The Comeback Nation

U.S. Economic Supremacy Has Repeatedly Proved Declinists Wrong

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As the 2020s dawn, it is hard to find any member of the U.S. foreign policy establishment who does not believe that the United States is in decline and that the waning of its influence has accelerated under a president who seems to revel in attacking U.S. allies and enemies alike. The debate is not over the fact of American decline but over how the United States should manage its diminishing status.

Declinists take as a given that the U.S. share of global economic output has been decreasing for decades and that the United States has either already lost its status as the world's largest economy to China or is fated to lose it within the next ten to 15 years. From these assumptions flow recommendations for resizing U.S. foreign policy to fit Washington's shrinking power: accept the loss of primacy, adapt to regional spheres of influence led by China and Russia, and work to avoid the wars that could erupt between a declining empire such as the United States and a rising one such as China.

But what if the United States is not in economic decline? Somehow, the prevailing pessimism survived a surge in American economic and financial might over the last decade. During the 2010s, the United States not only staged a comeback as an economic superpower but reached new heights as a financial empire, driven by its relatively young population, its open door to immigration, and investment pouring into Silicon Valley. The country is now facing new economic challenges as a result of the novel coronavirus. But no country was prepared for the pandemic, and there is no reason to believe the downturn will change the United States' standing among world economies.

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The American comeback was far from expected back in 2010. The United States had just suffered its weakest decade of economic growth since World War II and had hit bottom in the financial crisis of 2008, which started with the meltdown of mortgage debts in the country and quickly spread worldwide. Commentators said the United States had lost all credibility as an economic model and predicted further decline, particularly relative to China and other emerging economies. Instead, the 2010s turned out to be a golden decade for the nation where the crisis started, and not so good for the rest.

A GOLDEN DECADE

For the first time since at least the 1850s, when record keeping began, the United States traversed a full decade without suffering a single recession. Although many Americans were initially disappointed with the pace of the recovery, the United States grew significantly faster than other developed economies, and faster than many developing economies, as well. Defying the many declinist forecasts—one major global bank predicted in 2010 that China would overtake the United States by 2020—the United States actually expanded its share of global GDP during the 2010s, from 23 percent to 25 percent.

The 2020s have opened with the sudden shock of a global pandemic. Economists are downgrading their growth forecasts for countries all over the world, and the United States' record-long economic expansion is at risk of coming to an abrupt end. But there is little evidence to suggest that the downturn will hit the United States disproportionately hard. As of this writing, the U.S. stock market has fallen less than most other stock markets, and investors have bid up the U.S. dollar given its safe-haven status.

The United States now faces a more enduring obstacle: the cyclical churn of the global economy. The United States has had golden decades before. It prospered in the go-go 1960s, then faded amid the malaise of the 1970s. It boomed again with the rise of Silicon Valley in the 1990s, only to go flat after the dot-com bust of 2000. The lesson of history: the fact that the 2010s were great for the United States makes it less likely that the 2020s will be.

These decadal cycles guide the rise and fall of all nations, not just the United States. To make the case for chronic American decline, analysts often choose a measure called "purchasing power parity," or PPP, which aims to compare the living standards that people can afford in their home countries. The problem with PPP is that it rests its conclusions on theoretical currency exchange rates, calculated by academics. A more accurate measure of economic might is nominal GDP in U.S. dollars, based on real-life exchange rates in the global markets.

The United States emerged from World War II accounting for a dominant share of global output—40 percent or more. Based on PPP, calculations indicate that the United States' share of the global economy has declined steadily since then, dropping below China's in the mid-2010s, and today stands at just 15 percent. Nominal GDP measurements, on the other hand, show that the U.S. share fell to 25 percent by 1980 but then fluctuated over the subsequent decades. By 2020, it had bounced back to 25 percent—exactly where it stood in 1980.

