Time to Change America by Challenging Economic Fundamentals

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Global Research, February 19, 2007
dissidentvoice.org 19 February 2007

Region: USA
Theme: Global Economy

Though headlines are dominated by the war in Iraq, everyone realizes there is something wrong with the US economy. But few have focused on the connection between the two.

It is clear that the post-World War II era of worldwide dollar hegemony is beginning to slip. The ideas of a "New American Century" put forth by Washington-based neocons actually may represent a last-gasp attempt to use military force to hold onto a system whereby the US has supported its domestic economy through trade domination of most of the rest of the world.

But the world has changed. The US produced half the world's GDP in 1950 vs. twenty percent in 2003. The nations of what used to be called the "Third World" are growing up. Increasingly, their vision does not include continuing as dependencies of the IMF, World Bank, and WTO, all of which have become instrumentalities of US corporate/global finance. They include many of the nations of mainland Asia, the Islamic world, Africa, and Latin America. There is also a resurgent Russia.

US dogmas cause us to view these changes as hostile and ideological, even as a "clash of civilizations." It is this way of thinking, rather than viewing other nations and regions as having their own legitimate aspirations, that is contributing toward the possibility of a larger conflagration.

The US military-industrial complex, along with the Council on Foreign Relations and similar institutions, suggests that to reach for "full-spectrum dominance" is a sign of strength. Rather it is a weakness, showing a broad-spectrum failure to devise rational, humane, and multilateral solutions to trade and economic issues. History shows that the economic costs of imperial conquest usually outweigh the benefits. The British Empire, for instance, fell apart after Britain bankrupted itself fighting World War I.

But the tragedy that is calling to the US with its siren song of wealth, power, and glory might be averted if we change the way we think about economic fundamentals.

In this article, I will examine the unfolding disaster, starting with our domestic economy, then propose solutions based on the best thinking of cutting edge movements. Political progressives should take these ideas seriously. By a "political progressive," I mean anyone who wants to solve the deepening crisis without a major war.

Amid claims that Federal Reserve Chairman Ben Bernanke has engineered a "soft landing" by holding interest rates steady after the downturn of the housing market, he told the Senate Banking Committee on February 14, "The current stance of policy is likely to foster sustainable economic growth and a gradual ebbing of core inflation." But the sense of middle class voters that their standard of living is on a slippery slope downward was a factor in the Democrats' regaining control of Congress last November. This sense is not going away, because it's the result of trends over the last decade. Bernanke said nothing to the Senate on February 14 or to a House committee the next day to allay these concerns.

In his response to President George W. Bush's January 23 State of the Union address, freshman Senator James Webb of Virginia actually put the health of the economy first before discussing problems with the war. Webb said that, "Wages and salaries for our workers are at all-time lows as a percentage of national wealth, even though the productivity of American workers is the highest in the world." He added, "In short, the middle class of this country, our historic backbone and our best hope for a strong society in the future, is losing its place at the table."

While the economy grew 3.4% in 2006, the unemployment rate moved higher in January 2007, with manufacturing employment declining for the seventh straight month. The US household savings rate was negative again last year. What this means is that we are still in a "jobless recovery," with consumers taking on even more debt. According to economist Michael Hudson, the money that is sucked out of the economy when people pay interest on loans is being recycled by the banks for more loans, not invested in the producing economy. The debt pyramid is suffocating normal economic activity.

The Bush administration's strategy of Reagan-style supply-side tax cuts for the upper brackets, while the private sector replaces manufacturing occupations with low paying service jobs, has been a political loser. So was the Federal Reserve's attempt to float the economy by pumping in cash through lower long-term interest rates, a failed policy which resulted in asset inflation but is terminating in the deflating housing bubble.

Like soaring costs for higher education and health care, the housing inflation is eating away at the incomes of the middle class, after their initial delight from the cash realized by house-flipping and refinancing. Foreclosures and bankruptcies, made more arduous by the 2005 "reforms" enacted by Congress at the urging of the credit card industry, are soaring as ARM monthly payment increases kick in. Governments which saw tax windfalls from the housing boom are feeling the pinch from falling revenues due to the slowdown.

