discussion will now shift to a separate linkage: the dollar-related risks. Herein, the fundamentally important connection between the U.S. dollar and American national security interest lies within the notion of an international belief in the dollar's strength. While this is important for numerous reasons only implicitly related to the national security interest, there are several levels of connections explicitly significant for the latter. Foremost, the dollar's credibility secures its use as a global currency, ensuring that the international community adheres to the American currency system. It also incentivizes international investors, including the authoritarian powers, to continue purchasing dollar-denominated debt.

First, as long as the international community is adhering to the dollar as a global payment currency, numerous potentially hostile nations otherwise become attached to the U.S. Moreover, as Posen argues, the dollar-created "ties orient further the other country's leadership—military, financial, and otherwise—toward U.S. society and politics, be it in public matters of macroeconomic linkages and arms sales or in private decisions." In other words, the currency has relevant spill-over effects in forms of "soft power", which ultimately benefit American national security interests.[35]

In the context of growing foreign debt, the above benefits become increasingly altered. This is, foremost, due to "growing external debts and account deficits," which have both contributed towards weakening the dollar's stability and, hence, credibility of dollar's stability.[36] Considering that the dollar's global role has managed to support American foreign policy—mostly via "buttressing US power and policy autonomy within the global system"—the increasing indebtedness no doubt moves towards the U.S. in the opposite direction.[37]Moreover, as Drezner (2009) argues, this could prove potentially dangerous for the whole U.S. foreign debt issue as, so far, the federal government has been able to denominate the debt "in its own currency."[38] Most significantly, this is important due to America's unique ability to minimize exchange rate risks that several other nations have to face while issuing foreign debt. Furthermore, if a considerable change indeed occurred in the global currency system—which would most likely mean reducing the importance of the

35 D.W. Drezner (2008), p. 68.

36 E. Helleiner, Political determinants of international currencies: What future for the U.S. dollar? *Review of International Political Economy*. 15(3): 354-378. 2008.

37 Ibid, p. 372.

38 D. W. Drezner, Will currency follow the flag? *International Relations of the Asia Pacific.* 10: 389 -414. 2010.

dollar—it would present "potentially significant and unappreciated restraints upon contemporary American political and military predominance."[39] If this is true, not only would this reduce the competing nations' incentives for refinancing the current American debt,[40] but it would also potentially create a vacuum where the dollar's primacy had been serving as an international mediator. While the numerous implications of such a possible scenario could be debated, it is rather obvious that the American status as a superpower could be dealt a potentially detrimental blow.

Therefore, as Kirshner, for example, concludes, "…while dollar doomsayers have cried wolf repeatedly in the past, the current massive US debt, its unprecedented current account deficits," and a few other variables, "have caused the dollar to drift towards unchartered waters.[41]." Among several political consequences of the dollar's decline, argues Kirshner, would be reduction in the "ability for the US to use force abroad, macroeconomic distress during international crises, and consistent pressure on federal budgets."[42] From the perspective of considering whether foreign debt has undermined the American national security interest post-Great Recession, it now becomes increasingly complicated to overlook a connection between threats to national security interests and foreign liabilities.

However, just as was the case with the authoritarian powers potentially undermining national security interest, an alternative position can be identified. M. Fratzcher argues, for example, that weakening the dollar is absolutely necessary to resolve for the trade deficits, and therefore move the economy back towards more sustainable growth.[43] Given this perspective, potential decline in the dollar, which is exacerbated by U.S. foreign debt, would actually have an opposite effect on American national security interests. Since a weakened dollar would make the American exports cheaper, this would support U.S. economic production, which in turn would arguably contribute towards strengthening the whole U.S. position. Subsequently, although this would mean that the international currency system would have to go through several shocks, in the long run it would help solve the structural imbalances that the United States currently faces.[44] Hence, if this perspective were true, perhaps the potential decline of the dollar as a global currency would not have as negative of an impact after all.

All in all, although the looming share of foreign debt is likely to increase risks on

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39 J. Kirshner, Dollar primacy and American power: What's at stake? *Review of International Political Economy.* 15(3): 418 -438.2008.

