The Dismal Economic Outlook For The New Year.

By Dr. Paul Craig Roberts
Global Research, January 07, 2012
paulcraigroberts.org/ 7 January 2012

Region: USA
Theme: Global Economy

Visit Dr. Paul Craig Roberts new webiste at http://www.paulcraigroberts.org

Jobs offshoring, financial deregulation, and ten years of wars have severely damaged the US economy and the economic prospects of 90% of the American population. The signs are everywhere in front of our eyes. They are in the income distribution data, the BLS jobs data, the Census data, the poverty figures, and the high number of food stamp recipients.

The signs are in the foreclosed and boarded up homes and the accompanying homelessness. They are in closed strip malls, in office building, warehouse, and shopping mall vacancies, and in the huge population losses of America's manufacturing cities.

The New Economy was a hoax, like Saddam Hussein's "weapons of mass destruction" and the "war on terror." Americans were deceived by "their" corrupt government, by greed-driven corporations, and by corporate shills among economists and the pundit class into believing that they were trading middle class "dirty fingernail" jobs in manufacturing for better middle class "clean fingernail" high-tech service jobs. Instead, reasonably paid manufacturing and professional skill jobs, such as software engineering and information technology, were traded for lowly paid jobs as waitresses and bartenders and for jobs in ambulatory health care.

Consequently, real median US income fell for the vast majority of the population. To keep consumers spending when they had no raises, the Federal Reserve used low interest rates to create a real estate and credit bubble. The low interest rates drove up housing prices, and Americans refinanced their mortgages and spent the equity in their homes. Americans maxed out credit cards. The rise in consumer indebtedness kept consumer demand growing and the economy afloat.

But there is a limit to how far debt can outpace income, and the bubble burst. And when it burst the financial fraud that had been hidden in the euphoria was revealed. That set off the financial crisis.

As the US government is controlled by financial and armaments interests and not by the people, the government responded to the financial crisis by shoveling more debt and more hardships on the American people in order that financial interests did not have to pay for their own mistakes and crimes. Instead of blaming the responsible parties, "our" government handed the bill to the American people.

An important part of the bill is the huge number of new dollars being created in order to keep "banks too big to fail" afloat and in order to finance the federal government's enormous budget deficit from its illegal wars. Sooner or later, the proliferation of dollars will cost the American people sharply higher prices.

We will return to the dollar crisis later in this column. First, lets look at what the loss of manufacturing and manufacturing related jobs have done to the economy and the prospects of US citizens.

In the first decade of the 21st century, Detroit, Michigan, lost 25% of its population. Gary, Indiana, lost 22%. Flint, Michigan, lost 18%. Cleveland, Ohio, lost 17%. In St. Louis, Missouri, 19% of the housing is vacant. These population losses were not the result of the Black Plague or killer viruses or a nuclear attack. They were the result of corporate CEOs, pushed by their own greed, by the greed of Wall Street and that of large retailers such as Wal-Mart, aided and abetted by "our" government, into moving millions of manufacturing, software engineering, information technology, engineering, research, development, and design jobs offshore.

The process of moving American jobs offshore left cities, counties, and states with shrunken tax base.The resulting state and local budget deficits are being used to dismantle public sector unions and to cut social services. Public assets, such as water companies, and future income streams from parking meters, toll roads and bridges, are being sold off to foreign buyers in order to insure another year of local and state government solvency.

In the first decade of the 21st century, Americans lost 5,500,000 manufacturing jobs. US employment in the manufacture of computer and electronic products fell by 40%; in the production of machinery by 30%, in motor vehicles and parts by 44%, and in the manufacture of clothing by 66%.

In other words, in ten years the US economy was decimated by jobs offshoring for the sole purpose of higher rewards to capital in the form of multi-million dollar executive bonuses and large shareholder capital gains. A few hedge fund executives were paid a billion dollars in annual renumeration and a couple of dozen of them were paid $500 million in annual compensation. What sense does that make? Huge fortunes paid for one year's work, not in productive activity but in destroying the financial system and the value of pensions that tens of millions of Americans had worked their lives to achieve.