It is notorious that the federal government is staying afloat only through the purchase of Treasury debt by foreign central banks, chiefly those of China and Japan. On top of this are the astronomical costs of the failing Iraq/Afghan wars and the botched Katrina clean-up. Matters look even worse with President Bush's proposed FY 2008 budget, with sharply increased spending for defense and veterans' benefits and 9.3 percent growth in interest on the national debt. Social services for the most vulnerable Americans will be cut by twelve percent, and proposed reductions for health care are being called "devastating" by the American Hospital Association. The federal deficit is still projected at $250 billion.

Yet it's the best of times for the wealthiest class of Americans whose main financial problem is angst over where to park their surplus cash. It's the same for a banking industry whose wealth is multiplied by its ability to create and profit from liquidity from its fractional reserve lending privileges. While huge federal deficits from tax cuts and the Iraq War spill government red ink, they add to the banking system's reserve lending base and spread dollar hegemony abroad.

It’s also no problem for consumers to continue to get unsecured loans or run up huge charges on their credit cards. But while corporate profits have not been impressive, the glut of capital has kept stock prices high, with businesses taking advantage of productivity gains without raising wages. Meanwhile, the average wage and salary earner is steadily falling behind as debt payments come due and new loans must be taken out to pay down the old ones. Bernanke says debt is not a problem because bankruptcies are not increasing, without noting that 2005 “reform” legislation made the criteria for bankruptcy declaration much more onerous and excluded student loans from eligibility for debt relief.

What gives the situation urgency is the dilemma federal policymakers now face with the value of the dollar. If it continues to slide — the euro is now at $1.32 against the dollar vs. $1.18 two years ago — foreign investors will continue to dump them as a reserve currency, leaving the US with no way to finance its enormous trade and fiscal deficits. On February 14, the day of Bernanke’s House testimony, CNBC reported that foreign purchase of Treasury securities for December 2006 was at its lowest level for five years. On the other hand, if the government shores up its public and private debt through higher interest rates, millions of ordinary people could be worse off and even lose their homes and jobs.

The Iraq war is making things worse. The unspoken essence of the Bush administration’s war policy is to prop up the domestic economy through control of Middle Eastern resources. The policy is on the brink of disaster because even if we “win,” the costs are no longer sustainable. The total likely cost of the Iraq War has been estimated at $2 trillion. It we attack Iran, it will be much higher. It’s that much more money the government will have to borrow.

The solutions to the economic side of the problem proposed by the Democratic leadership in Congress would only nibble around the edges.

Their proposals include trying to roll back some of the Bush tax cuts for the wealthy, somewhat lower interest rates for college loans, vaguely-worded encouragement of technological innovation, raising the federal minimum wage to a slightly less-onerous plateau of poverty, cheaper prescription drugs under Medicare, collection of unpaid taxes, and federal fiscal discipline.

But these measures, even if any could be passed and were signed into law by President Bush, would only make life a little easier for the eighty percent of Americans who are struggling to compete in what is a fractured trickle-down economy. The only proposal that would help ameliorate the bubble economy would be to reverse Bush’s tax cuts.

Something has to give. Even Paul Volcker has said the economy is on thin ice due to non-existent household savings. Warnings have come from the International Monetary Fund about the dire effects of the US housing crash. Some even speak of a worldwide recession or depression or of a “controlled” disintegration of national economies.

We indeed may see epochal changes. We are at the end of the era of monetarism, where Federal Reserve monetary targeting was implemented by free market ideologues frustrated with the stagnation of New Deal and post-World War II central government planning strategies.

The Keynesianism from those days and the monetarism that followed each lasted a full generation. But as noted earlier, the world has changed, especially with the rise of the huge

Asian economies of China and India. We must now search for the principles and mechanisms that can work in a world no longer dominated by the Western victors of World War II, where domestic production is stagnant, and where financial bubbles distort measures of real value.

So what is the next big idea that can truly make a difference, and will it serve or undermine political and economic democracy?

One truly big — and bad — idea that is being pushed by economists with ties to the Federal Reserve (see the July/August Journal of the Federal Reserve Bank of St. Louis) is to open the floodgates to large-scale purchase of our domestic assets by China, which may want to use its massive dollar reserves to buy up real estate and businesses within the US

The Chinese tried this a couple of years ago, when it took White House intervention to block the purchase of Unocal by the Chinese government's oil agency. China is also using its US dollars to make loans to African nations and is gaining economic leverage on that continent as well as in Latin America. It appears that dollar hegemony has finally backfired and is starting to undermine national security. This is one reason observers assume the US military views China as a potential adversary.

