Somber Thoughts for the New Year Will There be a Recovery?

By Global Research
Global Research, January 06, 2009
Counterpuunch.org 6 January 2009

Region: USA
Theme: Global Economy

Economists will scoff at the question in the title. But that's because they are trying to fit the present into the past.

In the past recoveries were routine, because recessions were temporary restraints resulting from the Federal Reserve putting the brakes on an overheating economy. By restraining the supply of money and credit, the Fed caused inventory buildup, layoffs, and a halt to price rises and union wage demands. With the economy cooled by unemployment, the Fed would take off the brakes. Interest rates would decline, money would flow, consumer demand would rise and workers would be called back to the factories.

In those days when workers borrowed to spend, they were borrowing against rising real wages from rising productivity. In economic downturns, few workers actually lost their jobs. They were laid off from their jobs for temporary periods. Workers seldom lost their homes or cars, thanks to union funds and unemployment benefits.

Today the situation is different. In the 21st century real wages have not risen. Workers have spent more by accepting deteriorating household balance sheets. They have maxed out their credit cards and spent the equity in their homes. Imitators of the US government, American consumers borrow to pay their bills.

The expansion of household debt relative to income created the illusion that the economy was sound. But the consumer economy was as much of a credit-based bubble as the real estate bubble and the financial sector bubble. The economy has lost its real basis.

Today it is difficult to stimulate consumer demand by lowering interest rates. Consumers are too heavily in debt to borrow any more. Financial institutions are too impaired to want to lend to anyone except those who don't need to borrow. As the Keynesian macroeconomists used to say, "you can lead a horse to water, but you can't make him drink."

And there's another problem. Much of what American consumers purchase today is made offshore. Stimulating consumer demand in America puts factories back to work, but those factories are located elsewhere in the world.

How does an economy consume more than it produces? Previously, this question applied only to poor third world countries. These countries would consume by the grace of World Bank loans. From time to time they would pay for their consumption by being put through an IMF restructuring program that would curtail their consumption to make them repay their loans by forced saving.

The United States has so far avoided such humiliation, because its currency is the world money. The US has been able to borrow endlessly, because it can pay its debts in its own currency.

This ability might be coming to an end. The US has been using up the bulk of the world's supply of saving for years in order to finance its consumption. Considering the outlook for the US economy and dollar, the productive nations of the world and those with oil have more dollars and dollar-denominated assets than they want. The US, with its collapsing economy, its bailouts of financial institutions, and its wars, is facing the largest government budget deficit in its history, both in absolute amount and as a percentage of national income. The easy monetary policy, which the Fed hopes will arrest deflation, threatens inflation and further deterioration in the dollar. Foreigners simply do not want to lend more large sums to a country that, from all appearances, has no way to close its trade and budget deficits. They certainly do not want to lend when the interest rate offered is close to zero and the reserve currency status of the dollar is in doubt.

Economists and the policy-makers they advise are thinking in the past, a time when low interest rates stimulated consumer and investment demand, thus lifting the economy. Today the low interest rates threaten the dollar, discourage foreigners from lending more to the US, and deprive Americans of interest income necessary to their ability to pay their bills.

In the second half of the 20th century, American economic supremacy was a gift of World War II, which destroyed the productive capacity of the rest of the developed world. American economic supremacy also owes much to communism in Russia and China and to socialism in India, which rendered these large countries economically impotent. The United States did not have to compete for its economic hegemony. It simply inherited it from the choices made by the rest of the world.

The situation is different today. Unlike the US, other countries are free of the hubris of being the "indispensable nation." They know how hard it is to be successful and do not treat success as their birthright. They do not give away their economy for nebulous foreign policy goals or for short-term profits. They look ahead 20, 30 years while America's CEOs look to the next quarter's profits.

The United States is walking on quicksand. It is dependent on foreigners for the funding to conduct the day-to-day operations of its government. Its economy is a hollow shell reduced to dependence on a financial sector that is discredited worldwide. America's government believes that its foreign wars of aggression are more important than any domestic needs, including the health care of its population.

Now that its supply route to feed its war of aggression in Afghanistan is threatened, the American government has the delusion that it will be able to supply its army in Afghanistan through thousands of miles of Eastern Europe, Russia, and Central Asia. Only a government totally oblivious to reality would imagine that Russia's Putin, whose nose is rubbed in excrement every day by the US government, will permit America to transit Russian territory to resupply US imperial legions in Afghanistan.

What we are witnessing is a once great power engaging in fantasy to disguise from itself that it is a failed state.

Paul Craig Roberts was Assistant Secretary of the Treasury in the Reagan administration. He

is coauthor of The Tyranny of Good Intentions.He can be reached at: PaulCraigRoberts@yahoo.com