In short, the United States' share of global economic power has essentially held steady for four decades. Over this period, the European Union saw its share fall from 35 percent to 21 percent. Japan's share slipped from ten percent to six percent, and Russia's dropped from three percent to two percent. Meanwhile, China's share swelled during that time from two percent to 16 percent. So it is true that as China has risen, other major powers have declined. But the United States is not one of them.

DOLLAR DOMINANCE

The United States also emerged from the 2010s stronger than ever as a financial superpower, with the world's most sought-after stock and bond markets and its dominant currency. Lifted by the strong performance of American technology companies, the U.S. stock market rose by 250 percent in the 2010s, nearly four times the average gain in other national stock markets. The biggest underperformers were in Europe and, particularly, in emerging markets, which suffered their worst decade of returns since the 1930s. China's stock market rose by a mere 70 percent over the course of the decade—relatively slow growth for an emerging market.

By 2019, the United States accounted for 56 percent of global stock market capitalization, up from 42 percent in 2010. The value of the U.S. stock market, relative to all others, was at a 100-year high before the novel coronavirus hit and maintained this historic lead in the subsequent initial market crash. The 2010s saw the rise of a global "superstar economy," in which huge corporations increasingly dominated small ones, monopolizing market share and investment flows. And the biggest superstars were American. Today, seven of the world's ten largest companies by total stock market value are American, up from three in 2010.

Global markets reflect the collective mind of millions of investors, and market prices capture their estimate of the relative strength of the world's leading economies and companies. If the markets had one voice, it would not be singing the chorus of "American Decline."

Having the indispensable currency gives the United States tremendous geopolitical leverage.

The U.S. dollar also finished the 2010s on top of the world. When individuals and companies borrow from overseas, they increasingly borrow in dollars, which account for 75 percent of these loans, up from 60 percent before the crisis of 2008. Even though the crisis originated in the United States, U.S. banks today dominate global finance to a greater degree than they did ten years ago—in part because debt troubles have dogged banks in China, Japan, and the European Union even more persistently.

Close to 90 percent of global financial transactions conducted through banks use the dollar, even if the deal does not involve an American party. When South Korea sells phones to Brazil, it generally asks to be paid in dollars, because sellers everywhere prefer to hold the world's favorite legal tender. The share of countries that use the dollar as their anchor currency—the currency against which they measure and stabilize the value of their own currencies—has risen from around 30 percent in 1950 to about 60 percent today. Those countries collectively account for some 60 percent of global GDP. China is one of them.

And because the U.S. Federal Reserve controls the supply of dollars, it is, now more than ever, the world's central bank. When the Fed moves interest rates, every other central bank (including the People's Bank of China) faces heavy pressure to move in the same direction, or face destabilizing capital outflows. The dollar is also the currency that other nations overwhelming prefer to hold in their treasury reserves.

This "reserve currency status" has been a perk of empire since Portugal was the dominant world power, beginning in the mid-fifteenth century. A country that enjoys steady global demand for its currency—often purchased in the form of government bonds—can borrow cheaply from abroad. That's why Valéry Giscard d'Estaing, who was president of France from 1974 to 1981, once called the mighty dollar the United States' "exorbitant privilege." It helps Americans borrow money in order to buy cars and homes, and it allows Washington to run up deficits it could not otherwise afford.

Having the indispensable currency also gives the United States tremendous geopolitical leverage. In 2018, when U.S. President Donald Trump imposed financial sanctions on Iran after pulling the United States out of the nuclear deal that his predecessor, along with other major powers, had negotiated with the Islamic Republic, reluctant European governments ultimately decided they had no choice but to go along, because they could not risk losing access to U.S. banks. When the United States and the European Union sanctioned Russia for invading Ukraine in 2014, the Kremlin turned inward and gave up on promoting economic growth in favor of saving money so as to reduce its vulnerability to foreign creditors and sanctions threats. For all its aggression on the world stage, Russia is currently growing at half the pace of the United States and fading as a global economic power.