40 See for example: V. Shih. D. A. Steinberg, The Political Economy of the International Dollar Standard: A Statistical Analysis of Support for the Key Currency. 2000·2008. *Report Prepared for the Presentation at the 2009 meeting of the International Political Economy Society*. Retrieved from: http:// ncgg.princeton.edu/IPES/2009/papers/_paper2.pdf.

41 J. Kirshner, (2008), p. 431.

42 Ibid, p. 432.

43 M. Fratzcher. US shocks and global exchange rate configurations. *Economic Policy.* April 2008: 363 -409. 2008.

44 Ibid, p. 402.

national security, both due to the fact that authoritarian regimes have excessive power over influencing American policy, as well as the potential for undermining the credibility of the dollar, there is not enough evidence to conclude that the "catastrophic" scenarios are certain. Yet, while the current fiscal policy is continuing the expansion of federal debt, it must be noted that the unprecedented expansion of foreign liabilities throughout the Great Recession has sparked considerable uncertainty. Hence, while in the short run, there are probably no major threats likely to stem from the existence of foreign debt, there certainly are long-term national security issues that have not been considered seriously enough (e.g. loss of the dollar' s credibility and excess financial exposure to the authoritarian regimes).

Recent History of Federal Debt Policy and Politics

The current scope of fiscal deficits relative to GDP is rather exceptional, surpassing those of the World War I and the Great Depression, but still less than the deficits during World War II. Also, as the second half of the 20th century was the time of building the "liberal consensus," the role of the federal government in diminishing social inequality increased drastically, as opposed to the practices prior to "liberal consensus." Among other things, this meant increased federal debt levels that were used to fund the ideology of the "liberal consensus" (see Graph I, which shows that Federal Debt between 1950 and 2010 has remained constantly higher than was the case before World War I). Furthermore, according to K. Phillips-Fein, the post-World War II public "accepted the general framework of Keynesian economics, acknowledging that government spending could help counterbalance the destructive recessions."[45]

From a broad perspective, after the Keynesian reasoning was accepted, deficits became an integral part of conducting policy through fiscal measures, especially during times of economic difficulties. Perhaps one of the first examples for such an advocacy was the tax cuts initiated by President Kennedy, and finalized by Lyndon Johnson after Kennedy's assassination. As these cuts were designed to fight unemployment, while accepting an increase in deficits, the political rationale was rather similar to the current reasoning for deficits, to compensate for weaknesses within the private sector.[46]

Although it is arguable whether the policy had an overall positive effect on society, the gradual acceptance of federal deficits certainly started to spur the importance of government spending. Since the U.S. economy witnessed substantial difficulties throughout the 1970s due to stagflation, Uncle Sam was compelled to run even greater deficits, and thus compensate for the simultaneous spiraling of inflation and unemployment, both of which caused significant political pressure on the incumbent party. Subsequently, as Kettl points out, the deficits started to double in each decade—starting from the 1950s through the 1980s—regardless of whether Republicans or Democrats were holding power.[47]

45 K. Phillips-Fein, *Invisible Hands: The Making of the Conservative Movement from New Deal to Reagan* (New York: W.W. Norton, 2009).

46 See, for example, D.F. Kettl, *Deficit Politics: Public Budgeting in Its Institutional and Historical Context* (New York: Macmillan Publishing Company, 1992), p. 21

47 Ibid, p. 24.

Herein, although the debt issue gradually became a substantial matter within domestic political battles, it had no remarkable international implications. For example, during the fiscal year of 1992, only 18.3 percent of the total federal debt was held by international investors. Moreover, since the total amount of debt remained rather marginal compared to today's figures, ca. $3.2 trillion in 1990, owing less than one fifth of this to foreigners did not pose a substantial security risk.[48] Moreover, as the Clinton Administration during 1990s was mostly coupled with budget surpluses and strong economic growth, the issues regarding deficits faded from the debates of mainstream politics.

Yet, the post-World War II political economy still holds significant implications for the general willingness to opt towards fiscal deficits. Once the political decision was made to support Keynesian economics, it became rather difficult to cut spending; instead, for the most part, the federal deficits started to increase throughout ensuing decades. While there can be several reasons for such a phenomena, the issue tends to lie within the fact that "elected officials resist making the hard decisions."[49] Furthermore, as the practice of running deficits lasted decades before the expansionary fiscal policy was used in response to the recent crisis, such policies became easier to accept.

