

Why the Emperor has no Clothes

Decline of the US Dollar: Who Benefits?

By [Andre Gunder Frank](#)

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Uncle Sam has reneged and defaulted on up to 40% of its trillion-dollar foreign debt, and nobody has said a word except for a line in The Economist. In plain English that means Uncle Sam runs a worldwide confidence racket with his self-made dollar based on the confidence that he has elicited and received from others around the world, and he is also a deadbeat in that he does not honor and return the money he has received.

How much of our dollar stake we have lost depends on how much we originally paid for it. Uncle Sam let his dollar fall, or rather through his deliberate political economic policies drove it down, by 40%, from 80 cents to the euro to 133 cents. The dollar is down by a similar factor against the yen, yuan and other currencies. And it is still declining, indeed is apt to plummet altogether.

There was also a spate of competitive devaluations in the 1930s, called the “beggar thy neighbor policy” of shifting the costs for the neighbors to bear. True, as the dollar has declined, so has the real value that foreigners pay to service their debt to Uncle Sam. But that works only if they can themselves earn in currencies that have increased in value against the dollar. Otherwise, foreigners earn and pay in the same devalued dollars, and even then with some loss from devaluation between the time they got their dollars and the time they repay them to Uncle Sam. China and other East Asian nations do earn in dollars, to which they have pegged their currencies, so they have already lost a substantial portion of their dollar stake, by far the world’s largest.

And they, like all others, will also lose the rest. For Uncle Sam’s debt to the rest of the world already amounts to more than a third of his annual domestic production and is still growing. That alone already makes his debt economically and politically never repayable, even if he wanted to, which he does not. Uncle Sam’s domestic, eg credit-card, debt is almost 100% of gross domestic product (GDP) and consumption, including that from China. Uncle Sam’s federal debt is now US\$7.5 trillion, of which all but \$1 trillion was built up in the past three decades, the last \$2 trillion in the past eight years, and the last \$1 trillion in the past two years. Alas, that costs more than \$300 billion a year in interest, compared with, for example, the \$15 billion spent annually on the National Aeronautics and Space Administration (NASA). But no worries: Congress just raised the debt ceiling to \$8.2 trillion. To help us visualize, \$1 trillion tightly packed up in \$1,000 bills would create a pile 100km high.

But nearly half is owed to foreigners. All Uncle Sam’s debt, including private household consumer credit-card, mortgage etc debt of about \$10 trillion, plus corporate and financial,

with options, derivatives and the like, and state and local government debt comes to an unvisualizable, indeed unimaginable, \$37 trillion, which is nearly four times Uncle Sam's GDP. Only some of that can be managed domestically, but with dangerous limitations for Uncle Sam noted below. That is only one reason I want you to meet Uncle Sam, the deadbeat confidence man, who may remind you of the film *Meet Joe Black*; for as we get to know him better below, we will find that he is also a Shylock, and a corrupt one at that.

The United States is the world's most privileged nation for having the monopoly privilege of printing the world's reserve currency at will and at a cost of nothing but the paper and ink it is printed on. Moreover, by doing so, Uncle Sam can export abroad the inflation he generates by the extra dollars he prints, of which there are already at least three times as many floating around the world as at Uncle Sam's home. Additionally, his is also the only country whose "foreign" debt is mostly denominated in his own world-currency dollars that he can print at will; while most foreigners' debt is also denominated in the same dollar, but they have to buy it from Uncle Sam with their own currency and real goods. So he simply pays the Chinese and others in essence with these dollars that already to begin with have no real worth beyond their paper and ink. So especially poor China gives away for nothing at all to rich Uncle Sam hundreds of billions of dollars' worth of real goods produced at home and consumed by Uncle Sam. Then China turns around and trades these same paper dollar bills in for more of Uncle Sam's paper called Treasury Certificate bonds, which are even more worthless, except that they pay a percent of interest. For as we already noted, they will never be able to be cashed in and redeemed in full or even in part, and anyway have the lost much of their value to Uncle Sam already.

