Imports Keep Moribund U.S. Economy on Life-Support

by Richard Freeman

Led by a surging trade deficit, the U.S. current account deficit leaped to $129.59 billion during the second quarter of 2002, the Commerce Department reported on Sept. 12. This not merely sets a record, but is a larger deficit in one quarter, than any other nation in the world has ever had in an entire year.

The deficit shows conclusively that U.S. economy's collapse is accelerating. Unable to physically produce the means of its own existence (for example, machine-tool consumption is nearly one-quarter lower than last year), the physical economy is increasingly dependent on imports, and the current account deficit is mostly driven forward by the trade deficit. This is paid for by an inflow of dollar-denominated funds from foreigners.

To accomplish this, the Anglo-American financiers set up the biggest speculative bubble in the world, and an overvalued U.S. dollar—itself propped up by the speculative bubble—to attract foreigners to bring their money into the United States. But what happens, with the U.S. speculative bubble teetering, as foreigners no longer wish to hold dollar-denominated assets inside the United States, and choose to disinvest from America? Two processes will unfold in an interconnected, self-feeding way: First, the United States will no longer be able finance the trade deficit portion of the current account deficit. This will crumble the weakened, import-addicted U.S. physical economy. Second, as investors bail out of the dollar, it will fall, not by small increments, but likely by 40-50%. This will shatter the over-leveraged, cancerous financial system.

This process has already started, reflected in the dollar's 7-9% depreciation against major currencies since Jan. 1.

This is the reality that the Bush Administration, led by Treasury Secretary Paul O'Neill, and supported by Federal Reserve Board Chairman Alan Greenspan, wish to deny. But as this reality intersects the growing Federal budget deficit, and the further contraction of the U.S. economy, it will assert itself in the most forceful way.

Components of the Current Account Deficit

The growing problem is shown by the current account deficit's trajectory (**Figure 1**): In the fourth quarter of 2001, the deficit was $95.09 billion, and rose to $112.45 billion in the first quarter of 2002—which established a record—before leaping to $129.96 billion in the second quarter. Thus, it increased by $35 billion over the course of two quarters. For the first half of 2002, the deficit totalled $242.41 billion, but given its quarterly rate of increase, it is likely to soar past $500 billion for the year 2002.

An evaluation of the U.S. current account, which is composed of three components—the balances on goods and services; on income; and on unilateral current services—must focus on trade.

During the second quarter, the U.S. trade deficit on goods and services soared to a record $110.61 billion, accounting for 85% of the current account deficit. In fact, *the United States ran a trade deficit on physical goods alone of $122.64 billion;* this was partially offset by a trade surplus on services of $12.03 billion. The economy is suffering from a potentially lethal addiction to imports: As long as the dollar has been strong, the economy has been able to suck in a huge amount of physical goods imports, mostly because it has impaired or permanently destroyed the capacity to produce these goods through its own productive facilities.

An additional force played a secondary, but important role in increasing the current account deficit: the "balance on income," which is the cumulative amount of income that Americans earn on their holdings in foreign nations, minus the income that foreigners earn on their holdings in the United

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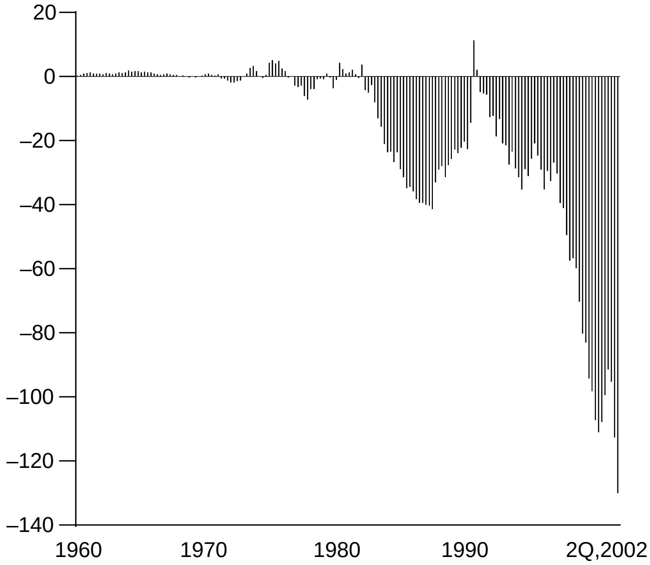
FIGURE 1

U.S. Current Account Deficit Grows: On Quarterly Basis, 1960-2002

($ Billions)



Source: EIRNS.