While this was happening, "our" government squandered several trillion dollars in Iraq and Afghanistan on wars based on lies and deception. The American people were lied to and deceived, and continue to be, in order that arms industries can enjoy record profits and in order that crazed neoconservative war criminals could pursue their ideology of world hegemony and empire. We were even lied to about US war casualties. As Dennis Loo points out in his book, Globalization and the Demolition of Society (2011), the 4,801 Americans killed in action in Iraq leaves out the 50,000 suicides of veterans and active duty US troops. The truth of the matter is that the casualties of the Iraq war are as high as those of the Vietnam war.

With all income gains redirected to the financial and war sectors, the distribution of income in the US has become, according to the Organization for Economic Co-operation and Development (OECD), the worst of all developed countries. The Central Intelligence Agency — yes, the CIA — concluded that America had achieved not only the worst income distribution of all developed countries but also a worst income distribution than Iran, Cambodia, Uganda, Nicaragua, Russia, and China.

The economic "recovery" that Washington and the financial press hype is all talk and no reality. The "recovery" is produced by understating the inflation rate, which overstates GDP growth, and by dropping the long-term unemployed out of the measurement of unemployment. An economy, the driving engine of which has been moved offshore, cannot recover unless the economy is brought back home, and that requires the repeal of Globalism.

Overstatement is common in order to produce good news, but eventually it catches up with the spinmeisters. Last month the National Association of Realtors reported that it had overstated home sales by 3.5 million. Statistician John Williams (shadowstats.com) reports that the "birth/death" model, which the Bureau of Labor Statistics uses to estimate the net affect on jobs data of unreported business closures and new start-ups, overstates the annual number of new jobs during troubled economic times by approximately one million jobs annually. Each year the accumulated monthly overstatements are quietly revised away by BLS.

Similarly, data can be understated in order to hide bad news. The understatement of inflation results from basing the Consumer Price Index (CPI) on substitution rather than on a fixed basket of goods, the traditional method. During the "progressive" Clinton regime, a deceptive change was made to the CPI. If the price of a good rises, for example, sirloin steak, the higher price does not appear in the index. Instead, the CPI assumes that consumers switch from sirloin to a cheaper cut, such as round steak. Thus, the rise in prices is negated by substituting goods that represent a lower standard of living.

By understating inflation, the government has been able to produce a "recovery," when in fact the positive economic growth number is created by counting inflation or nominal GDP growth as real GDP growth. John Williams says that when inflation is measured in the old way, prior to Clinton, the US has experienced essentially no real GDP growth in the 21st century. In other words, we have had a decade of essentially no growth in the GDP while the presstitutes in the media proclaim "recovery."

The government's forecasts of its budget deficits are based on the assumption that an economic recovery is underway. If in fact there is no recovery and the economy is about to worsen, the trillion dollar plus deficits that the government forecasts for as far as the eye can see will be even larger. As more debt creation likely means more money creation by the Federal Reserve, the future purchasing power of the US dollar appears to be dismal.

The federal government's reckless issuance of debt in order to finance its hegemonic wars and the Federal Reserve's misuse of its authority to create $16.1 trillion in secret loans to US and European banks (as revealed by the GAO audit of the Fed) have created an enormous number of new dollars. In addition, financial deregulation has resulted in banks creating paper claims on real assets that far exceed the value of the underlying real assets. This is an untenable situation. How is it likely to be resolved?

This is a two-part question: there is the banks' debt and there is the federal government's debt. Both are serious problems.

Mortgage-backed derivatives exceed the value of the homes, and Credit Default Swaps and other financial innovations have resulted in the paper claims on assets exceeding the value of the underlying real assets. Consider Credit Default Swaps, a form of unreserved "insurance." Investors, really speculators, do not have to own a Greek government bond or a mortgage-backed derivative in order to purchase a "swap" that insures its value. Thus, the total value of swaps issued on Greek bonds, for example, can far exceed the total value of Greek bonds. The value of swaps issued on mortgage-backed securities can exceed the total value of mortgaged real estate.

Financial institutions, such as US banks, that sold "swaps" on Greek bonds were gambling that Greece would be bailed out and would not default. The financial institutions regarded as gravy the fees paid to them for "guarantees" on which they cannot make good. I don't know the extent of swaps on sovereign debt, but I recently saw a report that the Bank of America alone has sold $2.1 trillion in swaps on sovereign debt. Imagine the crisis if the Bank of America had to pay off these swaps.

Obviously, if European sovereign debt blows up, the US financial crisis will become deeper.

