

Even Stephen Roach Has It Wrong

By
Peter Schiff
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In his latest commentary, Morgan Stanley's Stephen Roach, perhaps the only Wall Street economist who at least partially comprehends the looming economic danger, once again lamented that a "co-dependent global economy can't live without the excess consumption of Americans." This echoes the popular misconception that Americans are somehow doing the world a favor by consuming the fruits of their labor.

The world no more depends on American's consumption than medieval serfs depended on the consumption of their lords, who typically took 25% of what they produced. What a disaster it would have been for the serfs had their lords not exacted this tribute. Think of all the unemployment the serfs would have suffered had they not had to toil so hard for the benefit of their lords. What would they have done with all that extra free time?

According to modern day economists, if the lords had decided to increase their take, say to 35%, it would have been the equivalent of an economic boom for the serfs, who would have been insured more work. Too bad the serfs did not have economic advisers or central bankers to encourage such progressive policies!

I have written on this subject in the past (see my former commentaries entitled: "CNBC Redefines the Word 'Sacrifice'," Feb 10th 2005, and "The U.S. is Not a Special Case, Just an Extreme One," Jan 18th 2005). However, I would like to put the ridiculous assumption that the world benefits from America's excess consumption, and has something to fear from its cessation, to rest once and for all. Consider the following analogy:

Suppose six castaways are stranded on a deserted island, five Asians and one American. Further, suppose that the castaways decide to divide the work load among them in the following manner: (for the purpose of simplicity, the only desire the castaways work to satisfy is hunger) one Asian is put in charge of hunting, another in charge of fishing, and a third in charge of finding vegetation. A fourth is put in charge of preparing the meal, while a fifth is given the task of gathering firewood and tending to the fire. The American is given the job of eating.

So, on our island five Asians work all day to feed one American, who spends his day sunning himself on the beach. He is employed in the equivalent of the service sector, operating a tanning salon which none of the Asians on the island utilize. At the end of the day, the five Asians present a painstakingly prepared feast to the American, who sits at the head of a special table, built by the Asians specifically for this purpose. Realizing that subsequent banquets will only be forthcoming if the Asians are alive to provide them, he allows them just enough scraps from his table to sustain their labor for the following day.

Modern day economists would say that this American is the lone engine of growth driving the island's economy and that without his ravenous appetite, the Asians on the island would be unemployed. The reality, of course, is that the best thing the Asians could do to improve their lot would be to vote the American off the island. Without the American consuming all of their food, there would be a lot more available for them to eat.

Alternatively, they could spend less time on their food related tasks, devoting the extra time to greater leisure or to satisfying other needs, which currently go unfulfilled as much of their scarce resources are devoted to feeding the American.

Now some of you might be thinking that this analogy is flawed, because in the real world economy Americans pay for their food, so real-world Asians providing the meals receive value

in exchange for their effort. Okay, let's assume that the American on our island pays for his food in the same manner real-world Americans pay for theirs, buy issuing IOU's. Let's assume that at the end of the meal the Asians present the American with a bill, which he pays by issuing IOU's claiming to represent future payments of food.

However, all the castaways know that the IOU's can never be collected, as the America has no food, or the means, or even the intention, of providing any in the future. But the Asians accept them anyway, and each night add them to the piles of IOU's collected on previous days. Are the Asians better off as a result of this accumulation? Are they any less hungry? Of course not.

Now let's assume another Asian castaway washes up onto the island, and assumes the role of central banker. Now, each day the central banker taxes the other Asians on the island by confiscating a portion of the scraps of food the American throws them from his table. The central banker then agrees to return these morsels to the other Asians each day, in exchange for each Asian's daily accumulation of the American's IOU's, less a small percentage for himself, because the central banker also has to eat.

Does the existence of a central banker change anything? Do the Asians have any more to eat because their own central banker gives them back a portion of the food he took from them in the first place? Does the American's IOU's have any more value because they can now be exchanged in this manner? Of course not.

Well, if it does not make sense for the six make-believe Asians to support one make-believe American, it does not make sense for billions of real-world Asians to support millions of real world Americans. The fact that they do so in exchange for worthless IOU's in no way alters this reality.

There is no question that in the short-run, by allowing the U.S. dollar to collapse (in effect voting millions of Americans off the island), there will be some temporary disruptions to Asian economies. Of course there will be some initial losers, particularly among those Asians who currently profit from this arrangement. However, these profits come only at the expense of far greater losses borne by the broader Asian population.

In the end, the cessation of America's excess consumption, which is a burden that the Asians now disproportionately bear, not a benefit that they enjoy, will be the best thing that can happen to the Asian people. Like the serfs being liberated from their lords, their scarce resources will finally be freed to satisfy their own needs and desires, and their standards of living will rise accordingly. In addition, since their savings would then be available to finance additional capital investments, rather than being squandered by American consumers, their future standards of living will rise that much faster as well.

Unfortunately for Americans, being kicked off the Asian gravy train means it's time to get back to work. In simple terms, this means a whole lot more hunting and fishing, and a whole lot less eating.

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