In an earlier essay, I argued that Uncle Sam's power rests on two pillars only, the paper dollar and the Pentagon. Each supports the other, but the vulnerability of each is also an Achilles' heel that threatens the viability of the other. Since then, Iraq, not to mention Afghanistan, has shown confidence in the Pentagon not to be what it was cracked up to be; and with the in-part-consequent decline in the dollar, so has confidence in it and Uncle Sam's ability to use it to finance his Pentagon's foreign adventures (See [Coups d'Etat and Paper Tiger in Washington, Fiery Dragon in the Pacific](#) , which also conjures up the productive growth of China). Additionally we must realize that Uncle Sam's numbers above and below are also all literally relative. So far relations with other countries, in particular with China, still favor Uncle Sam, but they also help maintain an image that is deceptive. Consider the following:

A \$2 toy leaving a US-owned factory in China is a \$3 shipment arriving at San Diego. By the time a US consumer buys it for \$10 at Wal-Mart, the US economy registers \$10 in final sales, less \$3 import cost, for a \$7 addition to the US GDP. ([Blaming 'undervalued' yuan wins votes](#) , Asia Times Online, February 26, 2004)

Moreover, ever-clever Uncle Sam has arranged matters so as to earn 9% from his economic and financial holdings abroad, while foreigners earn only 3% on theirs, and among them on their Treasury Certificates only 1% real return. Note that this difference of 6 percentage points is already double what Uncle Sam pays out, and his total 9% take is triple the 3% he gives back. Therefore, although foreign holdings and Uncle Sam's are now about equal, Uncle Sam is still the big net interested winner, just like any Shylock, but no other ever did so grand a business.

But Uncle Sam also earns quite well, thank you, from other holdings abroad, eg from service payments by mostly poor foreign debtors. The sums involved are not peanuts or even small potatoes. For from his direct investments in foreign property alone, Uncle Sam's profits now equal 50%, and including his receipts from other holdings abroad now are a full 100% of profits derived from all of his own domestic activities combined. These foreign receipts add more than 4% to Uncle Sam's national domestic product. That helps nicely to compensate for the failure of domestic profits as yet to recover even their 1972 level, because Uncle Sam has failed to boost productivity sufficiently at home.

The productivity hype of president Bill Clinton's "new economy" in the 1990s was limited to computers and information technology (IT), and even that proved to be a sham when the dot-com bubble burst. Also, not only the apparent increase in "profits" but also that of "productivity" were, at the bottom, on the backs of shop-floor, office and sales-floor workers working harder and longer hours and, at the top, the result of innovative accounting shams by Enron and the like. Such factors still compensate for and permit much of Uncle Sam's \$600-billion-and-still-rising trade deficit from excess home consumption over what he himself produces. That is what has resulted in the multitrillion-dollar debt. Exactly how large that debt is Uncle Sam is reluctant to reveal, but what is sure is that it is by far the world's largest, even as net debt to foreigners, after their debt to him is deducted.

How has all this come about?

The simple answer is that Uncle Sam, who is increasingly hooked on consumption, not to mention harder drugs, saves no more than 0.2% of his own income. The Federal Reserve's guru and now you see it, now you don't doctor of magic, Alan Greenspan, recently observed that this is so because the richest 20% of Americans, who are the only ones who do save, have reduced their savings to 2%. Yet even these measly savings (other, poorer countries save and even invest 20%, 30%, even 40% of their income) are more than counterbalanced by the 6% deficit spending of the government. That is what brings the average saving rate to 0.2%. To maintain that \$400-plus-billion budget deficit (more than 3% of national domestic product), which is really more the \$600 billion if we count, as we should, the more than \$200 billion Uncle Sam "borrows" from the temporary surplus in his own Federal Social Security fund, which he is also bankrupting. (But never mind, President George W Bush just promised to privatize much of that and let people buy their own old-age "security" in the ever-insecure market).

So with this \$600-billion-plus budget deficit and the above-mentioned related \$600-billion-plus deficit, rich Uncle Sam, and primarily his highest earners and biggest consumers, as well as of course the Big Uncle himself, live off the fat of the rest of the world's land. Uncle Sam absorbs the savings of others who themselves are often much poorer, particularly when their central banks put many of their reserves in world-currency dollars and hence into the hands of Uncle Sam in Washington, and some also in dollars at home. Their private investors send dollars to or buy dollar assets on Wall Street, all with the confidence that they are putting their wherewithal in the world's safest haven (and that, of course, is part of the above-mentioned confidence racket). From the central banks alone, we are looking at yearly sums of more than \$100 billion from Europe, more than \$100 billion from poor China, \$140 billion from super-saver Japan, and many 10s of billions from many others around the globe, including the Third World. But in addition, Uncle Sam obliges them, through the good offices of their own states, to send their thus literally forced savings to Uncle Sam as well in the form of their "service" of their predominantly dollar debt to him.