Not surprisingly, rivals want a taste of the power that the dollar gives the United States. But Europe's reserve ambitions for the euro have been hobbled by widespread doubts about a currency that is only 20 years old and has been battered by repeated financial crises. China had similar hopes for the renminbi and in the early 2010s took steps to make its currency more readily convertible and easier to trade. Then, in 2015, millions of Chinese rushed out of this opening door. Faced with a stock market crash in Shanghai and a looming debt crisis, they began shipping renminbi to safe havens abroad, in amounts equal to hundreds of billions of dollars a month. In response, the authorities imposed capital controls that remain in place today, putting China's hopes of challenging the dollar's supremacy on hold indefinitely.

What the rest of the world wants in a reserve currency is a vast, liquid market in which people are free to buy and sell without fear that the government will suddenly change the rules. For now, they see this safe haven only in the U.S. dollar, which, as a result, has so far appreciated against most other currencies during the coronavirus shock. Global elites may not trust the current U.S. president, but they trust U.S. institutions, which is why the United States emerged from the 2010s as a financial empire without rivals.

DON'T DESPAIR

The perception of American decline is reinforced by the many pundits and politicians who say that recent decades have been great only for corporations and the rich. They point to data showing that U.S. wages have stagnated since the 1970s and that the United States is the only rich country where life expectancy has declined in recent years, owing to "deaths of despair"—from suicide, alcohol, and opioid abuse. In the 2020 presidential primary season, one of the signature lines of the Democratic front-runner, former Vice President Joe Biden, has been that the middle class is "getting killed."

To be sure, many Americans continue to struggle, and there are frightening concentrations of addiction and despair. But as wage and income growth revived in the mid-2010s, so, broadly speaking, did American spirits. During that period, according to the University of Michigan's monthly surveys of American consumers, confidence grew equally fast among consumers in the top, middle, and bottom thirds of the income ladder.

Of course, the buoyant mood is cracking in the pandemic. But when the United States reported its first coronavirus cases, in mid-January, small-business confidence matched the all-time peaks since surveys of small-business owners began, nearly five decades ago. Consumer confidence was at a high reached only twice before, during the economic booms of the 1960s and 1990s. The University of Michigan surveys blend questions about current and future conditions, asking Americans how well off they are compared to a year ago and how well off they expect to be a year from now.

Ever since Gallup first began asking Americans whether they were satisfied with the way their lives were going, back in 1979, the vast majority have said yes. But in January, that share hit a record 90 percent. That same month, three out of five Americans polled said they were better off now than they were four years ago, the largest proportion since Gallup began asking this question during presidential election years, back in 1992.

Although there are data showing that inflation-adjusted wages have stagnated since the 1970s, as many commentators point out, it's also possible to show that wages have risen—or fallen—by choosing a different start date for comparison or a different measure of inflation. The method and the story it tells are often chosen to support a political point of view. But this much is clear: weekly and hourly wage growth expanded in the 2010s. And broader measures of personal and household income, including census data, show both long-term gains and a noticeable jump in the 2010s.

Although inequality is growing, it is growing because income gains have disproportionately benefited the richest Americans, not because the middle class and the poor have seen no gains. According to the U.S. Census Bureau, the median household income in 2018, adjusted for inflation, was $63,000, an increase of around $15,000 from the early 1970s and of $7,000 from 2013. Those gains likely continued through 2019, a strong year for U.S. jobs, and may help explain why signs of popular optimism were still spreading early this year.

Even believers in middle-class decline should not conflate it with a broader American decline—because the same conversation about the loss of middle-class jobs and wages is going on all over the world, from India, to Japan, to the countries of the EU. And the middle classes in those countries are all suffering for a similar reason, the rise of cheaper and more competitive exports, first from China, lately from rivals such as Bangladesh and Vietnam, which has threatened middle-class manufacturing jobs elsewhere.

