On Mexico, for example? All around the world?

With the collapse of the relative value of the U.S. dollar, perhaps by more than 10%, ultimately to perhaps as little as 60% of its present exchange-rate, what happens to the world market serviced by the United States as importer of last resort for the world as a whole?

Something analogous, but far, far less severe happened in the U.S. during 1929-1932. What we faced then, was a world-wide financial and economic crisis. What threatens the world immediately today, is a global economic-breakdown crisis.

Now, taking such facts as the impact of a collapse of the purchasing-power of the importer of last resort, upon the U.S. and world economy as a whole, we have a situation in which none of the measures even conceived to be politically feasible by either the outgoing Clinton Administration or incoming Bush Administration, have any relevance for the realities of 2001. What must then be said of wishfully self-deluded fools, who are thinking in terms of "How do we adapt to the realities of the incoming new administration?" Since I am the only international figure who has a competent grip on the realities of this situation, where does the tactical, as well as the strategic center of world politics lie at this moment?

Time to leave wishful dream-land, and come back to reality.

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The Bursting of the U.S. Import Bubble

by Richard Freeman

During the past few decades, but especially the past five years, the United States has attempted to disguise and compensate for a physical economy that is contracting at the rate of 1 to 2% per annum, and producing a falling living standard, by a simple expedient: using its overvalued dollar to import—suck in—goods from other countries. What the U.S. does not produce, and in many crucial instances, is no longer capable of producing, it imports from abroad. As a result, imports have soared far above exports, leading to record trade deficits, with each year's deficit successively dwarfing the previous year's. In turn, the rising trade deficit is the leading element that swells the current account deficit.

To cover the current account deficit, Wall Street and the City of London have rigged the world financial system so that large flows of foreign-held dollars are attracted back into investment in the United States. What the United States pays in dollars for its physical goods and other items that make up the current account deficit, and more, is brought back into the United States.

This entire system of foreign goods flowing out of other countries and into the United States is held aloft by the U.S. financial bubble. Foreigners will bring dollars across the Atlantic and Pacific Oceans into the United States, for investment in the U.S., only as long as the dollar is seen as a sound currency, and as long as dollar-denominated investment instruments—such as U.S. Treasury bonds, corporate bonds, stocks, derivatives—pay a relatively higher rate of return than the comparable instruments of other nations in the world. Thus, the bubble of the U.S. investment market has to be maintained, in order for the Anglo-American financier oligarchy to keep its grip on power.

This is not a healthy arrangement for any of the nations concerned. The United States is importing such a huge amount of physical goods, mostly, not because its economy is expanding, but because it has impaired or permanently destroyed the capacity to produce these goods by its own productive facilities. The exception is the increase of imports of luxury goods, in particular cars, by the upper 20% of the population by income rank, whose income has come in significant measure from the financial bubble.

De-Leveraging Is Imminent

This bubble's imminent explosion, in the worst breakdown crisis in 300 years, ends this system. The recent halving

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of the value of the Nasdaq stock index over the past 10 months, wiping out over $3 trillion in market capitalization, indicates the direction this will take. As the value of the bubble falls, various foreign investors, for safety reasons, will yank their money out of the United States, and act to get out of dollar-denominated investments altogether. This will send the dollar plummeting: A 40% fall in the value of the overvalued dollar—whose strength rests upon the "strength" of the bubble—is likely. At that point, the effect will spread to cause a lightning de-leveraging of the highly leveraged U.S. financial system. The dollar-centered financial system as a whole will shatter.

There will be a simultaneous pulverizing of physical economies, given the way world trade is presently constituted. Without the flow of foreign-held dollars into the United States, the U.S. will not be able to finance its current account deficit, which consists primarily of its trade deficit.

This will have consequences from two sides. On the side of the United States, from consumer goods, such as clothing and household appliances, to capital goods, such as machine tools and electrical equipment, this country imports between 20 and 75% of all the goods it consumes each year. The flow of a large portion of these goods will be cut off.

On the side of the rest of the world: Japan, Taiwan, the Philippines, Malaysia, Thailand, and Nigeria export between 25% and 40% of all their physical goods exports to the U.S.; China exports 41.9% of its physical goods exports to the U.S.; Ibero-America, not counting Mexico, exports 36.5% of all its physical goods exports to the U.S.; Ibero-America, when Mexico is included, exports 56.6% of its physical goods exports to the U.S. In the case of Mexico and Canada, more than 83% of their physical goods exports go to the United States.

