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Uncle Sam, Your Banker Will See You Now

By Paul Craig Roberts

08/08/07 "ICH" --- - Early this morning China let the idiots in Washington, and on Wall Street, know that it has them by the short hairs. Two senior spokesmen for the Chinese government observed that China's considerable holdings of US dollars and Treasury bonds "contributes a great deal to maintaining the position of the dollar as a reserve currency."

Should the US proceed with sanctions intended to cause the Chinese currency to appreciate, "the Chinese central bank will be forced to sell dollars, which might lead to a mass depreciation of the dollar."

If Western financial markets are sufficiently intelligent to comprehend the message, US interest rates will rise regardless of any further action by China. At this point, China does not need to sell a single bond. In an instant, China has made it clear that US interest rates depend on China, not on the Federal Reserve.

The precarious position of the US dollar as reserve currency has been thoroughly ignored and denied. The delusion that the US is "the world's sole superpower," whose currency is desirable regardless of its excess supply, reflects American hubris, not reality. This hubris is so extreme that only 6 weeks ago McKinsey Global Institute published a study that concluded that even a doubling of the US current account deficit to \$1.6 trillion would pose no problem.

Strategic thinkers, if any remain who have not been purged by neocons, will quickly conclude that China's power over the value of the dollar and US interest rates also gives China power over US foreign policy. The US was able to attack Afghanistan and Iraq only because China provided the largest part of the financing for Bush's wars.

If China ceased to buy US Treasuries, Bush's wars would end. The savings rate of US consumers is essentially zero, and several million are afflicted with mortgages that they cannot afford. With Bush's budget in deficit and with no room in the US

consumer's budget for a tax increase, Bush's wars can only be financed by foreigners.

No country on earth, except for Israel, supports the Bush regimes' desire to attack Iran. It is China's decision whether it calls in the US ambassador, and delivers the message that there will be no attack on Iran or further war unless the US is prepared to buy back \$900 billion in US Treasury bonds and other dollar assets.

The US, of course, has no foreign reserves with which to make the purchase. The impact of such a large sale on US interest rates would wreck the US economy and effectively end Bush's war-making capability. Moreover, other governments would likely follow the Chinese lead, as the main support for the US dollar has been China's willingness to accumulate them. If the largest holder dumped the dollar, other countries would dump dollars, too.

The value and purchasing power of the US dollar would fall. When hard-pressed Americans went to Wal-Mart to make their purchases, the new prices would make them think they had wandered into Nieman Marcus. Americans would not be able to maintain their current living standard.

Simultaneously, Americans would be hit either with tax increases in order to close a budget deficit that foreigners will no longer finance or with large cuts in income security programs. The only other source of budgetary finance would be for the government to print money to pay its bills. In this event, Americans would experience inflation in addition to higher prices from dollar devaluation.

This is a grim outlook. We got in this position because our leaders are ignorant fools. So are our economists, many of whom are paid shills for some interest group. So are our corporate leaders whose greed gave China power over the US by offshoring the US production of goods and services to China. It was the corporate fat cats who turned US Gross Domestic Product into Chinese imports, and it was the "free trade, free market economists" who egged it on.

How did a people as stupid as Americans get so full of hubris?

Paul Craig Roberts was Assistant Secretary of the Treasury in the Reagan administration. He was Associate Editor of the Wall Street Journal editorial page and Contributing Editor of National Review. He is coauthor of The Tyranny of Good Intentions.

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