Fall 2006

ECON 105 E
Supplemental Questions for Assignment #2
Due Monday Dec 4th in Lecture

Below is an article about the U.S. dollar falling in value and some of the reasons why. Within the context of the models and theory presented in the course, answer the following questions:

1. What are the "Twin Deficits"? Why do they arise? Be sure to explain the linkage.
2. From the quick facts:
    a. If the U.S. Government had a balanced budget in 2005, What would be the approximate current account position of the U.S.?
    b. What does that suggest about the U.S. Economy.
3. What is meant by "the abuse" mentioned in the second paragraph? Be specific
4. From paragraph three:
    a. How is the U.S. "Freeloading"? make sure you answer this in the context of the Balance of Payments for the U.S.
    b. What would be your estimate of the position Chinese Balance of Payments accounts: their current and capital accounts (surplus/deficit)?
    c. Would you expect the Chinese currency to be overvalued or undervalued? What does this suggest about their overall balance of payments position (surplus or deficit)?
    d. Is the information in this paragraph about China consistent with a country running a balance of payments surplus?
5. What are two things the U.S. government could do to stop the fall of the U.S. dollar?

Before attempting these questions, be sure to review chapters 15 and 16 of the Textbook.

USA Quick Facts:
For 2005, the U.S. merchandise trade deficit is expected to total $782 billion, up from $665 billion in 2004. The current account deficit now is running at about 6.6 percent of GDP, compared to 1.5 percent in 1995. The U.S. budget deficit was $319 billion in fiscal year (FY) 2005, down from $412 billion in FY 2004.

Death Knell of the US Dollar...
Clive Maund
Nov 26, 2006

The dollar plunged with startling ferocity late last week, driven by heavy selling. This was very bearish action that signals panic, and the probable onset of a severe downtrend. A break below the crucial support at 80 on the dollar index is expected to mark the transition from a clandestine unloading of dollar assets to an all-out stampede to "get what you can for them" before it's too late.

The conditions leading to an inevitable dollar panic sell-off did not come about overnight. They are the result of years of abuse, principally by the Federal Reserve of the US, which has created a veritable blizzard of dollars, and the universal acceptance of this "funny money" has, up until now, allowed the United States to freeload economically on the rest of the world, living way beyond its means. The exponential growth in dollars has been and is created electronically at the touch of a button, so that paying for anything is never a problem, whatever you want you simply print the extra money to pay for. Because foreigners have so far played along with this game, they are now widely, and to some extent understandably, regarded as stupid. However, it is a dangerous mistake to underestimate the mental capacities of other peoples.

The Chinese, in particular, have an ancient and deep culture, and when it comes to strategic considerations, can outthink - and outflank virtually anyone. So what's going on? - why have they accepted a mountain of paper and IOU's over many years in exchange for real hard work and a vast quantity of real tangible products? The Chinese, and others, have done this to carry them over a bringing period during which they have built up their economies and infrastructure. Their goal - which they are fast moving towards - is to arrive at the point where there is sufficient domestic and regional demand that they no longer need to rely on orders from countries like the United States. At this point - which we may arrive at sooner rather than later - things will become very dangerous for the US dollar, and the situation is actually far worse than many now believe, because the Chinese and others are preparing to WRITE OFF THEIR DOLLAR ASSETS AS A BAD LOSS - they will try to get what they can for them, of course, but otherwise will be ready to fall back on domestic and regional demand and tough it out, thus severing the umbilical with the United States, which will be left stranded, with no takers for its funny money, a gutted manufacturing base, astronomic debts and fiscal chaos, and a huge military it can no longer afford to service.

When the forces of globalization are let loose, as they have been, this is actually a natural and inevitable process, as orders and work simply move to the lowest bidders. Europe and the United States are uncompetitive and will be sidelined by the powerhouse economies of China and South East Asia. The Chinese and other trading partners with the US are already rotating out of dollars and into Dinars, Euros, commodities generally and Precious Metals at an ever increasing pace. As we already know, this has been a primary driver for the commodities boom. The recent attempt by the United States to maintain its dominance by brute force - a big reason why Iraq was invaded was that it was planning to sell its oil in Euros - is right now, quite literally, running into the sand, and it is now only a question of when, not if, the helicopters arrive on the rooftops to evacuate the last of the embattled US service personnel, like in the film “The Killing Fields”, although a last wildly dangerous attack on Iran still cannot be ruled out.