

## Diagnosing the Diminishing Dollar

Holding a green piece of paper decorated with patriotic symbols as a proxy for economic value is an act of faith. To do so with the currency of your own country is a necessary act of faith, since daily life requires it in order to make economic transactions. But to hold sizable amounts of the currency, or the currency-denominated assets, of a *foreign* country is carrying faith beyond any warrant provided by human experience. History clearly reveals that the eventual debasement of currency is as predictable as night following day. Why, then, are our foreign-trade partners so eager to hold huge hoards of U.S. greenbacks?

A survey of the current economic landscape abounds with evidence of the debasement of the dollar. Gold, the hedge of last resort for financial liquidity, has returned to its former price of \$450 per ounce. Oil prices that hovered around \$20 per barrel in the 1990's have more than doubled, while housing prices are growing at double-digit rates.

The typical American homeowner is attempting to profit from this debasement by borrowing as much as mortgage lenders will lend to buy the largest home that he can(not) afford. Household debt as a percentage of Gross National Product has continually set records for the past two decades. When interest levels return to normal and join soaring energy costs, these households will have a painful financial hangover from their current libations.

The federal deficit (now approaching \$400 billion per year) is the principal source of the dollars that fuel the inflation of the price of commodities and other real assets. Financed primarily by foreigners and foreign central banks, with the balance bought by the Federal Reserve Banks, the deficit roughly correlates to the international current-account deficit generated by the negative balance of trade in goods.

The excessive growth of the money supply since the mid-90's has driven after-tax and risk-adjusted interest rates to negative real returns on fixed-rate investments. Stock-market returns, augmented by foreign earnings restated in depreciated dollars, and outsourcing of goods and services to cheaper foreign suppliers—

plus the valuation of earnings at unrealistically low interest rates—barely support otherwise unjustifiable common-stock prices. Both stocks and bonds provide unattractive real returns to U.S. investors, discouraging savings and encouraging excessive investment in cheap imports and an overpriced residential-housing market paid for with unsustainably cheap mortgage debt.

The Bush administration has been playing a game of chicken with our foreign competitors by devaluing the dollar as much as possible in an attempt to close the trade deficit. The European Union and, to some extent, Japan have allowed the relative appreciation of their currencies, but the remainder of the Asian countries have kept their currencies pegged to the dollar. The United States has been their most profitable market, providing the lowered costs that go along with access to the world's largest homogenous market—the only principal market that offers them relief from border-adjusted value-added taxes. U.S. manufacturers' exports are likewise priced out of foreign markets by those countries' value-added taxes, with no compensating relief offered by the U.S. Tax Code.

As the dollar depreciates, the rising prices of raw materials are soon followed by cost-of-living increases in wages and salaries, and that is on top of the cost-push of lower operating rates. So the devaluation of the dollar has had the effect of a dog chasing its tail. Compared with a basket of seven major currencies, the dollar has declined an average of 15 percent—and all to no avail; an equal decline is predicted during 2005. As the *Wall Street Journal* recently observed:

[T]he Bush Treasury, and perhaps Mr. Bush himself, seem to have fallen for the notion that a country can devalue its way to prosperity. . . . Britain tried this in the 1970's, and had to call in Margaret Thatcher to save the country from sinking to Third World status. The Carter administration also tried talking down the dollar and ended up inspiring a global run on U.S. assets.



*BusinessWeek* asks, in the same vein:

Will trade imbalances topple the greenback? . . . [F]or more than a decade the global economy has become more dependent on foreign capital to finance its (U.S.) demand. . . . Foreign money now finances three-fourths of U.S. net investment.

Neither of these astute observers, however, diagnoses the real source of the problem and, thus, cannot offer a remedy.

The declining dollar is the product of three deficits: The federal deficit, the difference between excessive federal spending and ill-advised tax cuts; the personal-savings deficit, characterized by "consume today, and worry about tomorrow later"; and the manufacturing trade deficit, which clearly indicates the desperate need to level the taxation playing field for our disappearing manufacturing sector. Ideological internationalists without concern for their nation, multinational corporations who profit from the hollowing out of the U.S. economy, and economists who do not understand the power of price mechanisms have used the media to mislead the public regarding the source of the problem and its obvious solution: border-adjusted (consumption-based) tax reform.

A country that manipulates her own currency to demean it as a store of value for the wealth of her citizens and as a respected medium of exchange; that borrows to encourage consumption at the expense of savings for investment (to be billed to future generations); and that provides foreign competitors with tax advantages that are insurmountable for her national industries' survival is not being governed in the interests of her citizens.

by Srdja Trifkovic

## Rumsfeld Stays

Having provided advice to a number of influential Balkan figures in my time, I know the sense of frustration when sound counsel is overruled in favor of proposals based on error or mendacity. I have been proved right, but only when it was too late: Crown Prince Alexander Karadjordjevic would have been better off had he discarded his notions of reuniting Yugoslavia in the early 1990's. The leaders of the Republika Srpska should have severed their link to Milosevic well before he stabbed them in the back in 1995. Instead of ratifying the International Criminal Court (ICC) statute in 2001, President Vojislav Kostunica should have signed a bilateral treaty with Washington on the nonextradition of U.S. citizens to the ICC.