The GAO audit of the Federal Reserve showed that the Fed made secret loans to banks of $16.1 trillion between December 2007 and June 2010. To put that figure in perspective, it is larger than the US GDP and larger than the US public debt. In other words, it took a tremendous amount of new money to keep the financial system from collapsing. Despite this huge sum pumped into the banking system, the banks are still regarded as weak and troubled. The insecurity of bank depositors is reflected in the one basis point interest rate on Treasury bill money funds. Many Americans are willing to receive a negative interest rate in order to have their money in instruments that can be paid off with newly created money.

When the paper claims on assets exceed the value of the underlying assets, one solution could be slow write downs of bad paper over time as the banks' profits permit. This would require suspending the mark-to-market rule and permitting the banks to remain "solvent" by counting bad assets as good until profits permitted write-downs.

This would be a sensible solution if the banks have profitable prospects. But with consumers too indebted and broke to borrow and the consumer market too impaired for good sales prospects for businesses, what profitable prospects do banks have? Only those created by the Federal Reserve's support of the "carry trade," the ability of financial institutions to borrow from the Federal Reserve at essentially zero interest rates and to put the money in Greek and Italian sovereign debt. This is gambling, otherwise known as "casino banking."

If reality rules out the solution of gradual write-downs, all that remains is bankruptcy or inflation. The Federal Reserve and the US government have ruled out permitting the banks to fail. That leaves inflation.

Except for a relatively few indexed Treasury bonds, financial instruments are in nominal values. Thus bad debts can be inflated away by driving up the nominal values of the underlying real assets and the nominal values of wages and salaries. It seems that the path that policymakers are taking is to reduce the purchasing power of money in order to drive up nominal asset values so that they exceed the claims against them.

For example, consider a person with a $200,000 mortgage whose home, if he could sell it, is only worth $175,000. This person's asset is under water. However, if inflation drives up the price of his home to $250,000, the person has gone from a balance sheet $25,000 in the red to one $50,000 in the black. It seems clear that in order to save the financial institutions and itself, the government will sacrifice the purchasing power of the dollar.

Thus, the same solution appears to be in effect for the government's growing debt. For the moment the US dollar is benefitting from flight from the euro due to the hyped sovereign debt crisis in Europe. As in the past, a scared financial world takes refuge in the dollar and in US Treasury debt instruments. The main difference between Greece's indebtedness and America's is that Greece cannot print euros, but the US can print dollars. Thus holders of US debt can always get back the nominal dollar value of Treasury debt issues. Of course, the real purchasing power of these printed dollars can be very low.

The dollar as a refuge is a short-run phenomenon. Once the transfer out of euros into dollars has occurred, how does the Treasury sell the next round of bonds to finance trillion dollar deficits? Sooner or later the Federal Reserve will be back to monetizing the new Treasury bond issues, that is, the Federal Reserve will create new money with which to purchase the new Treasury bond issues.

Sooner or later the new money will find its way into the economy and drive up prices, or the continual monetization of new US Treasury debt will cause the world to lose confidence in the dollar. Heavy sales of US dollars in currency markets would drive down the exchange value of the dollar and raise the prices of imports such as energy, manufactured goods, and food. Either way inflation is the result. Indeed, both can occur together, which is the likely result.

Normally, inflation is associated with a booming economy, but as too much of the US economy has been moved offshore, there is little left to boom other than prices. Therefore, the combination of high inflation with high unemployment is a likely fate that awaits Americans.

I cannot predict how long policymakers can hold economic armageddon at bay with spin, money creation, currency swaps, intervention in gold and silver markets, and outright lies. The onset could be sudden and take place this year, but we shouldn't underestimate the power of spin over a gullible public that trusts "their" government and fervently believes that Muslim terrorists are out to get them and that the demise of the Constitution, the product of a eight hundred year struggle that produced Anglo-American civil liberty, is worth the price of "safety."

There is no safety in a police state and a debauched currency. The comfortable world that Americans have known is falling apart at the seams.

Articles by: **Dr. Paul Craig Roberts**

About the author:

Paul Craig Roberts, former Assistant Secretary of the

US Treasury and Associate Editor of the Wall Street Journal, has held numerous university appointments. He is a frequent contributor to Global Research. Dr. Roberts can be reached at http://paulcraigroberts.org