Borrowed Empire

The dollar won't necessarily collapse if oil is billed in euros—but our crushing trade deficits might do the trick.

By Paul Craig Roberts

IN RECENT MONTHS a hot topic on Internet sites has been speculation that Iran will instigate a collapse of the dollar's value by billing its oil in euros. As the argument goes, Iran's desertion of the U.S. dollar would be followed by other oil producers, bringing to an end America's financial hegemony and severely affecting the living standards of most Americans. This Iranian threat is often said to be a main reason for Bush administration plans to attack Iran. Saddam Hussein is said to have provoked the Bush administration's attack on Iraq by harboring the same intention to switch oil bills to euros from dollars.

This argument assumes that the cost to the U.S. of oil being billed in euros is so great that it makes worthwhile wars of aggression that are illegal under international law, that turn most of the world against the U.S. and destroy its soft power, and that have massive financial costs running in the hundreds of billions of dollars—with no clear end in sight. Would abandonment of the dollar as oil currency impose costs greater than these on the U.S.?

The change, if it were to happen, would not be the catastrophe that some people believe. Saudi Arabia and the oil sheikdoms are too much in the American pocket to follow an Iranian move to euros, and the Europeans, faced with Asian competition, do not want a stronger euro. Moreover, the real question is not the currency in which oil is billed but whether foreigners find it desirable to continue to accumulate and to hold dollar-denominated assets—stocks, real estate, bonds, and U.S. companies. America's oil bill is dwarfed by the size of the U.S. trade and current account deficits. If the United States continues to run budget and trade deficits, foreigners' investment portfolios can become so loaded with dollar-based assets that they cease to acquire them. That is what would lead to a sharp fall in the dollar's value and, perhaps, to the end of the dollar's role as world reserve currency.

I am not saying that a move by Iran and other oil producers to euros would have no effect on the dollar. Such a development would result in a lower transaction demand for dollars as a means of payment. But the real question is: what do oil producers and the rest of the world do with the dollars associated with America's large trade and budget deficits?

The deficit in our trade imbalance due to mineral fuels is small compared to the deficit due to our imports of manufactured goods. In 2005, the U.S. trade deficit in manufactured goods was $506 billion, almost twice as large as the $260 billion deficit for mineral fuels. Those speculating about the currency of oil bills could paint a darker picture by worrying about the currency used to pay bills for manufactured goods.

The fundamental point overlooked by worries about an Iranian oil bourse is that oil is billed in dollars because the dollar is the reserve currency and, thereby, is acceptable as the means of international settlements. What is likely to dethrone the dollar is not Iran but Washington. Reveling in neocon hubris, not even Republicans any longer worry about deficits.

Deficits have different causes, and not all are equally worrisome. But the U.S. trade deficit is problematic for a variety of reasons. From 1990 through the first quarter of 2006, the U.S. trade deficit has accumulated to $4.7 trillion. For just the first quarter of 2006, the deficit is $208.7 billion—about twice the cost of one year's worth of war in Iraq. The trade deficit measures U.S. consumption that is not matched by U.S. production. In other words, Americans together are consuming $2.3 billion more per day or $1,610,000 more per minute than they are producing.

Free-trade economists, who seem to specialize in apologizing for red ink, say that our trade deficit is a very positive thing. It represents, they assert, the rest of the world's confidence in America's economic future. These economists say that the American trade deficit is the necessary offset to the capital surplus caused by foreign investment rushing into the U.S.

There are circumstances in which this explanation of a trade deficit would be correct. However, it is not a correct interpretation of the present case. The

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current crop of deficit apologists misinterpret the U.S. capital surplus as real net foreign investment that is increasing America's ability to produce and to grow. In actual fact, the majority of this foreign investment is merely a change of ownership of existing U.S. assets from Americans to foreigners. The United States is paying for its excess consumption of $2.3 billion per day by handing over the ownership of its existing wealth to foreigners. This worsens the current account deficit as the earnings on these assets now belong to overseas interests.

Another reason that our trade deficit is serious is that it has been growing faster than the economy—further evidence that foreign investment in the U.S. is primarily a change of ownership in existing assets and not new plants and equipment. In 1996, in real terms, the U.S. trade deficit was 1.0 percent of GDP. In 2005, it was 5.7 percent of GDP. In the first quarter of 2006, it was 5.9 percent of GDP. These are unprecedented percentages. When I was assistant secretary of the Treasury in the Reagan administration during 1981-82, the U.S. balance of trade varied between a surplus of 0.2 percent and a deficit of 0.2 percent.

One of the reasons for the unprecedented trade deficit is the offshoring of manufacturing and jobs. When U.S. corporations move production for American markets offshore and hire people in other countries to provide engineering and other services via high-speed Internet, goods and services that were produced in the U.S. are turned into imports. Free-trade economists who tout the benefits of Wal-Mart's low-priced Chinese goods do not tell you that the price you pay at the counter is only part of the full price. The other parts of the price are the American jobs that are transferred to China and the ownership of American assets that is transferred to the Chinese in order to cover our large trade deficit.

THEY DO NOT UNDERSTAND THAT AMERICA'S SUPREMACY DERIVES FROM TWO RAPIDLY DIMINISHING RESOURCES—**MANUFACTURING SUPREMACY** AND THE DOLLAR AS **WORLD RESERVE CURRENCY**.

The important question neglected by American policymakers is: at what point does the rest of the world decide that the accumulation of additional dollars is folly? Can the U.S. run a trade deficit of 10 percent of GDP and still remain the reserve currency?

The answer to the question depends in part on whether those accumulating U.S. assets see some means by which the United States can balance its trade. American economists, such as Fred Bergston, believe the U.S. can bring its trade into balance by reducing consumption, that is, by undergoing a recession that puts people out of work and reduces their ability to consume. However, Charles McMillion of MBG Information Services points out that this strategy ceased to work in the 2001 recession when the trade deficit actually increased. Why did Americans import more during recession? Do we see here the impact of offshoring and growing dependency on foreign-made goods?