It is somewhat consoling that the effect of those mistakes was minor in the global scheme of things. What happens in the Balkans is very important *vis-à-vis* the "War on Terror" and as a reflection of the postmodern Western mind-set, but individual decisions by the local actors are of limited significance. When the president of the United States accepts advice on matters of war and peace that is based on error or guile, however, the consequences are serious both for America and the rest of the world. If he continues receiving advice from the same source regardless of that source's past failures, the matter is alarming, indeed.

Alarm bells should have rung on December 3, when Secretary of Defense Donald H. Rumsfeld won a strong endorsement from President George W. Bush and remained at the Pentagon. This was a mistake for four reasons: It vindicated the false rationale for the war in Iraq; it perpetuated a flawed exit strategy (or, more precisely, the failure to develop one); it reiterated the strategy of global dominance; and it implied trust in Mr. Rumsfeld's two top advisors, Deputy Secretary of Defense Paul Wolfowitz and Under Secretary for Policy Douglas Feith, who are not deserving of it.

That the war in Iraq was fought for reasons different from those stated is by now certain. If there is one person more culpable than any other for the lies and the subsequent mess, it is Donald Rumsfeld.

As I pointed out in this space in October 2002, he and his team had long sought to construct an Iraqi pseudoreality in pursuit of a war "that, if successful, will do little to advance American interests: We would be saddled with yet another Muslim protectorate, unstable and resentful." That pseudoreality rested on two key claims: the threat of Saddam Hussein's weapons of mass destruction (WMD's) and his links to the September 11 attacks.

Mr. Rumsfeld and Dr. Wolfowitz had advocated war against Iraq on the grounds of her alleged possession of WMD's for many years. They were among the founding members of the Project for a New American Century (PNAC), established in 1997 and dedicated to "American global leadership." The PNAC started advocating the overthrow of Saddam almost immediately. In January 1998, in an open letter to President Clinton, the PNAC said that the only acceptable strategy was one that would eliminate the possibility that Iraq would be able to use, or threaten to use, WMD's: "In the long term, it means removing Saddam Hussein and his regime from power. That now needs to become the aim of American foreign policy."

This theme was to be a mainstay of the group's public speaking and private policy advocacy for years. Testifying to the House National Security Committee in September 1998, Wolfowitz asserted that Saddam was reconstituting his "prohibited weapons capabilities" and demanded "a serious policy" that would "free Iraq's neighbors from Saddam's murderous threats." There was no proof, then or later, that Iraq had any such capability; in 2002, however, that objection was discounted by Rumsfeld in a phrase worthy of Hegel: "the absence of evidence does not mean the evidence of absence."

When no WMD's were found following the occupation of Iraq, Rumsfeld refused to admit that he was wrong. "I have reason, every reason, to believe that the intelligence that we were operating off was correct," he declared, "and that we will, in fact, find weapons or evidence of weapons programs that are conclusive." After almost two years of diligent search, this has not happened, and it most like-



ly never will. On the basis of this blunder alone, Rumsfeld should have done the honorable thing and resigned, or the President should have replaced him.

As for the alleged terrorist link, the record is even more damning for the secretary and his aides. We now know that, within hours of the attacks on September 11, they were busy trying to insert the war against Iraq into the package of antiterrorist options. According to the final report of the National Commission on Terrorist Attacks Upon the United States, *that same afternoon*, Mr. Rumsfeld told Gen. Richard Myers that "his instinct was to hit Saddam Hussein at the same time — not only Bin Laden." Some months later, he blended two themes into one by declaring that, "within a week, or a month, Saddam could give his WMD to al-Qa'ida." Secretary of State Colin Powell told the commission that, within days of September 11, Dr. Wolfowitz had argued that Iraq should be attacked but had no rational basis for the demand:

Powell said that Wolfowitz was not able to justify his belief that Iraq was behind 9/11. "Paul [Wolfowitz] was always of the view that Iraq was a problem that had to be dealt with," Powell told us. "And he saw this as one way of using this event as a way to deal with the Iraq problem."

"Using" is an apt word: In the end, the commission concluded that there was "no credible evidence" of a terrorist link. It noted that Bin Laden had long opposed the secular regime in Baghdad and that his subsequent attempts to obtain help from Iraq were rebuffed by Saddam. Its conclusion, that there was no proof "that Iraq and al-Qa'eda cooperated on attacks against the United States," reflected the