While considering the influence of domestic politics on the rapid expansion of federal debt, several classifications may be used. Perhaps the most obvious starting point would be to look at the partisan differences. As Democrats are traditionally in favor of greater government involvement, whereas Republicans rather prefer small government, the first intuition would suggest that Democrats are also more debt-prone. A similar tendency is noted by M. A. Smith, who argues that Republicans have often been favored, when it has come to issues regarding the economy. As Smith uses the example of sets of surveys that he has been conducting since 1951, Republicans have had an "electoral edge" in this matter throughout most of the years.[50]Since the economic stance of Smith's surveys is related to the notion of social protection and other state-provided benefits, these directly relate to the core of budget deficits due to their expensive nature.

From this perspective, the proponents of the Republican advocacy could also be seen as one of the largest interest groups that stand against increasing federal debt. However, while looking at some of the policy action taken by previous governments, such logic does not hold ground. The Bush tax Cuts in contrast to President Clinton's budget surpluses are perhaps one of the most recent examples. Moreover, according to scholars such as J. D. Sachs, President Bush ran "the most reckless fiscal policy in the history of the U.S.[51]From the perspective of identifying relevant interest groups that affect the creation of

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48 For applicable readings, see D.F. Kettl, (1992), p. 27.

49 Ibid, p. 95.

50 M.A. Smith, "The right talk: How conservatives transformed the Great society into the economic society." (Princeton: Princeton University Press, 2007), p. 182. C.F Bersten, "The Dollar and the budget deficit," in *The Great Trade Collapse: Causes, Consequences and Prospect*, ed. Richard Baldwin. (Geneva:Vox-Eu.org Publication, 2010), 17-20.

51 J.D. Sachs, "How Bush ruined a decade's good work," *The Banker*, February 03, 2004.

budget deficits, the latter has rather important connotations.

Although it can be argued that the traditional Republican discourse favors the economy while lowering government influence, it does not mean reducing government spending. While the influence of the government can be curbed by lowering taxes, which also serves the interest of private businesses, it does not mean that government spending will necessarily be altered in the short run. On the contrary, within the context of looming debt, the government may be able to do both: reduce the extent of responsibilities the constituents have while increasing social benefits at the same time.

For the short-term political interest groups, such behavior is rather tempting. For example, N. Schoefield and G. Miller elaborate on a similar paradox. While they argue that the "Republican success depends on balancing the opposed demands of economic and social conservatives," they indicate the two major interests groups that affect GOP's politics. Furthermore, they do the same for Democrats by defining their critical challenges in "overcoming the policy demands of economic liberals and gaining support from cosmopolitans-the socially liberal but economically conservative potential supporters of the party."[52]

Since these challenges represent the demands of the constituents, they also define the broad framework for conducting budget politics. Moreover, while these paradoxes often contradict the "reasonable" economic policy, this also proves that the party-line division for determining debt-prone politicians is often misguiding. Herein, while concerning the domestic policy's and politics' implications on foreign debt *per se*, it is rather difficult to separate relevant domestic interest groups that would explicitly advocate for international liabilities. Hence, the issue needs to be rather considered in the context of the whole federal deficit, which has essentially become too big to be financed by solely domestic capital.

All in all, the nature of domestic policy and politics allows for the expansion of federal debt. While numerous issues are related to the general paradox of politicians having to satisfy their constituents even if the policy action may not be economically reasonable, this paper does not claim that other variables will not shape the politics regarding deficits. On a more conceptual level, however, the above provides a tentative framework for understanding how government spending and debt function within partisan rivalry. The following section will now briefly assess some of the paper's potential implication on the future of US foreign policy.