The effect of the contraction of this trade will be non-linear. In the midst of the financial disintegration of the past decade, for many nations in Asia and Ibero-America, exports to the U.S. represent all that allows them to keep certain factories open. The removal of this trade will force shutdowns of large swathes of manufacturing in their economies, which will impact the non-export domestic economy.

As for the United States, only by stealing goods from the rest of the world, through the strong dollar, has it been able to keep certain industries open, albeit at reduced rates of production. Now, the sharp contraction of goods trade between the U.S. and the rest of the world will step up the production collapse. This will create a worldwide interacting downward spiral, also affecting Europe, which will see the markets for trade in Asia and the Americas drastically fall.

By selecting key representative sectors of the economy, we will see just how extensive America's import dependency is. The high degree of U.S. import dependency emerged from the implementation of the "post-industrial society" policy, a deliberate policy of shutting down manufacturing and agriculture.

History of the Crisis

Emerging from World War II, the U.S. was an exporting nation, which exported many capital goods to war-torn nations of Europe, and elsewhere around the world. This is what an industrial nation should be: a capital goods exporter, exporting machine tools, tractors, electrical generating equipment, etc., with an emphasis on the developing world. Based on that, for the most part, it will run a trade surplus. The United States continued in that manner, in modified form, up through the end of the 1960s. Even as late as 1975, the U.S. ran a physical (merchandise) goods trade surplus of $8.9 billion.

But during the 1960s, the City of London-Wall Street financier oligarchy imposed a post-industrial society policy. This policy closed down manufacturing, agriculture, and infrastructure, and built up non-productive services and a large speculative bubble. In 1971, this policy reached a catastrophic turning point, when President Richard Nixon took the U.S. dollar off the gold reserve standard. This divorced financial flows from productive flows, and set the basis for the build-up of the speculative Eurodollar market.

In October 1979, under the Administration of Jimmy Carter, then-Federal Reserve Board Chairman Paul Volcker instituted a policy that he explicitly called "the controlled disintegration of the economy," as an extreme variant of the post-industrial society. Volcker began forcing upward the prime interest rate charged by commercial banks, so that by November 1980, the prime rate had reached 21.5%. Interest rates were held at double-digit rates for five years, through the end of 1984. As a result, in the period 1980-84, this killed off a layer of the U.S. manufacturing base, causing companies to shut down partially or completely. A surge of imports began, in order to replace the manufacturing capacity America had lost. The machine-tool industry makes this case in a particularly dramatic way.

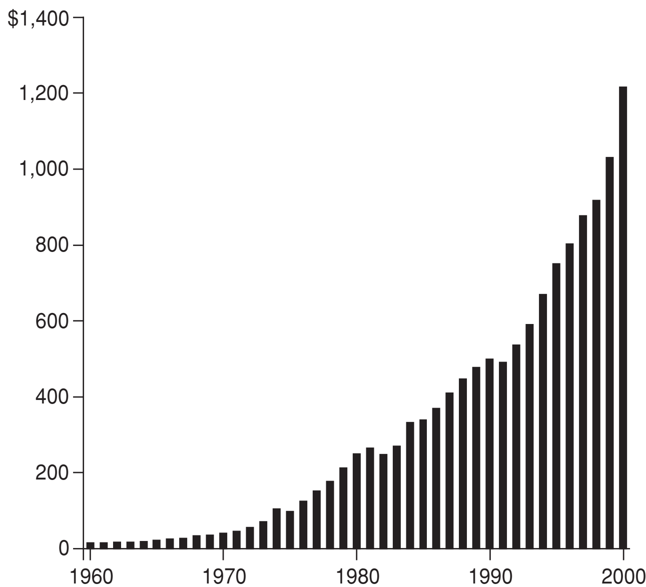
During the decade of the 1990s, the focus of the post-industrial society policy was to extend the process of "globalization," one of whose key features is that manufacturing is outsourced to some of the poorest countries. Goods are produced where workers—frequently children—are paid from 10¢, up to $2 per hour. The 1993 passage of the North American Free Trade Agreement (NAFTA), with its slave-labor *maquiladora* system, was carried out with this purpose in mind (see article, p. 24). During the 1990s decade, a second surge of imports was fostered.

