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How Far Will the Crash Go and What Do we Do Now? The "Crash of 2007-8" is underway

by Richard C. Cook

Global Research, August 18, 2007

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The immediate triggers are being described quite well: the collapse of the U.S. subprime mortgage market; the vulnerability of the rest of the economy to the subprime undertow, due to the "efficiency" of the markets in spreading risk; the worldwide overextension of cheap credit; the failure of large institutional investors and Wall Street brokerages to behave responsibly; and the long-term effects of the U. S. trade and fiscal deficits which are now coming home to roost.

Amazingly, some commentators have been asking "if the monetary crisis will affect the producing economy," and whether a recession lies ahead. In reality, the U.S. producing economy has been in a recession for the last year. This is shown most clearly by the decline in M1, the portion of the money supply immediately available to people for making purchases.

The causes of the M1 decline are two-fold. One is the weak purchasing power of American consumers, at least half of whose decently-paying manufacturing jobs have been eliminated by the outsourcing, mergers, and productivity improvements during the past two decades. The other is that while many of the U.S. corporations not connected to housing have been doing all right, their success has been tied to overseas investments and sales, such as GE and GM who are heavily invested in China.

This type of business activity props up the stock prices of these global corporations but does little for the working American. The presumption that overflow earnings from stockholders will benefit the rest of our domestic economy is the essence of "trickle-down," supply-side economics and is part of the justification for the system that makes the rich richer and the poor poorer.

But as Barron's reported earlier this year, much of the profits from the global corporations are being held as retained earnings for future growth, rather than being passed on to stockholders as dividends. Because of the heavy debt load corporations carry today, they are all in a grow-or-die mode. Again, the result is deficient purchasing power which works to negate the already dubious trickle-down effect.

The recession has been masked by four factors: 1) the government's phony GDP numbers, where the "churning" of financial transactions masquerade as production; 2) the froth on the stock market that took the Dow Jones Average (DJA) from a little over 11,000 to a record-breaking 14,000 during a one-year period that ended with the decline that began in mid-July; 2) the propensity of the American consumer, which is now ending, to continue to buy goods and services on credit, including necessities of life like health care; and 3) modest growth in low-paying service economy jobs, which also may be coming to an end.

These lesser bubbles have mirrored the big ones that are bursting as lenders lose confidence in the ability of borrowers to repay. These are the housing bubble,

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affecting consumers; the acquisition bubble, affecting equity funds; and the speculation bubble, affecting hedge funds.

As the house of cards comes tumbling down, the leading question on financial websites and blogs is how deep will the decline go. Will it stop at the level of the recessions of previous decades, including 2000-2002, with a decline that is reflected in the DJIA of somewhere around thirty-five percent from its peak? Or will it be the "Armageddon" scenario which would take us to depression-level conditions? Of course there are multiple possibilities based on a decline somewhere between a recession and a depression that would share some of the characteristics of each.

Muddying the waters is the fact that the DJIA is much less reliable as a measure of economic health today than in the past. This is because today the vast majority of financial transactions now take place within the furtive secrecy of the equity, hedge, and derivative markets. No one really knows what is going on, except that on any given day an announcement is made that another fund or company has been wiped out.

Neither the Federal Reserve nor the U.S. government believes they have an obligation to gather or publish data that will help the public gauge the effects of these crises on their homes or jobs. Some might call this negligence a crime against democracy. In fact the Federal Reserve made tracking even more difficult by ceasing to report the M3 macro-currency numbers, but researchers have shown that growth in M3 is soaring while M1 goes down.

What appears to be happening right now is that the Federal Reserve, which oversees the U.S. economy on behalf of the financial, corporate, and government elites, is deliberately trying to squeeze as much debt out of the economy as it can. It is doing this with interest rates that are high relative to actual conditions, while trying to avoid the Armageddon scenario.

The Fed is carrying out its "soft-landing" policy by holding credit tight while introducing "liquidity" into the markets on a day-by-day basis through use of overnight "repos" and by cutting the discount rate for bank borrowing. Conservative columnists like George Will and Bob Novak watch and shake their pom-poms from the sidelines.

But "liquidity" is just a fancy name for more loans. The one thing we can be certain of is that every loan bears interest charges which someday, somehow, will have to be paid by a person who works for a living.

And if you wondered where the Fed got the \$34 billion in liquidity it pumped into the markets on Friday, August 10, you weren't the only one. The answer is that the Fed has a secret room upstairs where it keeps a large "printing press." It's legalized counterfeiting, but as with any counterfeit money, if people accept it in trade it acts just like the real stuff—for a while.

The danger, which many commentators are pointing to, is that the Fed will ignite a hyperinflation, which may be what is happening and may actually be intentional because it devalues debt. It's what happens when debt is used to pay off debt and is in fact an invisible tax. Such inflation is difficult to discern, again because of the government's rigged statistics. The most important indicator to watch is the price of oil, which doesn't show up in "core inflation."

