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# U.S. stimulus plans raise concerns for global economy

By Nelson D. Schwartz
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**DAVOS, Switzerland:** As the U.S. Congress looks for ways to expand President Barack Obama's $819 billion economic stimulus package, the rest of the world has an urgent message to convey: Tell us how you are going to pay for it without drowning the world in debt.

Few observers here at the World Economic Forum debate the need to restart America, the world's largest economy, with a package that could hit $1 trillion over two years. But the long-term danger of increased borrowing by the U.S. government, and its potential to drive up inflation and interest rates around the world, seems to be getting more attention in Switzerland than in Washington.

"The U.S. needs to show some proof they have a plan to get out of the fiscal problem," said Ernesto Zedillo, the former Mexican president who helped steer his country through a financial crisis of its own in 1994. "We, as developing countries, need to know we won't be crowded out of the capital markets, which is already happening."

Unlike other countries in a financial jam, Zedillo added, Washington has the option of simply printing more money, since the dollar is a reserve currency for the rest of the world. But over the long run that could force long-term interest rates higher and drive down the value of the dollar, undermining the unique benefits that come with the U.S. currency's special status.

Until now, most of the fears about surging government debt have focused on borrowing by European countries like Spain, Greece and especially Britain, which is in the midst of its own huge bank bailout. That recently pushed the pound to a 23-year low against the dollar, and prompted some Londoners to wonder whether their city was turning into "Reykjavik-on-Thames" - an allusion to Iceland's financial meltdown.

While the dollar's status as refuge in a time of turmoil should prevent that kind of sell-off for now, one expert after another warned that if fundamental factors like the lack of U.S. savings and bloated budget deficits did not change, the dollar could also fall sharply in value.

"There aren't that many safe havens," said Alan Blinder, a Princeton University economist who is a former vice chairman of the U.S. Federal Reserve, explaining why the dollar's status as a reserve currency was unlikely to be threatened.

Instead, it's the dollar's long-term value against other currencies that is vulnerable. "At some point, there may be so much Treasury debt that investors may start wondering if they are overloaded in dollar assets," he said.

While the focus in Washington has been on how much the stimulus package will attract broader political support before it comes up for a vote in the Senate, in Davos the talk was about the avalanche of U.S. Treasury debt needed to pay for it, as well as the $700 billion Troubled Asset Relief Program, or TARP, and other rescue measures approved last autumn.

The stimulus was approved by the House of Representatives on Wednesday without any Republican support, and could grow even larger, most likely in the form of additional tax cuts, to attract a bipartisan coalition.

U.S. officials insist they are aware of the challenge.

On Thursday afternoon here, a top White House adviser, Valerie Jarrett, promised that once the stimulus plan achieved its intended effect, the United States would "restore fiscal responsibility and return to a sustainable economic path." Jarrett, a longtime confidante of both Obama and his wife, Michelle, is the highest-ranking administration official to come to Davos.

Of course, Congress and the White House will ultimately need to refill the government's coffers once the U.S. economy is growing again. But how they might do that is barely on the radar screen in Washington yet.

"Even before Obama walked through the White House door, there were plans for $1 trillion of new debt," said Niall Ferguson, a historian at Harvard who has studied past patterns of borrowing and its impact on national power. He now estimates that some $2.2 trillion in new government debt will be issued this year, assuming the stimulus plan is approved.

"You either crowd out other borrowers or you print money," Ferguson added. "There is no way you can have $2.2 trillion in borrowing without influencing interest rates or inflation in the long term."

Ferguson added that he was particularly struck by the new borrowing because the roots of the current crisis lay in an excess of debt at all levels, from individual homeowners with subprime mortgages to Wall Street banks who let their balance sheets balloon.

"This is a crisis of excessive debt, which reached 355 percent of American gross domestic product," he said. "It cannot be solved with more debt."

While Ferguson is a skeptic of the Keynesian thinking behind Obama's plan - rather than borrowing and spending to stimulate the economy, he favors corporate tax cuts - even

supporters of the plan like Zedillo and the economist Stephen Roach called on the White House to quickly address how it will be paid for in the long term.

"It's huge," said Roach, who is chairman of Morgan Stanley Asia. "President Obama has now laid out a scenario of multiyear, trillion dollar deficits."

To make matters worse, he said, the United States "is a savings-short, deficit economy. When we decide to borrow, we're asking lenders from around the world to step up and give us the money."

The stimulus is widely expected to pass, but once it does, Roach said the focus will shift to "who foots the bill and what is the exit strategy. We don't have the answer to either question."

Zedillo, who remembers how Mexico had to tighten its belt when it received billions from Washington to save its economy from collapse in 1994 , was even more blunt.

"People are not stupid," he said. "They see the huge deficit, the huge spending, and wonder what comes next."