# Impending Destruction of the US Economy

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Hubris and arrogance are too ensconced in Washington for policymakers to be aware of the economic policy trap in which they have placed the US economy. If the subprime mortgage meltdown is half as bad as predicted, low US interest rates will be required in order to contain the crisis. But if the dollar's plight is half as bad as predicted, high US interest rates will be required if foreigners are to continue to hold dollars and to finance US budget and trade deficits.

Which will Washington sacrifice, the domestic financial system and over-extended homeowners or its ability to finance deficits?

The answer seems obvious. Everything will be sacrificed in order to protect Washington's ability to borrow abroad. Without the ability to borrow abroad, Washington cannot conduct its wars of aggression, and Americans cannot continue to consume $800 billion dollars more each year than the economy produces.

A few years ago the euro was worth 85 cents. Today it is worth $1.48. This is an enormous decline in the exchange value of the US dollar. Foreigners who finance the US budget and trade deficits have experienced a huge drop in the value of their dollar holdings. The interest rate on US Treasury bonds does not come close to compensating foreigners for the decline in the value of the dollar against other traded currencies. Investment returns from real estate and equities do not offset the losses from the decline in the dollar's value.

China holds over one trillion dollars, and Japan almost one trillion, in dollar-denominated assets. Other countries have lesser but still substantial amounts. As the US dollar is the reserve currency, the entire world's investment portfolio is over-weighted in dollars.

No country wants to hold a depreciating asset, and no country wants to acquire more depreciating assets. In order to reassure itself, Wall Street claims that foreign countries are locked into accumulating dollars in order to protect the value of their existing dollar holdings. But this is utter nonsense. The US dollar has lost 60% of its value during the current administration. Obviously, countries are not locked into accumulating dollars.

The reason the dollar has not completely collapsed is that there is no clear alternative as reserve currency. The euro is a currency without a country. It is the monetary unit of the European Union, but the countries of Europe have not surrendered their sovereignty to the EU. Moreover, the UK, a member of the EU, retains the British pound. The fact that a currency as politically exposed as the euro can rise in value so rapidly against the US dollar is powerful evidence of the weakness of the US dollar.

Japan and China have willingly accumulated dollars as the counterpart of their penetration and capture of US domestic markets. Japan and China have viewed the productive capacity and wealth created in their domestic economies by the success of their exports as compensation for the decline in the value of their dollar holdings. However, both countries have seen the writing on the wall, ignored by Washington and American economists: By offshoring production for US markets, the US has no prospect of closing its trade deficit. The offshored production of US firms counts as imports when it returns to the US to be marketed. The more US production moves abroad, the less there is to export and the higher imports rise.

Japan and China, indeed, the entire world, realize that they cannot continue forever to give Americans real goods and services in exchange for depreciating paper dollars. China is endeavoring to turn its development inward and to rely on its potentially huge domestic market. Japan is pinning hopes on participating in Asia's economic development.

The dollar's decline has resulted from foreigners accumulating new dollars at a lower rate. They still accumulate dollars, but fewer. As new dollars are still being produced at high rates, their value has dropped.

If foreigners were to stop accumulating new dollars, the dollar's value would plummet. If foreigners were to reduce their existing holdings of dollars, superpower America would instantly disappear.

Foreigners have continued to accumulate dollars in the expectation that sooner or later Washington would address its trade and budget deficits. However, now these deficits seem to have passed the point of no return.

The sharp decline in the dollar has not closed the trade deficit by increasing exports and decreasing imports. Offshoring prevents the possibility of exports reducing the trade deficit, and Americans are now dependent on imports (including offshored production) for which there are no longer any domestically produced alternatives. The US trade deficit will close when foreigners cease to finance it.

The budget deficit cannot be closed by taxation without driving up unemployment and poverty. American median family incomes have experienced no real increase during the 21st century. Moreover, if the huge bonuses paid to CEOs for offshoring their corporations' production and to Wall Street for marketing subprime derivatives are removed from the income figures, Americans have experienced a decline in real income. Some studies, such as the Economic Mobility Project, find long-term declines in the real median incomes of some US population groups and a decline in upward mobility.

The situation may be even more dire. Recent work by Susan Houseman concludes that US statistical data systems, which were set in place prior to the development of offshoring, are counting some foreign production as part of US productivity and GDP growth, thus overstating the actual performance of the US economy.

The falling dollar has pushed oil to $100 a barrel, which in turn will drive up other prices. The falling dollar means that the imports and offshored production on which Americans are dependent will rise in price. This is not a formula to produce a rise in US real incomes.

In the 21st century, the US economy has been driven by consumers going deeper in debt.

Consumption fueled by increases in indebtedness received its greatest boost from Fed chairman Alan Greenspan's low interest rate policy. Greenspan covered up the adverse effects of offshoring on the US economy by engineering a housing boom. The boom created employment in construction and financial firms and pushed up home prices, thus creating equity for consumers to spend to keep consumer demand growing.

This source of US economic growth is exhausted and imploding. The full consequences of the housing bust remain to be realized. American consumers lack discretionary income and can pay higher taxes only by reducing their consumption. The service industries, which have provided the only source of new jobs in the 21st century, are already experiencing falling demand. A tax increase would cause widespread distress.

As John Maynard Keynes and his followers made clear, a tax increase on a recessionary economy is a recipe for falling tax revenues as well as economic hardship.

Superpower America is a ship of fools in denial of their plight. While offshoring kills American economic prospects, "free market economists" sing its praises. While war imposes enormous costs on a bankrupt country, neoconservatives call for more war, and Republicans and Democrats appropriate war funds which can only be obtained by borrowing abroad.

By focusing America on war in the Middle East, the purpose of which is to guarantee Israel's territorial expansion, the executive and legislative branches, along with the media, have let slip the last opportunities the US had to put its financial house in order. We have arrived at the point where it is no longer bold to say that nothing now can be done. Unless the rest of the world decides to underwrite our economic rescue, the chips will fall where they may.

Dr. Roberts was Assistant Secretary of the US Treasury for Economic Policy in the Reagan administration. He is credited with curing stagflation and eliminating "Phillips curve" trade-offs between employment and inflation, an achievement now on the verge of being lost by the worst economic mismanagement in US history.



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