His treasury secretary and his International Monetary Fund (IMF) handmaiden blithely continue to strut around the world insisting that the Third – and ex-Second, now also Third – World of course continue to service their foreign debts, especially to him. No matter that with interest rates multiplied several times over by Uncle Sam himself after the Fed's Paul Volcker's coup in October 1979, most have already paid off their original borrowings three to five times over. For to pay at all at interest rates that Volcker boosted to 20%, they had to borrow still more at still higher rates until thereby their outstanding foreign debt doubled and tripled, not to mention their domestic debt from which part of the foreign payments were raised, particularly in Brazil. Privatization is the name of the game there and elsewhere, except for the debt. The debt was socialized after it had been incurred mostly by private business, but only the state had enough power to squeeze the greatest bulk of back payments out of the hides of its poor and middle-class people and transfer them as "invisible service payments" to Uncle Sam.

When Mexicans were told to tighten their belts still further, they answered that they couldn't because they had already had to eat their belts. Only Argentina and for a while Russia declared an effective moratorium on debt "service", and that only after political economic policies had destroyed their societies, thanks to Uncle Sam's advisers and his IMF strong arm. Since then, Uncle Sam himself has been blithely defaulting on his own foreign debt, as he already had several times before in the 19th century.

Speaking of that, it may be well to recall at least two pieces of advice from that time: Lord Cromer, who administered Egypt for then-dominant British imperial interests, said his most important instrument for doing so was Egypt's debts to Britain. These had just multiplied when Egypt was obliged to sell its Suez Canal shares to Britain in order to pay off earlier debts and British prime minister Benjamin Disraeli explained and justified his purchase of the same on the grounds that it would strengthen British imperial interests. Today, that is called "debt-for-equity swaps", which is one of Uncle Sam's latter-day favorite policies to use the debt to acquire profitable and/or strategically important real resources, as of course also was the canal as the way to the jewel of the British Empire, India.

Another piece of practical advice came from the premier military strategist Carl von Clausewitz: make the lands you conquer pay for their own conquest and administration. That is of course exactly what Britain did in and with India through the infamous "Home Charges" remitted to London in payment for Britain administering India, which even the British themselves recognized as "tribute" and responsible for much of "The Drain" from India to Britain. How much more efficient yet to let foreign countries' own states administer themselves but by rules set and imposed by Uncle Sam's IMF and then effect a drain of debt service anyway. Actually, the British therein also set the 19th-century precedent of relying on the "imperialism of free trade" with "independent" states as far and as long as possible, using gunboat diplomacy to make it work (which Uncle Sam had already learned to copy by early in the 20th century); and if that was not enough, simply to invade, and if necessary to occupy – and then rely on the Clausewitz rule.

We shall note several recent instances thereof, and especially the Iraqi one, in the second article in this series.

After I wrote the above, I received by e-mail an excerpt from the Democracy Now! website, titled [Confessions of an economic hit man: How the US uses globalization to cheat poor countries out of trillions](#)

*We speak with John Perkins, a former respected member of the international banking community. In his book *Confessions of an Economic Hit Man* he describes how as a highly paid professional, he helped the US cheat poor countries around the globe out of trillions of dollars by lending them more money than they could possibly repay and then take over their economies ...*

JOHN PERKINS: Basically what we were trained to do and what our job is to do is to build up the American empire. To bring – to create situations where as many resources as possible flow into this country, to our corporations, and our government, and in fact we've been very successful. We've built the largest empire in the history of the world ... primarily through economic manipulation, through cheating, through fraud, through seducing people into our way of life, through the economic hit men. I was very much a part of that ... I was initially recruited while I was in business school back in the late '60s by the National Security Agency, the nation's largest and least understood spy organization ... and then [it] send[s] us to work for private consulting companies, engineering firms, construction companies, so that if we were caught, there would be no connection with the government ...

I became its chief economist. I ended up having 50 people working for me. But my real job was deal-making. It was giving loans to other countries, huge loans, much bigger than they could possibly repay. One of the conditions of the loan – let's say a \$1 billion to a country like Indonesia or Ecuador – and this country would then have to give 90% of that loan back to a US company, or US companies ... a Halliburton or a Bechtel ... A country today like Ecuador owes over 50% of its national budget just to pay down its debt. And it really can't do it. So we literally have them over a barrel. So when we want more oil, we go to Ecuador and say, "Look, you're not able to repay your debts, therefore give your oil companies your Amazon rain [forests], which are filled with oil." And today we're going in and destroying Amazonian rain forests, forcing Ecuador to give them to us because they've accumulated all this debt ... [We work] very, very closely with the World Bank. The World Bank provides most of the money that's used by economic hit men, it and the IMF.