The entire domestic and international economic system now has to be questioned. A slightly higher federal minimum wage is not enough. Neither is making it a little more affordable for young Americans to go to college if there are insufficient jobs waiting when they get out. Nor are welfare-to-work programs that generate a few more jobs at the poverty level the answer.

It's also time to realize that the problems cannot be solved by enhancing the ability of the US economy to compete in the international marketplace because every other nation obviously has the same objective.

Rather a solution, as put forth by the Asia Times, among others, may be a new worldwide focus on internal economic development. In the US, this could start with attention to our crumbling physical infrastructure — schools, hospitals, roads, mass transit, levee repair, electricity-generation, water and sewage systems, etc.

We must also address the threat from global warming and mobilize our R&D capability to break our dependence on oil, as outlined by the Rocky Mountain Institute in a 2005 report funded partly by the Defense Department: Winning the Oil Endgame: Innovation for Profits, Jobs, and Security. The report states that the technology exists today, not only for alternative energy, but also for a highly accelerated program of oil conservation. Such measures could be implemented through a meaningful government commitment, one which we have yet to see, despite the political rhetoric. Military R&D still outweighs energy research in the federal budget by a factor of 37:1.

How to shift focus in these new directions is what Congress should now be debating. As always, the question is: how to pay for it?

One way would be serious tax reform, not only by eliminating the Bush tax cuts, but also by heavily taxing non-productive asset transactions through restoration of higher capital gains taxes, shutting down offshore tax havens, a universal land-use tax on rents and mineral rights, or higher taxes on earnings from privatized public utilities and interest.

These would all be taxes aimed at the financial sector which rarely invests in real production but instead floats the speculative bubbles. These taxes would also attack value-less inflation of those assets and would lower the increasingly onerous tax burden on workers and the middle class.

If progressives looked at alternative monetary theories they would also find tools that could make a difference, as the American Monetary Institute (AMI) is proposing with its draft American Monetary Act. AMI questions the dogma that government expenditures can be paid for only through taxation or debt. One provision of the act would permit selected instances of direct spending of currency into circulation as was done with the Greenbacks during the Civil War, as President Roosevelt was authorized to do during the Great Depression, and as the British/Canadian Social Credit movement has advocated for decades.

Also, Congressmen Steven LaTourette (D-OH) and Dennis Kucinich (D-OH) have introduced legislation for a Federal Infrastructure Modernization Bank that would use existing Treasury funds on deposit at the Federal Reserve to make available $50 billion a year in interest-free loans for state and local infrastructure projects. Of course $50 billion would be a drop in the bucket. Such legislation would be much more effective if it allowed such a bank to multiply its capital by the same fractional reserve lending authority enjoyed by private sector institutions.

And writing in a 2006 article in The Progressive entitled “Our Sinful Economy,” editor Matthew Rothschild has proposed a guaranteed annual income for all citizens, an idea supported in the past by such disparate figures as Dr. Martin Luther King, Jr., and Milton Friedman. Legislation entitled “A Tax Cut for the Rest of Us,” written by members of the US Basic Income Guarantee Network, was introduced last year by Representative Bob Filner (D-CA) as H.R. 5257.

The legislation would transform the tax code’s standard deduction and personal exemptions into a refundable credit of $2,000 for each adult and $1,000 for each child, even if a person had no reportable income. The credit would be a first step toward a true basic income guarantee that could eliminate the scourges of poverty and homelessness that give the lie to every politician who claims our economy is either fair or fundamentally sound. Peace in the Middle East could immediately cut defense expenditures by a third, which alone could pay for “A Tax Cut for the Rest of Us.”

What these taxation and monetary reform proposals have in common is that they show how a developed national economy can pull itself up by its own bootstraps through central control of monetary resources rather than relying on massive deficits or exploitation of other nations through trade. Such resources would be invested or spent for tangible goods and services, not for paper wealth like financial securities. The workers, salary earners, and businesses of the producing economy would be protected from financial bubbles. It’s the way the US became an economic powerhouse in the first place.

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