

Inventing Mortgage-Backed Securities

But the system changed. From a government-sponsored entity, Fannie Mae became a private institution. It has more and more become concerned with building a housing bubble: Fannie Mae financed (by purchasing) over-priced home mortgages (though Fannie Mae has a limit of \$275,000 in the size of conventional home mortgages it can buy). Further, during the early 1980s—after Federal Reserve Board Chairman Paul Volcker raised interest rates into the stratosphere in October 1979—Fannie Mae effectively invented mortgage-backed securities, a form of a derivative, or speculative instrument. Through this process, Fannie Mae became a gigantic organization, concerned with making money off a rapidly expanding, speculatively driven home real estate market. In fact, its survival depended on the continuing expansion of this market.

Fannie Mae, Freddie Mac, and other institutions with a similar function, began issuing a ton of financial paper (bonds, mortgage pools, mortgage-backed securities) to finance the home mortgage market. By the end of the second quarter of this year, they had issued more than \$5.25 trillion of this paper. (In a future issue, *EIR* will present the full story of Fannie Mae.) Accordingly, the total amount of financial paper connected to the housing market, including U.S. home mortgage debt, plus the housing-related paper issued by Fannie Mae, Freddie Mac, etc., totalled \$10.39 trillion by the end of the second quarter of this year. This is an immense amount to be riding on the outcome of the U.S. housing market.

The top financiers, Fannie Mae, and the Federal Reserve Board of Governors have all reacted to this crisis frantically. Thus far, the Fed has cut interest rates ten times this year, which has consistently lowered the U.S. conventional mortgage rate, so that it is now 6.46%, the lowest rate in more than 25 years. This has created a surge in home mortgage refinancing, to take advantage of the low interest rates. Since Sept. 11, about 1 million people have applied for refinancing—six times as many as during the comparable period last year. By thus generating a new round of mortgage financing, this has kept the mortgage market alive.

But the bloated U.S. housing bubble cannot survive falling home sales and plunging home prices. A housing market bubble blowout that brings down \$10 trillion or more in paper values, will seize up the U.S. financial system.

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Pakistan's Gwadar A Potential 'Great

by Mary Burdman

A serious casualty of the ongoing U.S.-U.K. war against Afghanistan, could be an infrastructure project which has the potential to help transform one of the poorest regions in the world. This is the proposed deep-sea port at Gwadar, on the coast of Baluchistan, the largest but poorest province of Pakistan.

Constructing a deep-sea port at Gwadar has been discussed for many years, but only in 2001, when the government of China agreed to be sole sponsor of the project, did its construction become possible. However, the all-out move of U.S. forces into the area since war was launched on Afghanistan on Oct. 7, is jeopardizing the project.

A look at the map will indicate why. Gwadar, a port since ancient times, and one of the main communication routes between West Asia (the Middle East) and the South Asian Subcontinent, lies in a most strategic position, near the mouth of the Strait of Hormuz, where the Gulf of Oman joins the Arabian Sea. Every year, some 60% of the world's oil is transported through the Strait of Hormuz.

Plans to be carried out by China and Pakistan, to eventually turn Gwadar into a "world class" 21-berth port which could serve as a regional hub for Pakistan, Iran, the Gulf states, East Africa, and, if planned road and rail connections are constructed, Central Asia and western China, have caused what one Indian newspaper called an "antsy" reaction in Washington, notably at the rabidly anti-Chinese spook-sheet, the *Washington Times*.

Circles in India have also expressed concern. Certainly, New Delhi has a legitimate basis to inquire about the intentions for such a project, given its relations with Islamabad, and the role Pakistan has played in various operations originating with the U.S. Carter-Brzezinski Administration and the Iran-Contra drugs-for-guns operations. These operations have reduced Afghanistan, and areas of Pakistan, to a breeding ground for drug-runners and terrorists, posing a threat to the entire region.

However, the essential issue is what could ever finally lift this region out of its current chaos.

Pakistan lies at the border of West Asia—the Mideast, the Gulf region, and Iran—and the Subcontinent, one of the two greatest concentrations of population in the world. Afghanistan, to the north, is one of the world's great historic passageways, linking Central Asia to the Subcontinent, West Asia,

Port Is Project'

and beyond. Since pre-historic times, populations and conquerors passed through this region—mostly to its repeated destruction. At the same time, this region has also been, for millennia, one of the most densely traversed cultural crossroads in the world.

