Rubin, IMF Warn of U.S. Economic Catastrophe

by John Hoefle

Former Treasury Secretaries rarely make the news, but Paul O'Neill's revelations about a dysfunctional Presidency and Robert Rubin's revelations about that Presidency's dysfunctional economic policy, have sent shockwaves through political and financial circles.

The backdrop for both Rubin's and O'Neill's actions is the growing realization among certain Establishment institutional layers, that the combination of incompetence and arrogance of the Cheney-Bush Administration is a strategic threat to the United States and the world as a whole.

While many of these Establishment types would probably rather cut out their tongues than admit it publicly, their actions are heavily influenced by economist and Democratic Presidential candidate Lyndon LaRouche, whose diagnosis of the diseased state of U.S. society and the economy have proved painfully accurate. Agreeing with the diagnosis, however, is not the same as being able to see the cure.

As LaRouche has said repeatedly, the global financial system is hopelessly bankrupt, overloaded with far more debt than can ever be paid back, and must be put through the equivalent of a bankruptcy proceeding. The system cannot be saved through minor adjustments in policies and procedures, nor through hyperinflation. The system is bankrupt, now, and the solution begins with that admission. That is the standard to measure all policies.

'Unsustainable Path'

This global bankruptcy is the context for the refined brawl which broke out at the conference of the American Economic Association (AEA) in San Diego the first week of January. The meeting was attended by a host of economic notables, including Rubin, Federal Reserve Chairman Sir Alan Greenspan, and Fed Governor Ben "Benny Bubbles" Bernanke. The politically astute Rubin, who is careful with his public statements because he knows they can move markets, startled the group with a sharp public criticism of the Bush-Cheney Administration's disastrous fiscal policy. "The U.S. Federal budget is on an unsustainable path," Rubin observed, warning that the "scale of the nation's projected budgetary imbalances is now so large that the risk of severe adverse consequences must be taken very seriously." These consequences "may well be far larger and occur more suddenly" than analysts expect.

The growing deficits, and the fear that "the government would resort to high inflation to reduce the real value of government debt," could lead to a loss of confidence in the government, and "create a mutually reinforcing cycle" which would "substantially magnify" the nation's economic problem, Rubin said. "Indeed, the potential costs and fallout from such fiscal and financial disarray provide perhaps the strongest motivation for avoiding substantial, ongoing budget deficits," he added. Rubin's comments were contained in a study he co-authored with economists Alan Sinai and Peter Orszag.

The dire warning got people's attention, as Rubin knew it would. "Mr. Rubin has formally joined the coalition of the shrill," wrote Paul Krugman in a column in the Jan. 6 *New York Times.* When the "legendary" Rubin, known for his calm in the face of crisis, warns of looming catastrophe, it's time to pay attention, Krugman suggested.

Rubin continued his assault on Administration policy at a Jan. 13 forum on "restoring fiscal sanity" at the Brookings Institution in Washington, where he warned that the growing deficit could trigger both a rise in interest rates and a sharp fall in the dollar. "Substantial ongoing deficits may severely and adversely affect expectations and confidence, which in turn can generate a self-reinforcing negative cycle among the underlying fiscal deficit, the financial markets, and the real economy," he warned. As a former Treasury Secretary, a head of the powerful Goldman Sachs investment bank, and now a member of the Office of the Chairman of Citigroup, America's largest bank, Rubin is in a position to know a great deal about the precarious state of the financial system, including the inner workings of both Wall Street and Washington. If Rubin is worried enough to speak so openly, everyone should be.

The International Monetary Fund also issued a warning about the "long-run sustainability" of U.S. fiscal policies. "Deficits are projected as far as the eye can see," the IMF said in a paper released Jan. 7. "The emergence of twin fiscal and current account deficits has given rise to renewed concern." The paper noted that the United States "is on course to increase its net external liabilities to around 40% of gross domestic product within the next few years—an unprecedented level of external debt for a large industrial country." That could, in turn, lead to "adverse circumstances" arising from a "disorderly" drop in the dollar.

While no one in their right mind should take economic advice from the IMF, it is informed enough to worry about the economic incompetence of the Cheney-Bush crowd.

Economic Stupidity

Would that one could make such a statement about the leadership of the Federal Reserve. In presentations to the AEA conference, both Lord Greenspin and Governor Bernanke insisted that inflation was not a problem; Bernanke claimed that "core inflation rates" in the United States are "as low today as they have been in 40 years, and they have been trending downward." This "no inflation here" mantra is a crucial component of the Fed's offensive propaganda. The dramatic understatement of the true level of inflation allows the Fed to pretend that its liquidity pumping policies are not hyperinflationary, and also distorts a host of economic metrics, such as GDP. This has the effect of turning collapse into apparent statistical growth.