Figure 1 shows that the level of physical goods imported into the U.S. rose dramatically during the period 1960-2000. In 1981, the United States imported $265.1 billion worth of physical goods; by 1990, this had risen to $498.3 billion, a near doubling, which is already a sizeable amount. But between 1991 and 2000, the level of U.S. physical goods imports surged from $491 billion to a projected $1.215 trillion, which is an explosive growth of 2.5 times. But even this understates the actual growth: The forced devaluation of many currencies against the U.S. dollar during the latter part of the decade of

FIGURE 1

U.S. Physical Goods Imports, 1960-2000

($ Billions)

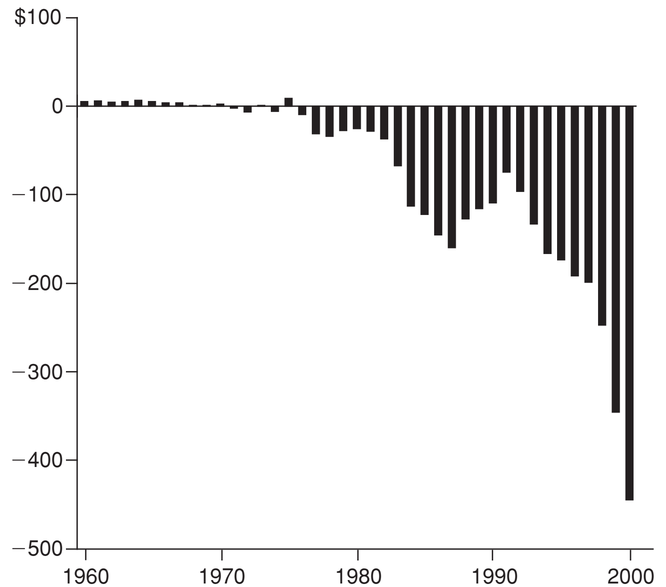


*First ten months of 2000, annualized.
Source: U.S. Department of Commerce; *EIR.*

FIGURE 2

U.S. Physical Goods Trade Deficit, 1960-2000

($ Billions)



*first ten months of 2000 annualized
Source: U.S. Department of Commerce; *EIR.*

the 1990s, meant that the dollar could buy more physical goods. Thus, whereas $1,000 worth of imports may have commanded and represented 50 goods from Mexico in 1990, because of the devaluation of the Mexican peso, the same $1,000 worth of imports may have commanded and represented 100 goods from Mexico in 2000. *EIR* is investigating further this added volume of goods imports commanded by an overvalued dollar.

Figure 2 shows that the surge in imports pushed forward the U.S. trade deficit in physical goods. In 1995, the U.S. physical goods trade deficit had already reached a record $173.6 billion, but by 2000, it had skyrocketed to a projected $444.1 trillion, an increase of more than two and half times in only five years. (For the same reason that the dollar amount understates the size of the U.S. physical goods import level, it also understates the size of the U.S. physical goods trade deficit.)

Figure 3 presents the U.S. current account deficit, in which the trade deficit is the principal force. There are two main differences between the current account deficit and the physical goods trade deficit. First, the current account is comprised of three main elements. Two of the elements are the balance on investment income, and the balance on unilateral transfers. Second, while the third element of the current account deficit is the trade deficit, the current account utilizes the trade deficit on goods and services, whereas above, we concerned ourselves only with the physical goods trade deficit and excluded services. But, given its overwhelming size, the trade deficit in physical goods drives forward the deficit of the current account. (For a more detailed explanation of how the current account balance works, see "U.S. Current Account Deficit Could Rupture Economy," *EIR,* April 21, 2000).

Based on the trend of Commerce Department data, the U.S. current account deficit for 2000, would be projected to a record $440 billion. But even that disguises the deficit's real magnitude, which, due to the reason cited above and other reasons, is, in fact, significantly larger.

Thus, the imposition of the post-industrial society policy fed the rising U.S. physical goods trade deficit, which in turn, swelled the current account deficit.