To transform this area, new infrastructure is vital, to link it to the great “Eurasian Land-Bridge.” This certainly is an enormous task. The issue is, whether projects such as developing a new port, and linking it to the regional transport system, could be made to contribute to overall development—or, whether it will fall victim to the geopolitical wars and resource grabs dominating world policy today.

Clearly, the domination of Afghanistan by the Taliban regime—which is not recognized by Beijing—was already a fundamental problem for this project, and is now becoming an existential issue.

Links To Western China

Islamabad had let it be known in 1997, that it wanted to build a bigger port at Gwadar, because the one at Karachi is totally inadequate. The tensions which arose over the nuclear tests in May 1998 caused the project to be shelved, and, because of its own financial disaster, Pakistan has had to put off construction from year to year.

China had long expressed interest in the project. A deep-sea port at Gwadar could provide one link in China’s overall strategic plan to develop its vast, but impoverished and landlocked western provinces. Further to the east, already routes are being opened from China’s Yunnan Province, via the old World War II “Burma Road” and the Irrawady River, through Myanmar, one of the poorest of nations, to the Bay of Bengal and the Indian Ocean. This would lessen Chinese dependence on shipping lanes in the South China Sea. To the north and west, China is also investing in improving the Karakoram Highway, along the famous “Silk Road,” which highway was itself built by Pakistan and China in the 1970s, and the Gwadar project.

In November 2000, the Governor of Baluchistan, Amirul Mulk Mengal, took up the issue with a Chinese delegation visiting Qetta, and asked for Chinese support for the port, and to link it by rail to the Pakistani rail system at Dalbandin, the “jumping off point” from South Asia, through Afghanistan, to Central Asia.

During the visit of Chinese Prime Minister Zhu Rongji to Pakistan in May 2001, the Gwadar port was a key item of discussion. China agreed to cooperate with Pakistan on seven important projects, including to provide a \$198 million-equivalent credit toward the \$250 million total needed to construct Phase I of the port. This loan, unprecedented in size for foreign lending by China, is to be guaranteed by the Beijing Exim Bank; \$50 million would be an outright grant, \$50 million a commercial credit, and \$98 million a state credit, repayable at generous terms over 15 years. The remaining \$50 million in funds, is to be arranged by the government of Pakistan. Phase I includes dredging the existing port, and construction of the first three berths and other essential facilities.

Most important, is that in September, a group of Chinese experts told Islamabad that it should reject the existing plan for the port, designed by a British firm, because it lacked planning to accommodate long-term requirements. The Chinese experts embarked on creating a new design, which would include, in Phase II, building a large railway station and laying rail tracks to the main Pakistani rail line via Panjgoor and Dalbandin. This line connects to Qetta and Islamabad, and, to the west, to Zahedan in eastern Iran. From Dalbandin, there is a road link to Kandahar, Afghanistan. Modern road links between south and north Afghanistan were first built in 1937, uniting the country. These links still exist—were the civil war ever ended. Eventually, Gwadar could also be connected to China directly, via the Indus Highway and the Khuzdar-Ratodero road, and to the Karakoram Highway.

Phase II

During his May visit, Prime Minister Zhu Rongji called the Gwadar port a “monumental project” to mark the 50-year friendship between China and Pakistan. China also agreed to sell Pakistani Railways 69 locomotives and 175 passenger coaches, and Pakistani Minister for Communications and Railways Javed Ashraf Qazi announced that China is to provide \$100-200 million in financial assistance in soft loans to modernize Pakistan’s rail system. Other projects include development of the Lakhra coal reserves in Sindh, and the Sust “Dry Port,” on the Pakistani-Chinese border on the Karakoram Highway. Extension of financial agreements, under which the Bank of China had deposited \$500 million in the National Bank of Pakistan in 1997, were also under discussion.

Intensive back-and-forth on the Gwadar port followed. In June, Chinese Communications Minister Huang Zhendong and a team of experts visited Pakistan, and the two sides began work on a detailed study of the technical aspects of the projects. In August, a Pakistani delegation led by Finance Minister Shaukat Aziz and Communications Minister Qazi visited Beijing, to meet Chinese Minister of Foreign Trade and Economic Cooperation Shi Guangsheng. Shi and Aziz signed a formal agreement for funding Phase I of the Gwadar port, and Beijing also pledged to assist in construction of the

FIGURE 1

West, Central, And South Asia Rail Connections, East And West



John Sigerson / EIRNS 2001

- Existing main rail lines
- == Lines completed since 1996
- Projected new rail routes

coastal highway linking Karachi with Makran. Construction was to have started by December 2001, and both projects were to have been completed within three years.

