
Allies pay for our nukes by holding US bonds, economists suggest

By Editorial Staff Thu, Apr 5, 2018

The countries that benefit most from American military protection are the ones who hold the biggest share of their foreign reserves in US Treasuries, which may lower our borrowing costs, according to a new research paper.

If other nations believe that President Trump intends to break America's international defense agreements, interest rates on U.S. Treasury debt could rise as a result, according to a new article by economists Barry Eichengreen, Arnaud J. Mehl, and Livia Chitu.

In their paper, "Mars or Mercury? The Geopolitics of International Currency Choice" (NBER Working Paper No. 24145), the authors claim that certain nations indirectly pay to be under the U.S. nuclear umbrella by holding a large percentage of their foreign reserves as U.S. Treasury debt.

Military alliances as well as financial considerations influence the composition of a nation's foreign currency reserves, they write, and suggest that if the U.S. were to withdraw from global geopolitical affairs, foreign demand for dollars might decline. This could ultimately lead to higher long-term interest rates in the U.S.

America's vast global security umbrella, in place since the end of World War II, protects the dollar's status as the leading international currency (established by the Bretton-Woods Agreement of 1944). As a consequence, a high percentage of global trade is conducted in dollars, which makes U.S. debt more marketable overseas.

This "exorbitant privilege," as the dollar's status has been called, allows Americans for instance to pay for Chinese goods in dollars, for instance, instead of paying in renminbi, which we would have to earn by exporting goods or services to China. The dollar's status allows us to run a big trade deficit without dire consequences.

If the United States is no longer seen as a predictable guarantor of the security of its allies, then countries that are currently dependent on the U.S. for military protection could reduce the share of their reserves held in dollars by as much as 30 percentage points, while increasing the shares of such other currencies as the euro, yen, and renminbi, the researchers proposed.

The researchers estimate this would raise the long-term U.S. interest rate by 80 basis points, raising interest payments by the U.S. Treasury by roughly \$115 billion each year given the level of public debt in late 2016. They note that this is more than many estimates

of the cost of maintaining the American military's overseas presence.

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