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An August 1998 Default on a Global Scale

By Boris Kagarlitsky

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On June 1, U.S. Congress rejected a bill to increase the debt limit by $2.4 trillion, delivering a humiliating defeat to President Barack Obama.

For now, there is no immediate threat of a U.S. default on its debt, but the government will have to dramatically cut costs or go back to Congress with new proposals. Obama will be forced to reach a compromise with the Republicans in Congress, and the only question now is the price he will have to pay for it.

Republicans are demanding fundamental changes to U.S. financial policy and limits to the emission of dollars and to the endless government borrowing on financial markets that threatens to put the United States in the same position that Russia found itself at the end of President Boris Yeltsin's rule. During Russia's crisis, government bonds essentially became a financial pyramid that finally collapsed during the default of August 1998.

Now Washington finds itself in a similar position. But in contrast to the Yeltsin government, which limited the money supply so sharply that people did not receive salaries for months, U.S. authorities have resorted to borrowing actively on the credit market and printing dollars, otherwise known as "quantitative easing." Those dollars have spread like wildfire throughout the world economy, fueling speculative investment and keeping oil prices high.

By trying to keep its own financial system afloat, the United States is essentially financing Russian raw materials companies, Chinese exporters and European bankers.

The flip side of the U.S. monetary expansion is a ubiquitous rise in the price of food and housing (except for in the United States) and the transformation of many ordinary consumer goods into unaffordable luxuries for a significant percentage of the world's population. These dangerous tendencies could easily result in serious political upheavals across the globe, including Russia, if they continue unabated.

No matter how the conflict between Congress and the Obama administration is resolved, it will inevitably affect the fate of the international economy. A sharp cut in government spending and a limit on the emission of dollars threatens to send the U.S. economy back into another recession.

For Russia, the looming second wave of a global recession threatens to become a full-blown social catastrophe. Russian leaders escaped this kind of disaster in 2009 with almost no effort. They were saved only when the U.S. Federal Reserve began printing dollars. But they won't be saved in the next crisis, which may hit the country before the March presidential election.

Russian leaders are probably well aware of these dangers. But this hardly means that they will change their policies and take measures now to help control the damage. Instead, they have proposed commercializing education and selling off state property.

There is a fierce battle for power among the ruling elite, but there is no battle of ideas. The result is that all the major decisions have already been made, and they are devoid of common sense. To have a true battle of ideas, you have to have prudent and forward-thinking ideas in the first place.

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