Last but not least, oil producers also put their savings in Uncle Sam. With the "shock" of oil that restored its real price after the dollar valuation had fallen in 1973, ever-cleverer-by-half Henry Kissinger made a deal with the world's largest oil exporter, Saudi Arabia, that it would continue to price oil in dollars, and these earnings would be deposited with Uncle Sam and partly compensated by military hardware. That deal de facto extended to all of the Organization of Petroleum Exporting Countries (OPEC) and still stands, except that before the war against Iraq that country suddenly opted out by switching to pricing its oil in euros, and Iran threatened to do the same. North Korea, the third member of the "axis of evil", has no oil but trades entirely in euros. (Venezuela is a major oil supplier to Uncle Sam and also supplies some at preferential rates as non-dollar trade swaps to poor countries such as Cuba. So Uncle Sam sponsored and financed military commandos from its Plan Colombia next door, promoted an illegal coup and, when that failed, pushed a referendum in his attempt at yet another "regime change"; and now along with Brazil all three are being baptized as yet another "axis of evil").

After writing this, I found that the good (hit) man Mr Perkins was in Saudi Arabia too:

Yes, it was a fascinating time. I remember well ... the Treasury Department hired me and a few other economic hit men. We went to Saudi Arabia ... And we worked out this deal

whereby the Royal House of Saud agreed to send most of their petrodollars back to the United States and invest them in US government securities. The Treasury Department would use the interest from these securities to hire US companies to build Saudi Arabia – new cities, new infrastructure – which we’ve done. And the House of Saud would agree to maintain the price of oil within acceptable limits to us, which they’ve done all of these years, and we would agree to keep the House of Saud in power as long as they did this, which we’ve done, which is one of the reasons we went to war with Iraq in the first place. And in Iraq we tried to implement the same policy that was so successful in Saudi Arabia, but Saddam Hussein didn’t buy. When the economic hit men fail in this scenario, the next step is what we call the jackals. Jackals are CIA-sanctioned people that come in and try to foment a coup or revolution. If that doesn’t work, they perform assassinations. Or try to. In the case of Iraq, they weren’t able to get through to Saddam Hussein. He had – his bodyguards were too good. He had doubles. They couldn’t get through to him. So the third line of defense, if the economic hit men and the jackals fail, the next line of defense is our young men and women, who are sent in to die and kill, which is what we’ve obviously done in Iraq.

To return to the main issue and call a spade a huge spade, all of the above is part and parcel of the world’s biggest-ever Ponzi-scheme confidence racket. Like all others, its most essential characteristic is that it can only continue to pay off dollars and be maintained at the top as long as it continues to receive new dollars at the bottom, voluntarily through confidence if possible and by force if not. (Of course, the Clausewitz and Cromer formulas result in the poorest paying the most, since they are also the most defenseless: so that the ones sitting on/above them pass much of the cost and pain down to them.)

What if confidence in the dollar runs out?

Things are already getting shakier in the House of Uncle Sam. The declining dollar reduces the necessary dollar inflows, so Greenspan needs to raise interest rates to maintain some attraction for the foreign dollars he needs to fill the trade gap. As a quid pro quo for being reappointed by President George W Bush, he promised to do that only after the election. That time has now arrived, but doing so threatens to collapse the housing bubble that was built on low interest and mortgage – and remortgage – rates.

But it is in their house values that most Americans have their savings, if they have any at all. They and this imaginary wealth effect supported over-consumption and the nearly as-high-as-GDP household debt, and a collapse of the housing price bubble with increased interest and mortgage rates would not only drastically undercut house prices, it would thereby have a domino effect on their owners’ enormous second and third remortgages and credit-card and other debt, their consumption, corporate debt and profit, and investment. In fact, these factors would be enough to plummet Uncle Sam into a deep recession, if not depression, and another Big Bear deflation on stock and de facto on other prices, rendering debt service even more onerous. (If the dollar declines, even domestic price inflation is de facto deflationary against other currencies, which Russians and Latin Americans discovered to their peril, and which we observe below.)

Still lower real US investment would reduce its industrial productivity and competitiveness even more – probably to a degree lower than can be compensated for by further devaluing the dollar and making US exports cheaper, as is the confident hope of many, probably including the good Doctor. Until now, the apparent inflation of prices abroad in rubles and pesos and their consequent devaluations have been a de facto deflation in terms of the dollar world

currency. Uncle Sam then printed dollars to buy up at bargain-basement fire-sale prices natural resources in Russia (whose economy was then run on \$100 bills), and companies and even banks, as in South Korea. True, now Greenspan and Uncle Sam are trying again to get other central banks to raise their own interest rates and otherwise plunge their own people into even deeper depression.