The Future of US Foreign Policy

Herein, as Joe Biden and other high ranking politicians were shown to acknowledge the fact that several authoritarian powers, particularly China, have a potential of altering the US national security interest, it could be hypothesized that the Government could seek for foreign policy that minimizes these risks. Since it was shown that China, for example, has a crucial role in securing the stable refinancing of the US federal debt, the

52 N. Schoefield, and G. Miller, Elections and Activists Coalitions in the United States. American Journal of Political Science, 51 (3): 518-531. 2007, 518.

future policy will most likely remain neutral to the Chinese purchase of liabilities. Therefore, although the Treasury Secretary was quoted to threaten potentially protectionist measures in response to the Chinese currency manipulations; such a threat is most likely unrealistic. Also, US policy makers will want to maintain American super power status, which supports the continued War on Terror. Additionally, this was found necessary to ensure that the US meets its obligations in pursuing democratization and executing domestic, humanitarian, and military operations other than war.

Hence, the foreign policy options that the US Government could employ towards reducing the influence of authoritarian powers will rather be peaceful and lack explicit confrontation with the primary competitors (such as China). What is quite clear, however, is that the US will drift back to realist rather than neo-liberal practices. This is supported by P. M. Cronin, who argues that "The United States retains broad security interests and a dedication to global process, but its strained resources should oblige a pragmatic reexamination of how the country pursues its ambitious aims."[53] This means both focusing on business activity abroad in order to foster the American economic engine, as well as reexamining the former power alliances with nations such as Japan, UK, and other European countries. The latter is likely since it will better equip USA for fighting the challenges posed by the fiscal dependency on authoritarian states.

B. Fine from the London University argues, for example, that the recent crisis might have "delivered a death blow to neo-liberalism," and even "if there now are any neo-liberals left, they are liable to be keeping a low profile." [54]This implies that the current state of fiscal difficulties will most likely prescribe a very rational approach for the US foreign policy, primarily driven by narrow self-interest. This would be especially true, since America cannot afford to lose its dominant economic position as it would be difficult and overly expensive to resolve the current financial difficulties.

Consider, for example, the reasoning for why the decline of the dollar would theoretically be dangerous for the US; it would reduce the incentives of foreign investors for purchasing the American debt. Such a prospect could potentially outweigh the considered alternative, where a relative decline of the dollar would be beneficial for the US exports and be potentially advantageous for the American national security interest. One of the primary reasons for why the US policy makers would not benefit from the latter scenario is that if the foreign investors stop purchasing the US debt, the country would be left into a fiscal quagmire. A loss in the credibility of the dollar would lead the US one step closer to such an unfortunate threat, and US policy makers will most likely realize this as they return to realist roots.

Therefore, while considering the Future US foreign policy, it is most likely

53 P.M. Cronin, Restraint Recalibrating American Strategy, *Center for a New American Society*. June 2010, p. 5

54 B. Fine, Neo-Liberalism in Retrospect: It's Financialization, Stupid. Prepared for Conference on "Developmental Politics in the Neo- Liberal Era and Beyond." October 2009. Retrieved from: https://eprints.soas.ac.uk/7993/1/seoulart.pdf (accessed on 12/3/2010).

determined to ensure that its economic power remains strictly supported, and that nothing would further risk the already fragile conditions of post Great Recession recovery. Hence, a realist lens would serve as most functional for such a pragmatic policy. This is supported by O. C. Hendrickson, who has argued that the US has been living in an “Empire Bubble,” mainly caused by a feeling of over confidence after winning the Cold War and being the hegemony for almost two decades.[55] After the Great Recession, however, the “Empire Bubble” is bust• such as proven by the potential, although not straightforwardly foreign debt related national security threats. After the realization has reached to most of the political elite (which it has been shown to already reach Joe Biden and other high ranking officials), it is most likely that American foreign policy will adjust to explicitly concerned in self-interest rather than waning away by build the neo-liberal world.

Another scholar that supports such observations is D. M. Oglesby, who has noted that the Great Recession has given rise to “a new diplomacy.” More specifically, the “new age of international politics” will be “characterized by weak but assertive states, rising powers, and waning American primacy.”[56] Furthermore, while elaborating on the fact that the Great Recession has significantly weakened the American positions, Oglesby argues that for “the United States to operate effectively on the shifting ground of the global landscape, it needs better alignment between its instruments of statecraft and the work do be done.” Indeed, while this remotely hints that the future of American foreign policy will be altered due to the changed conditions of national security, Oglesby also points towards the necessity of “a new diplomacy grounded in the reality of our plural existence, where the stakes are high and passions and perspectives clash.”[57]

With regard to how the US foreign policy could potentially become driven by the implications of foreign debt, the general principles would most likely be similar to the Oglesby’s characterization of “new diplomacy.” This would mean that the American policy makers would become extremely weary of the potential national security threats· i.e. “the stakes are high-” whereas at the same time, the country will probably not back down from most of its global commitments (especially with regard to the War on Terror).