In a polarized age, Americans tend to see economic reality through a partisan lens. The Democratic presidential candidates have dwelled on themes of decline and stagnation, which, given the popular mood, had promised to be a tough sell. Fear of the coronavirus will reshape the 2020 election conversation, but again, there is no evidence yet that the pandemic will depress the economy or economic confidence in the United States more than in other major powers. The underlying question now is, will the U.S. economy rule the 2020s the way it ruled the 2010s, with or without the virus?

THE BIG RISK

Countries that dominate the global economy and markets in one decade rarely dominate them in the next. The more they grow, the more complacent their leaders get. They lose discipline, abandon reforms, mire the country in debt and deficits, and push the economy off the rails. This decadal cycle has taken down every economic star of the postwar era, including the United States twice before. The U.S. economy was dominant in the 1960s but stumbled in the next decade. In the 1970s, rising oil prices led some U.S. intelligence analysts to predict that the Soviet Union was on track to become the world's largest economy, but it collapsed economically in the next decade. The 1980s were all about "the rise of Japan," but Japan fell when its market bubble burst in 1989. The 1990s, another American decade, ended with the bust in Silicon Valley. The problem the United States now faces is that its current economic expansion is almost 11 years old, the longest since 1850, and every boom eventually creates excesses that foreshadow its own destruction.

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For all the talk of American despair, the bigger risk is complacency in the face of growing threats from debt, deficits, and demographics. Any economy's growth potential is a function of population and productivity. The United States likes to think that its big advantage is productivity, owing to relatively flexible regulations and a culture of innovation fostered in elite universities and in Silicon Valley. Indeed, U.S. productivity has gotten a boost from investment in technology in recent years, but the more important U.S. advantage has been a relatively high population growth rate: babies and immigrants, not Stanford and Google.

In the 1990s, productivity was growing significantly faster in the United States than in Japan and Europe, but that lead began narrowing in the subsequent decade. Meanwhile, the United States' demographic advantage was growing. In Japan and the EU, the working-age population started to shrink after the turn of the millennium. But it kept growing in the United States. If the United States' population had been growing as slowly as Japan's in recent decades, today the U.S. share of the global economy would be 17 percent, not 25 percent.

This advantage, however, is now threatened by politics. During the postwar period, around two-thirds of U.S. population growth was driven by the country's relatively high birthrate. The rest was driven by its relatively open door to immigrants. That door has begun to close under Trump. Since 2016, the number of legal immigrants entering the United States has fallen at an average pace of 43,000 a year.

At the same time, U.S. policymakers have grown complacent about debt and deficits. The United States was growing faster than the rest of the developed world under President Barack Obama, and it widened its lead as Trump pushed through cuts in taxes and regulations.

But cutting taxes without reducing spending has raised the U.S. budget deficit, which is closing in on five percent of GDP, the highest it has ever been except in the aftermath of a recession or a war. Major voices in both parties are now making the case that deficits no longer pose a threat to growth—Republicans in order to defend low taxes, Democrats to defend higher public spending.

Following the 2008 financial crisis, the United States moved more decisively than other rich nations to reduce its debt, but it has been backsliding in recent years, encouraged by endless new rounds of easy money offered by the Federal Reserve in order to keep the economic recovery alive. The big change since 2008: the largest and riskiest debts are now concentrated in the corporate bond market, not bank loans to homeowners.

Today, 16 percent of American public companies are "zombies," meaning they earn too little to cover the interest payments on their debt and stay alive only by issuing new debt. The Fed's record-low interest rates were intended to stimulate investment in productive companies, but much of that money has gone to support zombies or has flowed into the stock market, which is now more than 80 percent larger than the U.S. economy, well above the highs reached during the market manias of the 1920s and late 1990s. The popping of those bubbles led in the first instance to the Great Depression and in the second to a recession. If the coronavirus shock leads to a full-blown financial crisis, troubled corporations will default on their debt payments not only in the United States but worldwide. China, Japan, and Europe are also riddled with zombies.