Shaukat Aziz then outlined Phase II, to be launched when funds are available. This would require an investment of \$800 million, to make Gwadar an important transshipment point for the entire region. Another 18 berths would be constructed, as well as new container terminals, a dry bulk terminal, a grain terminal, oil terminals, and dredging facilities.

A desalination plant would be established for drinking water, and the power grid would also be extended to Gwadar. Work has already begun on a 900 kilometer, 132 kilovolt power transmission line from Turbat to Gwadar. Oman, which, until 1958, controlled Gwadar, and Saudi Arabia have proposed economic aid to the project.

The Greater Regional Potential

Gwadar port's potential to become a regional hub is great. The Pakistani province of Baluchistan is strategically located, but extremely poor, and with a history of social unrest. In recent years, severe drought, also affecting Afghanistan, has struck the region, where most people are dependent upon their livestock herds for survival. Reportedly, the serious lack of water has led to friction, including with neighboring Iran, and there are indications that this has held up completion of the Karman-Zahedan railroad in Iran, which would eventually link Pakistan to West Asia. However, Baluchistan also has great underground and coastal reserves of petroleum, gas, coal, and minerals, including uranium. It is also marked out as being the place where Pakistan carries out its nuclear tests.

Gwadar could become an alternative oil transport route to the Strait of Hormuz, which had been so long blockaded during the Iran-Iraq War. Pakistani analysts note that, eventually, Gwadar could offer Central Asian nations a far more reasonably priced outlet for their oil than current Western operations.

The long-discussed Iran-India natural gas pipeline project could also pass through Gwadar. This could also lead to building an oil pipeline, and, potentially, an oil refinery could be built at Gwadar. An oil pipeline link to Kazakstan is being mentioned, and China also has interests in the oil potential of the area.

Another link to this hub, could be the "ECO Highway," to Turkmenistan and other Central Asian states. In 1996, the Economic Cooperation Organization (ECO), the Tehran-based association of Iran, Pakistan, Turkey, Afghanistan, Azerbaijan, Kazakstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan, set up the ECO Highway. This project was to upgrade existing roads in Afghanistan to link Chaman, the Pakistani border town, to Tor Ghundai in Turkmenistan via Afghanistan. It has been blocked by the civil war in Afghanistan. The same year, agreements were signed among Pakistan, China, Kyrgyzstan, and Kazakstan, to send truck convoys

along the Karakoram Highway to Karachi. The four countries had already signed an agreement to upgrade the road into an international highway and complete the routes to Bishkek and Almaty.

The wider potential is indicated by the fact that there even exists, in France, an initial survey, made in 1971, for building a rail line in Afghanistan—which has *no* railways at all—from Kabul, to Herat, and to Turkmenistan, Iran, and Pakistan.

India, the most populous nation of South Asia, could also benefit, and not only from the Iran-India energy pipelines. A proposal was published in *EIR* in April 1999, for India to build a connecting road to the Karakoram Highway, linking it directly to China, Tajikistan, Kyrgyzstan, and other Central Asia nations.

War Or Development

The continuing war against Afghanistan is endangering not only millions of lives in that country, but also the potential, however distant, of ever building the "Great Projects" which could end the decades of disaster. At this time, the overwhelming U.S. military presence in the area is casting doubt on plans to go ahead with the Gwadar project this year. It was reported by Pakistan's *The Nation* on Oct. 26, that Pakistani President Gen. Pervez Musharraf is likely to visit China soon, to keep the project from being shelved.

The U.S. military is reportedly demanding some kind of control over about 1,200 km of Gwadar-area coast. The United States also, reportedly, does not want to encourage any such major construction, either near the Strait of Hormuz or its military base in the Indian Ocean, Diego Garcia. It was reported, that the Gwadar port project, considered by the Bush Administration as against U.S. strategic interests, was on the agenda when, in September, Pakistani Foreign Minister Abdus Sattar visited Washington. Meanwhile, the Karakoram Highway has been closed since Oct. 27 by armed Pakistani tribesmen, protesting Musharraf's support for the U.S. war. China had already partially sealed the road after Sept. 11.

If the highly tense situation in Pakistan brings down the Musharraf government, it is unlikely that the construction of Gwadar port would go forward. Like the long-planned Afghan railroad, another project which could, potentially, help transform an impoverished region, the Gwadar port project could be destroyed by war.

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