Since the stakes are high, however, US foreign policy will most likely exhibit a rather nervous and somewhat less patient discourse. The case of the Treasury Secretary threatening China with protectionist measures is an example. Nevertheless, as it was discussed under the Policy and Politics sections, the Democratic and Republican discourse has grown rather apart in these matters. It is most likely that the American political elite, from both of the parties, will still primarily be driven by the motivation to appeal to the electorate rather than making unpopular decisions. Such action potentially means that the US will engage in some reckless foreign policy acts (such as a trade war, for example) with

55 D.C. Hendrickson, The Curious Case of American Hegemony: Imperial Aspirations and National Decline, *World Policy Journal.* Summer 2005.

56 D.M. Ogesby, Statecraft at the Crossroads: A New Diplomacy. *SAIS Review.* XXIX(2): 93-107. 2009.

57 Ibid, p. 94.

the motive of appeasing the electorate that is likely to increasingly demand the reinstatement of the now bust "Empire Bubble."

This would mean that even if the national security has currently not explicitly been threatened by foreign debt, the American decline and financial indebtedness to competing nations (e.g. China), will begin to most likely shape the type of foreign policy that America chooses to conduct. This is supported by R. Wade, who has argued that while the "continued rise of US budgetary deficits" is rather likely, this also brings "continued unemployment, and perhaps rising social unrest." [58]Hence, a somewhat impatient foreign policy, especially towards the nations that potentially make the US post Great Recession recovery more difficult, while at the same lime, threatening the national security interest, will again be likely.

In fact, the current international discourse already has several indications that a change in the fundamental drivers of foreign policy, which foreign debt is now part of, has already occurred. For example, R. Skidelsky, a Professor of Political Economy and a Member of the British House of Lords, has made such observations after the latest G20 meeting in Seoul. While particularly focusing on the fact that both China and United States "accused each other of deliberately manipulating their currencies to get a trade advantage," he concludes that as a matter of fact, "amid talks of the 'risks' of new currency and trade wars, such wars have already begun."[59]

Moreover, Skidelsky argues that the current international arena resembles very much 1930s· the era post Great Depression. Interestingly enough, he elaborates on the fact that Henry Morgenthau, then the head of the US Treasury Department, and F. D. Roosevelt met virtually every morning in the middle of 1930s in order to set a higher price for the gold (as the US was operating under the Gold Standard). This in tum reduced the relative price of the dollar, and made exports of US products cheaper. A result of such an advocacy was an artificial increase of demand for the US' manufactured goods, a policy that very much represented a mercantilist realist ideology.[60]

While coupling this to the fact that currently, the US Federal Reserve engages in Quantitative Easing programs, which virtually stands for printing vast amounts of new dollars with the purpose of reducing the dollar's exchange rate, and hence, favoring US exports, a very same (realist) policy is now arguably conducted with somewhat different methods. With regard to how the US foreign debt comes into play, the key lies, once again, in the fact that numerous authoritarian states (especially China) are the ones that are holding most of the liabilities. Now, although China itself engages in exchange rate protectionism and therefore harms the US economic recovery, American foreign policy cannot directly confront the Chinese (mainly due to the fact that they are needed to

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58 Wade, R, From global imbalances to global reorganizations. *Cambridge Journal of Economics.* 33: 539-562.

59 R. Skidelsky, The Irrepressible 1930's Project Syndicate. November 2010. Retrieved from: https://www.project-sydicate.org/commentary/skidelsky35/English (accessed on 12/3/2010).

60 Ibid

refinance the foreign debt in the future). Nevertheless, a confrontational foreign policy is conducted through indirect measures, such as the Quantitative Easing programs, which in essence serve the purpose of protecting the national security interest, and are very similar to what H. Morgenthau proposed in 1930's.