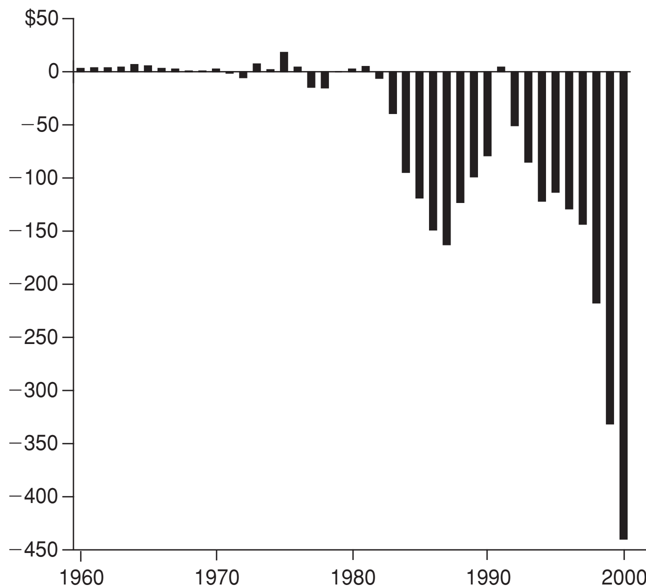
Rising Consumer Goods Imports

We now look at key sectors of the U.S. economy, to see how extensive America's dependency on imported physical goods has become. A large portion of everything we consume, from the clothing on our backs, to home appliances, to machine tools, is imported. To depict this point, *EIR* has selected representative sectors from the consumer goods market basket, the producer goods market basket, and intermediate goods.

FIGURE 3

U.S. Current Account, 1960-2000

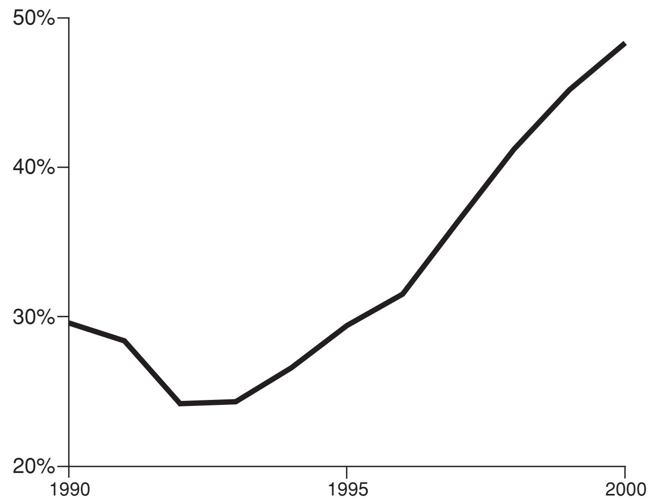
($ Billions)



*first nine months of 2000 annualized
Source: U.S. Department of Commerce; *EIR*.

FIGURE 4

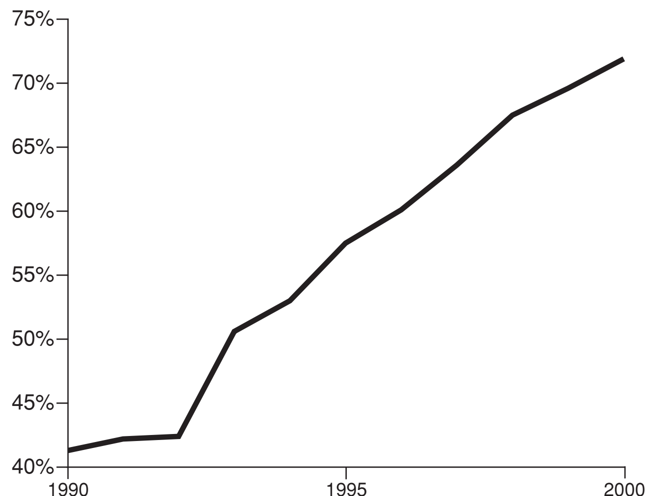
Men’s/Boys’ Trousers: Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 5

Men’s/Boys’ Shirts: Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

In each case, we examine America’s total consumption of a particular good, and what percentage is supplied strictly by imports. Start with consumer goods.

