Bank Of England Policymaker Predicts Unprecedented Dollar Collapse
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A former member of the Bank of England's Monetary Policy Committee has predicted a massive collapse of the dollar within the next two to five years, warning that a government increase in spending under President elect Obama could be disastrous.

Willem Buiter, who served the BOE from June 1997 to May 2000, has stated that he expects to see the plug pulled from under the dollar as foreign investors turn away from the dollar and other US backed assets including government bonds.

Writing for the Financial Times, Buiter, now a Professor with the London School of Economics European Institute, comments: "There will, before long (my best guess is between two and five years from now) be a global dumping of US dollar assets, including US government assets. Old habits die hard. The US dollar and US Treasury bills and bonds are still viewed as a safe haven by many. But learning takes place."

Buiter, who has previously advised the World Bank, the IMF and the European Commission, points out that the dollar has managed to stay afloat due to the misguided notion that the US can make more capital on overseas investments and interests than foreign investors can make on US assets - a hypothesis that economists have referred to as "American alpha".

However, he believes the global financial crisis has exposed the fatal flaws in that assumption.

"The past eight years of imperial overstretch, hubris and domestic and international abuse of power on the part of the Bush administration has left the US materially weakened financially, economically, politically and morally," Prof Buiter writes. "Even the most hard-nosed, Guantanamo Bay-indifferent potential foreign investor in the US must recognise that its financial system has collapsed."

Buiter warns that a Keynesian-style increase in public spending, the economic stimulus plan mooted by President elect Obama, will not work in the long term because underlying the fundamentals of the US economy is what he describes as a "deep structural rot".

"If the authorities go ahead with the short-run Keynesian stimulus without having convinced the global capital markets and domestic producers and consumers that there will be a timely reversal, the policies will not work." Buiter states.

"If the government is believed to be fiscally continent (future taxes will be raised and/or future public spending will be cut by enough to safeguard the solvency of the state) but turns out not be so after all, the Keynesian fiscal policy will be effective in the short run (as long as the public believes in the fiscal virtue of the government) but will become highly contractionary once the truth dawns." he continues.

Buiter also states that he expects Federal authorities to allow the dollar to depreciate under an inflationary monetary policy, rather than default on Federal debt.

"The US Federal government has taken on massive additional contingent liabilities through its bail out/underwriting of the US financial system (and possibly other bits of the US economic system that are too politically connected to fail)." Prof Buiter comments. "Together will the foreseeable increase in actual Federal government liabilities because of vastly increased future Federal deficits, this implies the need for a future private to public sector resource transfer that is most unlikely to be politically feasible without recourse to inflation. The only alternative is default on the Federal debt. There is little doubt, in my view, that the Federal authorities will choose the inflation and currency depreciation route over the default route."

Buiter warns that this course of action on behalf of the Federal government is unsustainable and will ultimately lead to a massive dollar collapse.

“If I can figure this out, so can anyone in the US or abroad who follows recent economic developments. The dawning of the realisation will lead to the dumping of the assets.” he concludes.