All in all, although this paper has not completely proven that the current levels of foreign debt undermine the American national security interest, it has been noted that such a considerable risk does exist. While coupling this to the overall decline of the American global status, it could be seen to increasingly have an impact on the US foreign policy. While it is herein recognized that foreign debt is certainly not the only driver, and perhaps also not the primary determinant of the future of US foreign policy, it can be noted to be among the ones that shape future foreign policy. The potential threats posed by the authoritarian powers holding vast amounts of US foreign debt, and the risks of weakening the credibility of the dollar are too big of national security risks to be just overlooked. Hence, while the US foreign policy will most likely shin towards more realist practices, it will also become more concerned in reducing the latter national security risks.

Conclusion

The goal of this paper was to study whether foreign debt has undermined the American national security interest post Great Recession. In order to do so, the paper was divided into three main sections: Linkages between US national security and foreign debt; recent history of the federal debt policy and politics; and the future of US foreign policy. While defining what national security interest stands for, it was recognized that providing a comprehensive definition is rather challenging. Nevertheless, Lasswell's explanation was found to serve as the best guideline for clarifying some of the ambiguity: "Our greatest security lies in the best balance of all instruments of foreign policy, and hence in the coordinated handling of arms, diplomacy, information, and economics; and the proper correlation of all measures of foreign and domestic policy."[61]

Since US policy makers were assumed to function in the country's best interest, the findings of this paper anticipated to support current policy-which would have meant that no significant risks for national security could be found. However, albeit the paper remained inconclusive on whether the American national security interest has explicitly been undermined due to foreign debt, there still were significant risks identified-which in some cases, should be unacceptable for the US political elite (e.g. the authoritarian power's potential to destabilize the American fiscal policy via Sovereign Wealth Funds). This was also shown to be recognized by Joe Bide-the current Vice President-and Joe McConnell, the former director of the US national intelligence.

While being guided by Lasswell's definition for what national security stands for, the latter is arguably violating the "balance between all instruments," since as it was also shown, it is constraining the American policy responses to issues such as Chinese currency manipulations. At the same time, because the American economic recovery

61 H.D. Lasswell, National Security and Individual Freedom, *New York: McGraw-Hill*, 1950, p. 75.

is banned by such manipulations, the US policy makers were shown to be looking for alternative measures to lower the harmful impacts. As discussed under The Future of US Foreign Policy, the American Quantitative Easement programs have the effect of artificially lowering the dollar's exchange rate.

On the one hand, this represents a policy similar to the realist advocacy in the 1930s, when the value of the greenback was altered via the Gold Standard in order to ease American exports the immediate effect is indeed that the US policy makers are able to indirectly deal with the Chinese currency manipulations. On the other hand, however, this undermines the credibility of the dollar. Since the latter was shown to be another relevant national security issue for the US, the Americans are in fact potentially risking their own national security interest (because of undermining the credibility of the dollar), while attempting to solve for the other• authoritarian states holding too large amounts of the US foreign debt.

At the same time, under the section Recent History of US Federal Debt Policy and Politics, it was elaborated how until 2000s, the issue of federal debt was primarily considered within a domestic framework. This could be seen as one of the primary reasons for why the current political discourse has been largely disregarding the issue of increasing foreign liabilities. To a certain degree, this may be considered understandable: as there are almost no historic references for significant foreign liabilities, there has also been no considerable debate about the pros and cons of allowing for such policy.

Yet, this does not justify the potential undermining of national security interest. Under the linkages between US national security and foreign debt, it was elaborated on how the policy potentially harms the credibility of dollar as a global currency, and how the US' financial dependence has become excessively exposed to major authoritarian regimes. Both of these findings have found to potentially undermine the long-term American national security interest, which in turn others tentative evidence for falsifying the current debt policy. However, it must be said, that further research still needs to answer, what exactly were the US policy-makers' mistakes.

At the moment, it can be hypothesized that current policy has somewhat harmed the US national security interest via the two variables (allowing for excessive financial exposure to authoritarian states and weakening the dollar), which in tum may indicate that once the errors have been recognized by the political elite, certain policy changes will take place on the international arena. This is mainly due to the fact that if the hypothesis is true, the US will attempt to compensate for the previous shortfalls-and as suggested by the future of US foreign policy section, most of the strategy willingly be guided by realist connotations.