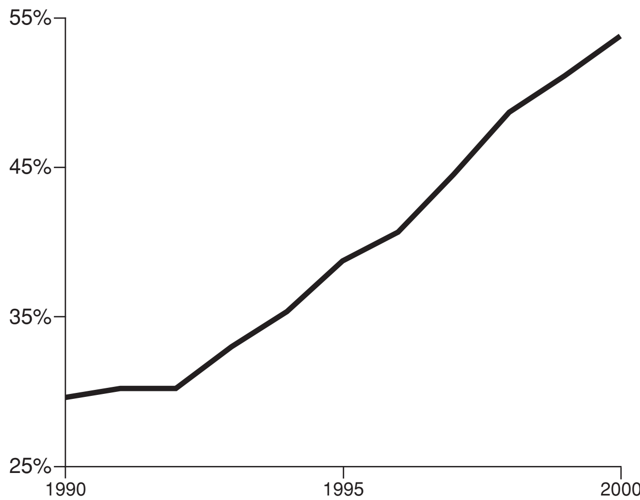
Figure 4 documents that in 1990, 26.1% of all the men’s/boys’ trousers that America consumed were imported. By 2000, 48.3% were imported. This near doubling indicates just how strong the policy of the overvalued dollar was during the decade of the 1990s, in flooding America with imports. (In many instances, consistent U.S. Commerce Department data only extend back to either 1989 or 1990, and therefore our graphs only go that far back. However, in instances where either Commerce Department or industry trade association data permitted a longer timeframe, *EIR* utilized those data.)

Figure 5 shows that between 1990 and 2000, the percentage of all shirts that America’s men and boys consumed, which were imported, rose from 42.9% to 71.9%. **Figure 6** shows that between 1990 and 2000, the import content of all the outerwear garments (that is, all clothing that is not underwear) which America’s men and boys consumed, rose from 28.3% to 53.7%.

Figure 7 shows a similar story for women’s/girls’ blouses. **Figure 8** documents that between 1990 and 2000, the import content of all the outerwear garments which America’s women and girls consumed, rose from 31.5% to 51.1%.

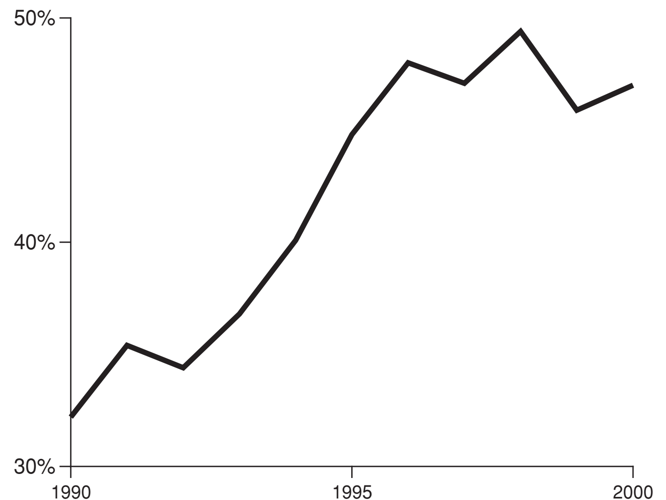
Thus, between 1990 and 2000, the import content of all outerwear garments consumed by all Americans, rose from 29.9% to 52.5%. Today, half of all clothing that every man, woman, and child wears, is imported. But consideration of

FIGURE 6
All Men's/Boys' Outerwear Clothing: Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 8
All Women's/Girls' Outerwear Clothing: Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 7
Women's/Girls' Blouses: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

this arrangement, shows how America exists through looting. The imported clothing is produced in slave-labor conditions in countries such as Bangladesh, the Dominican Republic, and Thailand, where workers—often children—are paid as little as 10 to 25¢ per hour. A large retailer, like Wal-Mart or K-Mart, will buy a finished shirt, for example, for perhaps $3, and sell it for $8 in its store in America. Had the shirt been produced in America, with the garment worker paid a decent wage, it might cost $15 to $20 to make, and sell for $25. Inside the United States, as a result of the post-industrial society policy, real living standards are falling. But through this arrangement, the American family, whose living standard would not permit it to buy a $25 shirt, may be able to purchase it for $8. Thus, even with the imports, America's total level of reproductive economic activity is falling; but remove the imports, and the economy would be in a free-fall.

