# The Shrinking Dollar

Mason Gaffney, December 2007

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In January 2006 *Insights* showed how successive administrations in Washington have doctored the Consumer Price Index (CPI) to conceal the real rise in the Cost of Living (COL). Self-defined "mainstream" economists have served as tools, some as active leaders and others as sheep in the herd.

As late as the spring of 2007 Professor Robert Gordon of Northwestern University, speaking at U.C. Riverside on another topic, strayed from his theme to defend the doctored CPI. He himself had been one of the doctors, as a member of the (Michael) Boskin Commission of 1995. That Commission, recall, had accepted a directed mission from House Speaker Newt Gingrich to show why the CPI should be lowered; and it obliged. Since then its findings have been parroted, and never questioned, in dozens of new economics textbooks by individual authors supposedly responsible for their own judgments.

By the spring of 2007 it was clear as a silver bell that the true COL, led by land and raw materials prices, had far outraced the CPI. Dozens of journalists had ganged up on the obvious point, but Gordon did not budge. Neither did the dozens of overpriced textbooks foisted on college students taking economics, even though they come out in new editions every two or three years to spoil the second-hand market that would save students hundreds of dollars yearly.

Gordon's stance was a personal sorrow, too. His father, Aaron Gordon, had been a Professor of Economics at Berkeley when I went through that mill. Aaron was a *Mensch*, one of the few in that icy group. He had pulled my chestnuts out of the fire, although I had given him no reason to care what happened to me. Some other professors had tried to throw me out of graduate school for the misdemeanor of soliciting a letter of recommendation from Carey McWilliams, Editor of *The Nation* and a land reformer sympathetic to Henry George. This was during the McCarthy era, when the "charge" was not as laughable as it would seem at most times. Professor Paul Taylor, on whose support I had counted, disparaged me as "that single-taxer". Aaron befriended and helped me through that time of troubles. It also helped, I suppose, that the Dean of the Graduate School doted on my new wife, a favorite student of his, but, well, one goes to war with the army one has. Anyway, I owed Aaron and he still holds a warm spot in my heart.

While Robert gravitated rightwards to Northwestern, which hasn't changed much since Richard T. Ely, Aaron's other son, David Gordon, took a left turn to the New School in New York. David was outstanding but died young, and Aaron is gone, leaving us with Robert and the Boskin connection, a sorry trade.

You can fool some of the people all of the time, but it is harder to fool traders on the foreign exchanges. The dollar price of the Euro has soared over 60% since the Boskin Report. The dollar price of copper on the London Metals Exchange has risen six-fold, 2001-date. The price of gasoline, which is somehow kept out of the CPI, is on everyone's mind. Corn is way up, along with corn-land, while Congress continues its annual giveaways to the "poor farmers". Meantime the CPI creeps up at about 2-3% a year, along with the social security checks that are keyed to it, while politicians in Washington blame national bankruptcy on these elderly pensioners who might interfere with their routine welfare for the rich.

An early theory of foreign exchanges was called Purchasing Power Parity (PPP). The idea was that if your COL doubles, your currency value is halved. It was far too simple, by omitting many other factors that move foreign exchanges, so economists disparaged it. They overreacted, as herds will, and PPP became "politico-academically incorrect". One hardly dared mention it, for fear of losing caste, so the profession threw out the wheat with the chaff. Today we might benefit by noticing there is a strong connection, since all prices are linked by markets.

The various "other factors" have sustained the dollar for years now, while its domestic value fell. It has been a glorious time for big spenders in Washington, careening down the primrose path, but there is a reckoning due. These factors can work in reverse, and turn an orderly correction into a rout. Here are some of the factors.

- Foreigners hold a big part of the national debt, denominated in dollars. As the debt turns over, why should they relend to a prodigal nation whose leaders keep spending more and taxing less? Each withdrawn loan weakens the dollar, prompting more withdrawals, and round and round she goes, and where she stops, nobody knows

- Foreign banks hold huge dollar reserves. They have used the dollar as the basic international currency because its value was so stable. Now it is dropping fast they are likely to seek a replacement, of which there are many candidates. Iran has already stopped selling oil for dollars; Chavez could well be next. This could lead to a run on the dollar. Such a run is cumulative in a positive feedback loop aka a "vicious downward spiral".

- We have induced oil-exporting nations to "recycle" their huge rents into buying U.S. assets, including lots of "income properties" and "trophy properties" in high-grade locations – i.e. land. The combination of a falling dollar and falling land prices will encourage dumping, possibly in a panic.

- U.S. banks and other mortgage lenders have "bundled" their loans in what once seemed like attractive packages, hiding the sub-prime loans in the bundles. Foreigners bought into these bundles, which seemed sound on the upswing of the land cycle. Bundling made it so easy to forget that it IS a cycle, always has been and probably always will be. On the downswing, all the bundles, good and bad, are tainted by the subprime loans hidden in the bad.

- Collapse of the U.S. homebuilding industry lowers investment opportunities in the U.S., sending foreigners looking elsewhere for higher yields and sounder collateral. Bernanke of all people should have seen this coming: he published an early career-building article on how credit-rationing cum collateral value collapse choked off loan volume in the Great Depression, even though the few loans that were made were at low interest rates, because they were made only to the few borrowers whose collateral was still good.

- Ben Bernanke has bet his reputation and our farm on there being a continual glut of foreign loans from thrifty savers in new economic giants like China, to sustain the dollar. He is losing that bet.
- Washington's fiscal crisis will force cuts in military spending, releasing and encouraging obstreperous foreign nations to go their own way, as several, including Putin's Russia, already are. The glorious hayride is over; the bills are coming due.

> "Far-called our navies melt away; on dune and headland sinks the fire
> And all our pomp of yesterday is one with Nineveh and Tyre
> Lord God of Hosts, be with us yet
> Lest we forget; lest we forget" – Kipling

Michael Hudson did not forget, he warned us more than once. A majority did forget, however, and here we are facing an ever-shrinking dollar and all the wrenching adjustments that will imply. More denial won't change the facts, and the Lord God of Hosts is not likely to let us off the hook, however much we invoke His name to get votes. The Fed cannot stop the recession by easing money because we must keep interest rates up to attract foreign loans, and avoid losing those we already have. This is a constraint that small nations have always had to face and understand, but it is new to the swollen-headed U.S.A. which still lives in denial and will probably not learn without a severe economic chastisement.

Higher interest rates will help collapse land prices. This is desirable and inevitable in the long run, but painful in the short because it is offer prices that will fall first, not asking prices. How do I know that? Because it has always happened that way, cycle after cycle. Sales and records of "deeds recorded" have always fallen much sooner and faster and farther than prices after the peak of a land boom, it's the nature of the human beast, almost as though genetically imprinted. Oh, yes, governments will intercede, as they always have, to sustain land prices and avoid the "calamity" of making land affordable. This we will observe from our storm cellars, hoping the value of our remaining dollars does not blow away in the tempests. Let us Georgists resolve to use this opportunity to promote better ideas for avoiding the next cycle of boom and bust.