But there are signs that the "soft landing" is working, such as a modest increase in U.S. exports. Reflecting the weak dollar, China is now charging more for its own exports, which will stimulate our industry here at home. And the Fed's discount rate cut last Friday sparked a modest stock market rally.

Meanwhile, there is a debate over whether quasi-public agencies like Fannie Mae and Freddie Mac should be used to spread the housing market losses across the entire taxpaying population. While society as a whole is made poorer, many individuals who might have lost their homes or jobs are spared some pain. So it's hard to argue against it. But this type of bail-out would benefit individual homeowners more than the big banks, so the conservative politicians and commentators oppose it.

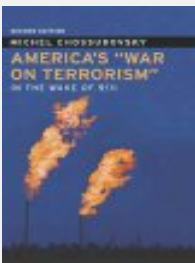
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But there's a bigger picture. The strategy of the Fed is likely to allow the recession to proceed but it does want to get the economy moving again before the downturn goes too far. In fact they probably plan to do it in time for the 2008 presidential election.

The Fed wants to see a recovery in place by then so the American public will go back to sleep and elect another politician who will steadfastly protect the privileges and powers of the magnates who, through the Fed, rule the world. Even if a new president has some progressive ideas, he or she won't be able to alter much if a recovery has started.

The "soft landing" is a political power play.

It's what they did in 1984, when Ronald Reagan was reelected on a campaign theme of "It's morning in America," after the Fed let up following the twenty percent-plus rates it used to trash the producing economy from 1979-83. The Fed did the same with the housing bubble to get George W. Bush reelected in 2004.

The financiers' worst fear is that if things get too bad the American people might elect a reformer in 2008. So far the corporate press has kept two such reformers—Ron Paul and Dennis Kucinich—in the shadows. Now that Hillary Clinton is starting to sound more progressive, they'll attack her overtly since she is too big a player to be ignored. The Washington Post has already begun.

So we'll see if the Fed's plan succeeds as well over the next couple of years as it has in the past. In the meantime, what remains firmly in place is the monetarist regime through which the financiers and the Fed have ruled America for the past thirty-six years, since President Richard Nixon closed the gold window for international exchange in 1971.

During this period, we have seen several interlocking phenomena:

- 1) interest rates that on the whole have been much higher than the previous period of the New Deal and its aftermath, lasting into the 1960s;
- 2) inflation that has eroded eighty percent of the value of the dollar;
- 3) replacement of our producing industrial economy with a service economy dominated by high finance;
- 4) almost continuous warfare with a clear objective of world domination whose purpose is to shore up the dollar as the world's reserve currency;
- 5) ever-deepening public, private, and household debt;
- 6) the ever-widening gap between rich and poor, with increasing numbers of the poor, homeless, and hungry who are left out of the nation's economic life;
- 7) a crisis in the nation's crumbling infrastructure; and
- 8) the constant whipsawing of over 200 million ordinary people.

It's our citizens who are batted around like ping pong balls between alternating conditions of boom and bust as every few years many of them watch the overnight disappearance of their homes, pensions, savings, health insurance, and jobs. Added to this is the stress that has eroded the health and even life expectancy of the U.S. population.

It's a horrible picture created by a filthy system. It's why religious leaders for thousands of years have characterized usury, and a culture ruled by usury, as a crime against God and humanity. The monetarist rule of the Federal Reserve is legal, institutionalized usury. Over the years they have mastered all the tools of the trade, the objective of which is to continually allow the financial superstructure to skim the cream off the producing economy. Come to think of it, isn't that how the Mafia used to work with its protection and loan-sharking rackets?

And can anything be done about it? Of course.

In previous articles on the Global Research website and elsewhere, this writer has offered a list of reforms—mostly monetary—that can and should be made. They all involve the recognition of credit as a public utility, part of the societal commons, not the private playground of the financiers, with the Fed as their facilitator.

Low-cost credit overseen by the federal government was the basic building block of the New Deal. It was done by strong people with an ideal of public service, though in many respects they didn't go far enough and relied too much on World War II and armaments to attain a full-employment economy. We now need a New Deal for the 21st century that would correct the flaws of the last one, resolve the present crisis, and carry us into a future that will benefit everyone, not just the privileged few.

Richard C. Cook is a retired federal analyst, whose career included service with the U. S. Civil Service Commission, the Food and Drug Administration, the Carter White House, and NASA, followed by twenty-one years with the U.S. Treasury Department. His articles on monetary reform, economics, and space policy have appeared on Global Research, Economy in Crisis, Dissident Voice, Atlantic Free Press, and elsewhere. He is the author of "Challenger Revealed: An Insider's Account of How the Reagan Administration Caused the Greatest Tragedy of the Space Age." His website is at www.richardccook.com.

Richard C. Cook is a frequent contributor to Global Research. [Global Research Articles by Richard C. Cook](#)

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