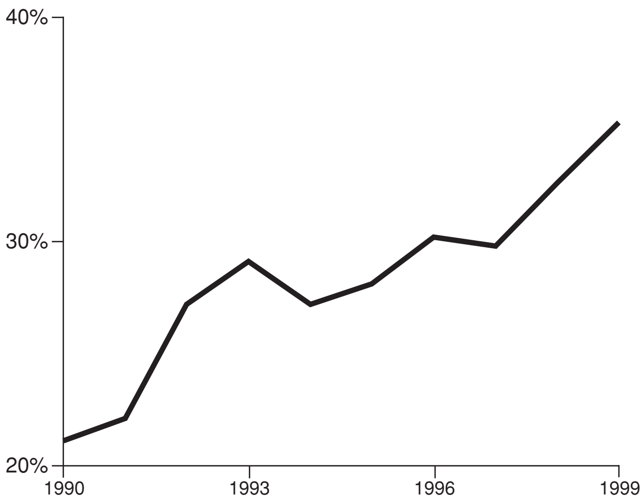
Figure 9 shows that in 1990, 21.1% of all household cooking equipment that Americans consumed, was imported. Today, the figure is 35.3%. **Figure 10** shows that the same process is under way for housewares and fans.

Figure 11 documents that in 1972, 2.5% of all the motor vehicles that Americans purchased, were imported. Today, the figure is 34.2%. (*EIR* is investigating what percentage of parts that go into American motor vehicles, is imported.)

Intermediate Goods

But the dependency of America's economy on imported goods, even to function at a declining level, extends beyond the consumer goods sector to all other processes of the economy.

FIGURE 9
Household Cooking Equipment Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 10
Electric Housewares and Fans: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 11
Motor Vehicles and Vehicle Bodies: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 12
Ceramic Tile: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

There is a whole range of intermediate goods that are necessary for the production process. **Figure 12** shows that in 1972, 35.4% of all the ceramic tile that America consumed, came from imports. By 1997, 61.8% came from imports. Ceramic tiles are used on floors and walls in houses, for example.

In the cases of steel, and sawmill and planing products—different types of cut lumber—which are shown in **Figures**

FIGURE 13
Steel: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

FIGURE 14
Sawmill and Planing Mill Products: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

13 and **14,** respectively, the import dependency has grown.

Figure 15 shows that in 1972, 8% of all industrial fasteners which America consumed—consisting primarily of a basic product, screws—were imported. In 1999, 22.2% were imported.

FIGURE 15
Industrial Fasteners: Imports as a Percent of Total U.S. Consumption

Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

Capital Goods

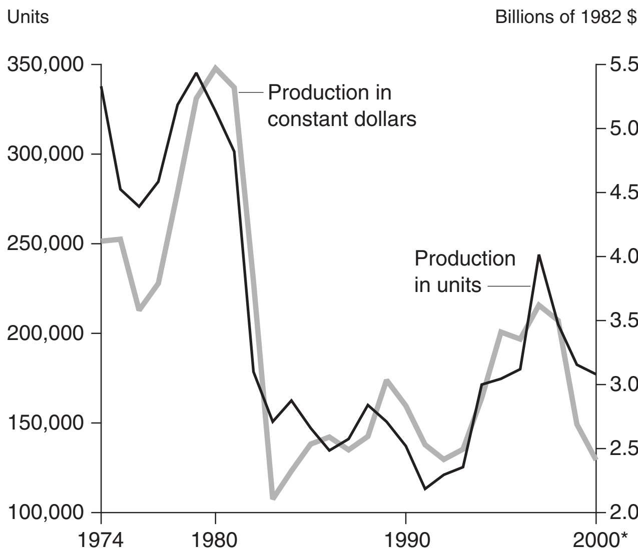
But most fascinating, is the way that imports have moved into a domain in which America had long been a leading force: capital goods.

This process is most clearly elucidated by the machine-tool industry, which forcefully makes a general point that applies to most industries throughout the United States: that the primary reason that America imports most goods, including machine tools, is that the corrosive post-industrial society policy had been implemented to destroy America's internal production capacity first. The flood of imports came only secondarily.

In October 1979, Jimmy Carter's Federal Reserve Board chairman, Paul Volcker, sent the prime interest rate into the stratosphere, so that it reached 21.5% by November 1980. He held the rate at double-digit levels through the end of 1984. This crushed all manufacturing, but is most exemplified by machine-tool production. **Figure 16** shows that after an 18-month delay following the start of the policy, Volcker's policy caused a straight free-fall collapse in production. America's machine-tool production has never remotely recovered, either in units produced or in dollar volume of shipments, to the level that it had in the period prior to Volcker's action. The catastrophic effect of Volcker's policy is that it forced the permanent shutdown of America's capacity.