Another way of reducing the trade deficit is to export more. But how does a country that is offshoring its production of goods and services export more? (By more I don't mean in absolute terms but relative to imports.) It is possible that offshoring has permanently affected the tax base, the incentives of young people to enter the high-productivity and formerly high-paid occupations that are now offshored or filled with foreigners on work visas, and the ability of American industry to mass produce advanced technology products.

A third way of reducing the trade deficit is through dollar devaluation or the appreciation of the currencies of countries with whom we run trade deficits. But what magnitude of dollar depreciation is required to wipe out an annual trade deficit of $800 billion, and what impact would such a large decline in real purchasing power have on our living standards? Devaluation is like inflation. It raises the prices of everything with foreign-made components, which today is almost everything. Just imagine what a significant dollar devaluation would do to U.S. gasoline prices.

These serious questions are given short shrift by free-trade economists who answer with mantras.

Today Americans, whether or not they are aware of it, are under the control of a government determined to achieve U.S. hegemony over the world. Neocons in the Bush administration advocate military attacks on Iran, Syria, Pakistan, and Saudi Arabia. They threaten a pre-emptive nuclear attack on North Korea. Neocons worry that China might attain military parity with the U.S. by 2020 and advocate policies designed to wreck the Chinese advance. Writing in *The Nation*, Stephen F. Cohen documents the neocons' drive to marginalize Russia and to assert U.S. hegemony in Russia's legitimate sphere of influence. These aspirations are inordinate, as well as criminal, and they will bring America to ruin.

Neocons are ignorant and disdainful of economics. They assume that hegemony derives from military power and the will to use it ruthlessly. They do not understand that America's supremacy derives from two rapidly diminishing

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resources—manufacturing supremacy and the dollar as world reserve currency.

America alone emerged from World War II with manufacturing capability. It is easy to dominate world trade when no one else can produce anything. The benefits that free-trade economists attribute to America's postwar experience were due to the impairment of every other country's ability to produce. Great Britain was impoverished by two world wars and overwhelmed with war debts. The Breton Woods agreement dethroned the British pound sterling and established the U.S. dollar as reserve currency. This has been the source of America's strength.

It is a strength that is close to exhausted by chronic budget and trade deficits that have sorely abused the reserve currency role, while the neocons' grand designs for hegemonic power completely ignore the diminished economic basis on which U.S. power rests. Today Asia, or even individual countries such as Japan or China, could easily topple American hegemony simply by dumping their holdings of U.S. Treasury bonds and abandoning the use of the dollar as reserve currency.

Tough-talking neocons who are creating conflict with our major bankers, such as China, and with energy-rich countries, such as Russia, are leading America into ruinous conflict that serves no sane purpose. Indeed, the U.S. could not even wage war in Iraq if the Chinese were not lending us the money. What Gordon Prather calls the "neocon-crazies" are likely to discover that the U.S. is about as hegemonic as Hitler was at Stalingrad—and the consequences of their will to power can be just as destructive for America. ■

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DEEP BACKGROUND

The revelation that the Department of the Treasury and the CIA have been routinely monitoring international banking transactions should be seen as part of the Total Information Awareness program proposed by former Defense Department contractor John Poindexter three years ago. Poindexter's proposal, which assumed that the government needs to know everything about everyone all the time, was publicly rejected by Secretary of Defense Donald Rumsfeld after public and media outcry. With White House support, it was subsequently quietly revived and integrated into the much broader surveillance program run by the NSA that has been data-mining telephone, fax, and e-mail transmissions. The data is shared across the intelligence community, including the FBI, and employs link analysis to uncover suspicious patterns that may have terrorist connections. The electronic bank transactions that are being monitored have provided significant leads but not recently. Bank transaction linkage analysis resulted in the capture of al-Qaeda operative Riduan Isamuddin, better known as Hambali, in Thailand in August 2003. Hambali, believed to be the key financial link between al-Qaeda and the radical Indonesian group Jemaah Islamiyah, was also the mastermind behind the 2002 Bali bombings that killed more than 200. There was also an alleged early 2003 operation in which the bank transaction database helped identify a U.S. citizen later convicted of helping an al-Qaeda member launder $200,000 through a Pakistani bank. Since 2003, however, the program has not produced any new information resulting in exposure of terrorist activity. In the wake of the arrest of Hambali, professional terrorist groups like al-Qaeda have understood the security vulnerability of wired international funds. Couriers carrying cash now often service their direct funding requirements, and money used for operations is very often raised locally to avoid any financial trail.

The improbably named House Homeland Security Subcommittee on Intelligence, Information Sharing, and Terrorism Risk Assessment has responded to traveler complaints by demanding that the Transportation Security Administration (TSA) take steps to improve its travel watch list. According to the subcommittee, TSA frequently engages in information dumps to expand the database. As more names of suspected terrorists are discovered worldwide, the list becomes longer and more inclusive without any effort to add further identifiers to determine whether the Abdul Mohammed who lives in Des Moines might be the person of the same name who was identified in Kashmir. When names pop up on the list as a traveler checks in, the "hit" frequently has to be resolved though a manual check of files, which almost always results in a missed flight or worse. This would presumably be acceptable if anyone were actually detected as a result, but law enforcement sources suggest that no terrorist has ever been caught because of the TSA list. The current watch list just does not work and, worse, once you are on the list, it is almost impossible to get removed. Plans to introduce a much more inclusive and complicated system called Secure Flight, in which travelers register in advance to establish their identities, have stalled due to technical problems, privacy protection issues, and lack of funding.

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