Eventually, rising debt could threaten the U.S. financial empire. In 1985, the United States owed the rest of the world $104 billion, an amount equal to a negligible 2.5 percent of GDP. Since then, those liabilities have risen to nearly $10 trillion, 50 percent of GDP, a threshold that has often pushed nations into a currency crisis. Empires lose their reserve currency status when foreign nations lose confidence that the imperial power can pay its bills.

Before the United States, five countries had held reserve currency status: Portugal, Spain, the Netherlands, France, and the United Kingdom. On average, each lasted 94 years in the leading role. Today, the dollar's run as a reserve currency is 100 years old. One reason it is likely to endure even a pandemic-induced recession is the absence of viable national rivals, but in the void, new contenders are emerging, including gold and cryptocurrencies. Facebook is trying to launch a digital currency, Libra. Just because the dollar is the indispensable currency today doesn't mean it will be forever.

AMERICA IS NOT IN DECLINE

If the U.S. economy slips up in the 2020s, will it mean that the declinists were right all along? Unlikely. Beyond the next five to ten years, no forecast is better than a random guess, because too much can change in the intervening years, as the cycles of economics, politics, and technology turn. The long run is a myth.

In most tellings, the declinist narrative reaches its denouement when the United States loses its place as the world's largest economy to China. Often, this story is couched in historical inevitability, evoking the vastness of China's population, the glories of its imperial past, even the fact that sixteenth-century China accounted for 25 percent of the global economy—as if distant past performance guaranteed future results.

Declinists often exaggerate how soon China could overtake the United States by assuming that it can maintain overstated growth rates indefinitely and never once suffer a financial crisis or a recession. For the sake of argument, let's pretend that these exercises in straight-line extrapolation make sense. If into the future, China and the United States maintained their officially reported 2019 nominal GDP growth rates—around six percent and four percent, respectively—China would not catch up to the United States until around 2050.

And since all developing economies slow down as they mature and grow richer, China's economy is likely to slow further than it already has over the past decade. If its growth slowed by one percentage point, China would not catch up until 2090, and even that pace would be tough to sustain. South Korea and Taiwan, the two most successful development stories in history, grew rapidly for five decades, then slowed sharply. China has already been growing rapidly for four decades. Moreover, South Korea and Taiwan boomed during the postwar miracle years, when economic growth was supercharged all over the world by the baby boom and hyperglobalization. Now, the baby boom has gone bust. Trade growth has stalled. Economic growth is slowing worldwide. And all these headwinds are hitting China harder than the United States.

What is more, China's debt now amounts to nearly 270 percent of GDP (the comparable figure in the United States is 250 percent), and it is much harder for a middle-income country such as China to grow with a debt that high. Zombies account for ten percent of corporate debt in China, so unlike in 2008, when its debt was much lower, China is now highly vulnerable to a global financial crisis. Moreover, the United States is the battle-tested survivor of 12 recessions and a Great Depression over the last century. China has not suffered a recession since its economic boom began four decades ago, and its leaders now respond to any hint of a downturn by pumping more debt into the economy.

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The most important driver of any economy is the working-age population, which is still growing in the United States but started shrinking in China five years ago. Historically, countries with a shrinking workforce have had virtually no chance of sustaining rapid economic growth for even one decade. Yet declinists assume that China's rise can continue indefinitely. More likely, few Americans alive today will be around to see the United States fall to second place.

Foreign affairs experts may be correct to argue that the United States should modernize its global strategy, restore ties to traditional allies and critical trade partners, rejoin international agreements, and help rebuild the institutional pillars of the postwar order. But often, the argument is not that these moves would be wise; it is that they are necessary to match U.S. policy with the reality of the country's declining economic clout.

That, however, is not the reality. The United States is not in decline. It was the comeback nation of the 2010s. And if the experts aren't right about where the United States is coming from, they may not be right about where it needs to go.