A little over a year ago, Sir Alan publicly stated that the Fed would act as the lender of last resort to the financial markets, and that the American public would be called on to bail out the derivatives banks, if necessary; Bernanke echoed that by stating that the Fed could print unlimited amounts of money as needed. "If we choose to enjoy the advantages of a system of leveraged financial intermediaries, the burden of managing risk in the financial system will not lie with the private sector alone," Greenspan said in a Nov. 19, 2002, speech to the New York Council on Foreign Relations. "Leveraging always carries with it the remote possibility of a chain reaction, a cascading sequence of defaults that will culminate in a financial implosion if it proceeds unchecked. Only a central bank, with its unlimited power to create money, can with a high probability thwart such a process before it becomes destructive. Hence, central banks have, of necessity, been drawn into becoming lenders of last resort. . . . Thus, central banks are led to provide what essentially amounts to catastrophic financial insurance coverage."

That bailout policy still stands, as evidenced by a paper submitted to the AEA in 2004 by Bernanke and Fed Monetary Affairs director Vincent Reinhart. In that document, the pair said that even with interest rates at or near zero, the Fed still has plenty of room to intervene through such measures as an "unlimited commitment" to buy Treasury securities at a guaranteed price. The Fed could also "consider purchasing assets other than Treasury securities, such as corporate bonds or stocks or foreign government bonds." The prospect of the Fed using its "unlimited" supply of money to bail out the derivatives markets, the bond markets, and the stock markets at the same time—at an ultimate cost of hundreds of trillions of dollars—is perhaps the craziest economic scheme ever proposed. No amount of academic gloss can cover up the reality that these guys are truly nuts!

Out of Control

During LaRouche's Jan. 10 webcast, a former member of the President's Council of Economic Advisors commented to LaRouche that Rubin "clearly echoed what you've been saying," and cited Rubin's warning that the Administration's policy of driving down the dollar is not only incompetent, but catastrophic in a dollarized world. LaRouche responded that the Administration was driving down the dollar, but only in the sense that its policies are so bad that the world is losing confidence in America and its currency. Discovering the dollar is falling, the Administration attempted to claim it was instigating, rather than reacting to, that drop. LaRouche compared the White House policy on the dollar to a fellow driving a dilapidated car down the street, with one wheel after another falling off. The fellow insists that the car is actually cheaper to operate without wheels!

Reflect on the sharp discrepancy between those claims of "recovery," the warnings of people like Robert Rubin, and the desperation of the Fed. If the economy is growing, why the warnings of catastrophe from people clearly in a position to know? If no catastrophe looms, why is the Fed openly promising a bailout?

Those are not the hard questions, however. Why do the American people tolerate this duplicity, and support elected officials and political candidates who refuse to touch this economic crisis? Has, as Schiller observed about an earlier period, a great time found a little people? If the American voters chose one of the nine dwarves over LaRouche, we shall have the answer.

Greenspin Confronted in Berlin

Before an elite gathering at the Bundesbank Lecture in Berlin on Jan. 13, Fed Chairman Alan Greenspan was confronted by LaRouche representative Dr. Jonathan Tennenbaum, who chided him for ignoring and abetting "the collapse of the greatest financial bubble in history." Said Tennenbaum: "You, Mr. Greenspan, will be the last chairman of an independent central bank in the United States. What do you say about that?" Sir Alan, taken aback, vehemently defended financial derivatives, but nevertheless was compelled to admit that he could not deny the possibility of a collapse.

Greenspan insisted that the use of credit derivatives"defuse[d] the makings of what could have been a very major financial crisis" in the meltdown of the telecommunications sector. Without them, he said, "we would have had a very major collapse in banking. In the event, however, because credit derivatives moved the risks from banks who initiated the credits, to those far less leveraged institutions—which were insurance companies, reinsurance, pension funds, etc.—not a single major international financial institution was in trouble. These have been very major instruments for *smoothing out the system*. . . .

"And you presume that as a consequence of all of these issues, that we are sitting on some massive financial bubble, which is going to blow up in our faces?" Greenspan said. "You are not the only one who says that. . . . How do we know that the total system will not collapse? Well . . . no one has the omniscience and certainty to say, without qualification, that you are wrong. I shall merely say that . . . most of us who evaluate the data with respect to trying to answer that question, have overwhelmingly come to the conclusion, that that is extraordinarily unlikely to happen."