States. Throughout its history, America generally ran a positive balance on income, based on the fact that America owned a greater amount of foreign assets than foreigners owned of U.S. assets, and thus earned more income in foreign countries than foreigners earned in the United States. But foreigners have been induced to bring dollars into the United States by increasing their investment holdings of U.S. assets, dramatically changing the relationship.

The U.S. Commerce Department gives the name of "America's net international investment position" to the difference between Americans' holdings in foreign nations (stocks, bonds, etc.), and foreigners's holdings in America. In the second quarter of 2002, Americans owned $6.02 trillion of assets in foreign nations, and foreigners owned $8.48 trillion of assets in America. Therefore, America built a net international investment position of a staggering –$2.46 trillion.

During the second quarter 2002, the U.S. ran a "balance on income" deficit of $5.34 billion. This contributed to swelling the current account deficit.

Lure of the Housing Bubble

A primary mission to prevent disaster, involved drawing in sizeable foreign funds into the United States to cover the $129.59 billion current account deficit of the second quarter. It appears that the sale of secondary housing market-related paper was the principal lure to draw foreign funds in.

According to the Commerce Department's report on international transactions during the second quarter, "foreign-owned assets in the U.S. increased $221.2 billion," representing an inflow of $221.2 billion during that quarter, while they had increased by only $113.5 billion during the first quarter. During the second quarter, foreigners purchased net $11.4 billion in U.S. stocks (down from $25.0 billion during the first quarter); net $1.4 billion in U.S. Treasury securities (up from –$7.3 billion during the first quarter); and an unprecedented net $92.3 billion in U.S. corporate and agency bonds (up from $46.1 billion during the first quarter). (There were other means and instruments by which foreign funds flowed into the United States.) The combined inflows covered the $129.59 billion current account deficit.

Foreign purchases of U.S. stocks and Treasury securities combined, totalled a rather meager $12.8 billion, as the stock market was rather depressed.

The key category was that of "corporate and agency bonds." Agency bonds represent, principally, the bonds of the giant secondary housing market agencies known as Fannie Mae and Freddie Mac. These two agencies are engaged in building and maintaining the giant U.S. housing bubble (see *EIR*, June 21), and to do so, issue bonds. An initial report is that foreigners bought a significant amount of agency bonds, investing in the U.S. housing bubble. But that super-hot bubble is on the verge of bursting, and when it bursts, few alternate gimmicks exist to suck in foreign funds. The funds to cover the current account deficit may soon not be there.

Federal Budget Deficit

On Aug. 13, the U.S. Congressional Budget Office released a report, entitled, "Where Did the Revenues Go?" which reported that whereas earlier this year, "experts" had predicted a balanced Federal budget for fiscal year 2003, now the CBO is predicting a $157 billion deficit, as a result, mostly, of collapsed revenues. In fact, the deficit is much larger. The fiscal 2003 Social Security Trust Fund surplus of approximately $150 billion was illegally mixed into the so-called "unified Federal budget." Were it properly removed, the fiscal 2003 general revenue budget deficit would be closer to $307 billion.

On the surface, the U.S. Administration is intent on ignoring reality. While the current account deficit threatens the U.S. financial system, Treasury O'Neill pooh-poohed it as "not very significant," and Fed Chairman Greenspan said it is "not, in and of itself, a measure of anything bad, because what that means, is that that much money is coming into the U.S. on the part of those who want to invest here."

Still, behind closed doors, the consequences of issues such as the current account deficit are causing hysteria in the Bush Administration, and fueling the lunacy of the "perpetual war" faction. Either this matter is addressed, through such measures as bankruptcy reorganization of the global financial system, or, with the disinvestment from the U.S. dollar, it will shatter this system.