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Hiding Economic Depression With Spin

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Global Research, August 01, 2013
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Time is running out for the US economy and the American people. The financial press and economic commentators, with few exceptions, do a good job of keeping this fact from the public.

Consider for example the spin put on the "advance estimate" of the real GDP growth rate for the second quarter announced on July 31. The annual rate of 1.7 percent real GDP growth for the second quarter of 2013 was presented optimistically as an acceleration in real GDP from the first quarter's 1.1 percent growth rate. However, the reason for the "acceleration" in growth is that the first quarter's estimate was revised down from 1.8 percent to 1.1 percent. The second quarter GDP growth rate is also subject to revised estimates. Most likely, the final number will be lower.

Consider also that the reason that real GDP is positive is that nominal GDP is deflated with an understated measure of inflation. The measure of inflation has been manipulated in order to deny Social Security recipients cost of living adjustments. Statistician John Williams (shadowstats.com) reports that if deflated by previous official methodology, GDP growth has been negative since the downturn in 2007. In other words, the "recovery" is just another government hoax.

Another failure of the financial press and economic commentators is the interpretation of the Federal Reserve's policy of Quantitative Easing. The Fed is said to be keeping interest rates low in order to stimulate business investment and the housing market. This explanation is nothing but cover for the real purpose of QE, which is to drive up and keep high the debt related derivatives on the books of the banks too big too fail. Low interest rates pull up the prices of all debt instruments, and the higher prices raise the values on the banks' balance sheets, making the banks look more solvent or less insolvent.

The Fed has continued QE for years, despite the policy's failure to revive the economy, in order to hold the banks' collapse at bay in the hopes that the banks would succeed in boosting their earnings sufficiently to get out of trouble.

The Fed's QE policy has been costly for important areas of the economy. Retirees have

been denied interest income. This has reduced consumer expenditures and, thereby, GDP growth, and it has forced retirees to draw down their savings in order to pay their bills.

The Fed's QE policy has also jeopardized the US dollar because of the several-fold increase in the number of dollars over the last few years. In order to support bond prices, the Fed has created 1,000 billion new dollars annually over the last several years. The supply of dollars has out grown the demand for dollars, putting the dollar's exchange value under pressure. To protect the dollar from QE, the Fed and its dependent bullion banks have engaged in ruthless shorting of gold in order to suppress the price of gold. The rapidly rising gold price indicated falling confidence in the dollar, and the Fed feared that this lack of confidence would spread into the currency markets.

By printing dollars to support the banks, the Fed has created a bond market bubble, a stock market bubble, and a dollar bubble. If the Fed stops printing money, not only will the banks' balance sheets take a hit, but so will the bond, stock, and real estate markets. Wealth would be wiped out. No one could any longer pretend that there is an economic recovery.

The impact on the dollar is less clear. On the one hand, curtailment of the dollar's rapid increase in supply would help the currency. On the other hand, the drop in values of dollar-denominated assets, such as stocks, bonds, and real estate could cause the demand for dollars to decrease. Foreigners for example who sell dollar-based assets might also convert their dollar proceeds into their domestic currencies.

The failures of the financial press require the explanation that I have provided of QE, the bubble economy, and the manipulated measures of real GDP, inflation, and unemployment. However, although these explanations are necessary, they are themselves a diversion.

The real reason that the US economy cannot recover is that it has been moved offshore. Millions of US manufacturing and tradable professional service jobs such as software engineering have been moved to China, India and other countries where wages and salaries are a fraction of those in the US. Using "free trade" as a cloak, corporations have turned labor costs into a profits center. The drop in labor costs raises profits, which are then distributed to executives as "performance bonuses" and to shareholders as capital gains. The impact on US employment can be seen from the BLS monthly payroll jobs data and from the declining US labor force participation rate. The participation rate is not falling because consumer incomes are rising and fewer family members are needed in the work force. The rate is falling because discouraged workers have given up looking for employment and have left the work force.

The use of foreign labor in place of US labor is beneficial to executives and shareholders in the short-run, but it is detrimental in the longer-run. The long-run effect is to destroy the US consumer market.

When jobs offshoring halted the rise in US consumer income, in order to keep the economy going the Federal Reserve substituted a growth in consumer debt for the missing growth in consumer income. For example, the housing bubble created by Federal Reserve chairman Alan Greenspan allowed home owners to spend the inflated equity in their homes by refinancing their mortgages. The substitution of consumer debt for the missing growth in real wages and salaries is limited by the burden of debt on households. Unlike the government, American citizens cannot print the money with which to pay their bills. Once consumers were unable to take on more debt, the consumer economy ceased to expand.

The government can print money with which to pay its bills, but if history is a guide, governments cannot forever print money without serious consequences. The real economic crisis will hit when the bubble economy can no longer be supported by the printing press.

It should be obvious to economists, but apparently is not, that Walmart-type jobs of the "New Economy" do not pay sufficiently to support a consumer-dependent economy. As

Obamacare is phased in, consumer purchasing power will suffer another blow. Even the subsidized premiums are expensive, and the cost of using the policies in terms of deductions and co-pays will be prohibitive for most. As employer-provided benefits and Medicare are cut back, the health care crisis will worsen in the midst of an economic crisis.

The scary part of the pending economic crisis occurs when the federal budget deficit widens as the economy contracts and the Fed finds itself in a situation where it cannot print yet more dollars without causing a loss in confidence in the dollar and US Treasury bonds. What does a desperate government do in such a situation? It confiscates what remains of private pensions, piles on taxes, and drives the people and the economy deeper into the ground.

This is the path that US economic policy is on. What is the solution?

Capitalism could be allowed to work and the banks to fail. It is cheaper to bail out depositors than to bail out the banks.

Corporations could be taxed on the basis of the geographical location at which value is added to their product. If corporations create the goods abroad that they market to Americans, they would have a high tax rate. If they create value domestically with US labor, they would have a low tax rate. The tax difference could be used to offset the labor cost advantage of offshored production.

It would take time, but jobs would come back to the US. Cities, states, and the federal government would slowly see their tax bases rebuilt. Consumer incomes would again rise with productivity, and the economy could be put back together.

As for the federal deficit, it could be significantly reduced by ending Washington's wars. As various experts have established, these wars are extremely expensive, adding trillions of dollars to the financing needs of the US government. As other experts have shown, the wars do not benefit anyone but a narrow clique of military/security industries. Obviously, it is not democratic to destroy a people's future for the sake of special interests.

Can these solutions be implemented or are the entrenched special interests too strong and too short-sighted?

There is no prospect of finding out when the financial press and economic commentators are immune to reality. Until the real situation is understood, nothing can be done. It is difficult to sell a solution when the problem is not recognized and understood. That is why I focus on explaining the problems.

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