But even if he can, thereby also canceling out the relative attractiveness of his own interest-rate hike, how could that save Uncle Sam? What remains the great unknown and perhaps still unknowable is how a more wounded, Ponzi-less Uncle Sam would react with more “Patriotic” acts at home and abroad with the weapons – including the now almost ready “small” nukes – he would still have, even if his foreign victims no longer paid for new ones. So, to compensate for less bread and civil rights at home, an even more patriotic, nay chauvinist, circus at the cost of others abroad is the real danger of the current policies to “defend freedom and civilization”.

So, far beyond Osama bin Laden, al-Qaeda and all the terrorists put together, the greatest real-world threat to Uncle Sam is that the inflow of dollars dries up. For instance, foreign central banks and private investors (it is said that “overseas Chinese” have a tidy trillion dollars) could any day decide to place more of their money elsewhere than in the declining dollar and abandon poor ol’ Uncle Sam to his destiny. China could double its per capita income very quickly if it made real investments at home instead of financial ones with Uncle Sam. Central banks, European and others, can now put their reserves in (rising!) euros or even soon-to-be-revalued Chinese yuan. Not so far down the road, there may be an East Asian currency, eg a basket first of ASEAN + 3 (China, Japan, South Korea) – and then + 4 (India). While India’s total exports in the past five years rose by 73%, those to the Association of Southeast Asian Nations (ASEAN) rose at double that rate and sixfold to China. India has become an ASEAN summit partner, and its ambitions stretch still further to an economic zone stretching from India to Japan. Not for nothing, in the 1997 East Asian currency and then full economic crisis, Uncle Sam strong-armed Japan not to start a proposed East Asian currency fund that would have prevented at least the worst of the crisis. Uncle Sam then benefited from it by buying devalued East Asian currencies and using them to buy up East Asian real resources, and in South Korea also banks, at bargain-basement reduced-price fire sales. But now, China is already taking steps toward such an arrangement, only on a much grander financial and now also economic scale.

A day after writing the above, I read in *The Economist* (December 11-17, 2004) a report on the previous week’s summit meeting of ASEAN + 3 in Malaysia. That country’s prime minister announced that this summit should lay the groundwork for an East Asian Community (EAC) that “should build a free-trade area, cooperate on finance, and sign a security pact ... that would transform East Asia into a cohesive economic block ... In fact, some of these schemes are already in motion ... China, as the region’s pre-eminent economic and military power, will doubtless dominate ... and host the second East Asia Summit.” The report went on to recall that in 1990, Uncle Sam shot down a similar initiative for fear of losing influence in the region. Now it is a case of “Yankee Stay Home”.

Or what if, long before that comes to pass, exporters of oil simply cease to price it in ever-devaluing dollars, and instead make a mint by switching to the rising euro and/or a basket of East Asian currencies? That would at one stroke vastly diminish the world demand for and price of dollars by obliging anyone who wants to buy oil to purchase and increase the demand price of the euro or yen/yuan instead of the dollar. That would crash the dollar and tumble Uncle Sam in one fell swoop, as foreign – and even domestic – owners of dollars

would sell off as many of them as fast as they could, and other countries' central banks would switch their reserves out of dollars and away from Uncle Sam's no-longer-safe haven. That would drive the dollar down even more, and of course halt any more dollar inflow to Uncle Sam from the foreigners who have been financing his consumption spree. Since selling oil for falling dollars instead of rising euros is evidently bad business, the world's largest oil exporters in Russia and OPEC have been considering doing just that. In the meantime, they have only raised the dollar price of oil, so that in euro terms it has remained approximately stable since 2000. So far, many oil exporters and others still place their increased amount of dollars with Uncle Sam, even though he now offers an ever less attractive and less safe haven, but Russia is now buying more euros with some of its dollars.

So also many countries' central banks have begun to put ever more of their reserves into the euro and currencies other than Uncle Sam's dollar. Now even the Central Bank of China, the greatest friend of Uncle Sam in need, has begun to buy some euros. China itself has also begun to use some of its dollars – as long as they are still accepted by them – to buy real goods from other Asians and thousands of tons of iron ore and steel from Brazil, etc. (Brazil's president recently took a huge business delegation to China, and a Chinese one just went to Argentina. They are going after South African minerals too.)

So what will happen to the rich on top of Uncle Sam's Ponzi scheme when the confidence of poorer central banks and oil exporters in the middle runs out, and the more destitute around the world, confident or not, can no longer make their in-payments at the bottom? The Uncle Sam Ponzi Scheme Confidence Racket would – or will? – come crashing down, like all other such schemes before, only this time with a worldwide bang. It would cut the present US consumer demand down to realistic size and hurt many exporters and producers elsewhere in the world. In fact, it may involve a wholesale fundamental reorganization of the world political economy now run by Uncle Sam.

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