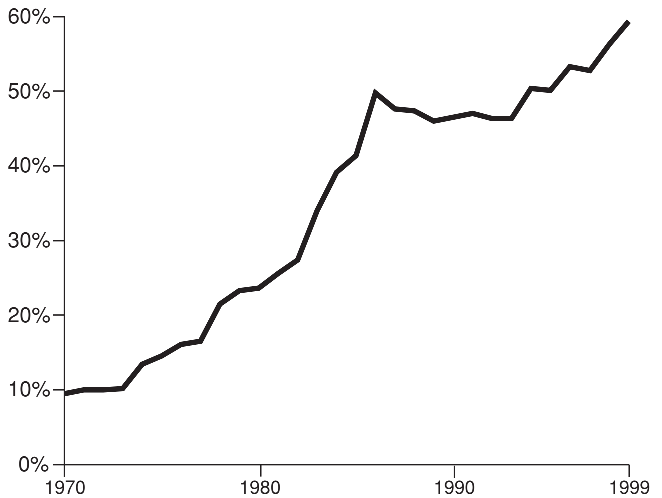
The Midwest and New England are America's two main regions for machine-tool production. Between 1977 and 1992, the number of operating machine-tool plants in the

FIGURE 16
U.S. Machine Tool Production, in Units and in 1982 Constant Dollars



* First six months, annualized.
Sources: Association for Manufacturing Technology; U.S. Department of Commerce; *EIR*.

FIGURE 17
Machine Tools: Imports as a Percent of Total U.S. Consumption



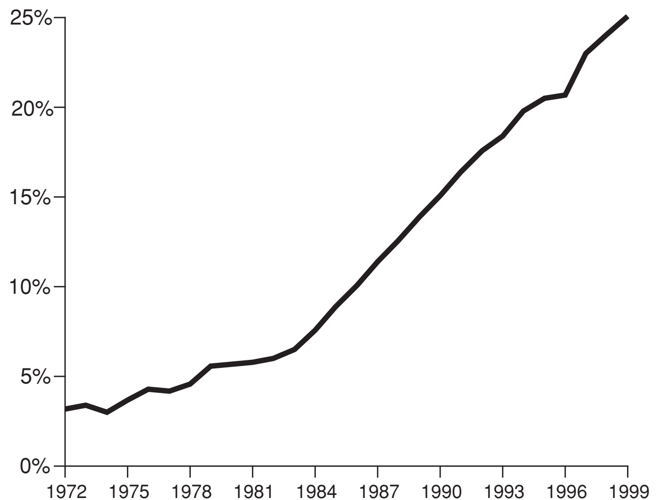
Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

Midwest fell from 567 to 317, a reduction of 44.1%; the number of machine-tool plants in New England fell from 275 to 155, a reduction of 58.2%. Most of these closings occurred by 1984.

America compensated for the loss of productive capacity by importing; overwhelmingly, it was not the level of imports that caused the loss of production, but the other way around. **Figure 17** shows that in 1970, 9.5% of all machine tools that America consumed, were imported. Even by 1979, the year that Volcker imposed his interest rate action, only 23.3% of all the machine tools that America consumed, were imported. However, by 1986, as a consequence of Volcker's action, the percentage of all machine tools consumed, which were imported, shot up to 49.8%. Today, 59.4% of all machine tools used in the U.S. are imported.

Figure 18 shows that import dependency has struck another U.S. capital goods industry, that of electrical equipment. This category includes such crucial machines as specialty transformers; steam, gas, and hydraulic turbines; and and turbine generator sets. In 1972, 3.2% of all electrical equipment in use in America was imported. By 1999, imports accounted for 25.1%.

FIGURE 18
Electrical Equipment: Imports as a Percent of Total U.S. Consumption



Source: U.S. Department of Commerce; World Trade Organization; *EIR*.

The tremendous dependency, fostered by the post-industrial society policy of the United States, to loot physical goods imports from other countries, extends across the American economy, from consumer goods to intermediate and capital goods. On the opposite side, there are nations that send a large percentage of their exports to the United States. This relationship has become unsustainable, as the financial bubble that held this relationship together, is bursting. This will collapse the world financial system, and pulverize world trade.