

First Casualty of an Iraq War Will Be the U.S. Dollar

by Edward Spannaus

While President George W. Bush thinks he's going to war in the Middle East, he's being warned that the U.S. economy may not come back. U.S. forces may return, but the dollar won't. This is the admonition that has been directed at the United States from a number of sources recently.

The threat to the dollar results, of course, from a long-term process, reflecting what Lyndon LaRouche has identified as the 35-year transformation of the United States from a producer society to a consumer society. The dollar's decline has accelerated in recent months, and it is now in its worst fall against European currencies since 1987. The point that is being made to the President, is that if he marches off to war in defiance of the rest of the world, he will face a sharply-increased capital flight out of U.S. markets, and should not expect much help in bailing out the dollar when it crashes.

While a unilateral U.S. attack on Iraq could detonate a precipitous fall of the dollar, the attack would not be the cause of the problem. While market commentators have their excuse-of-the-day as to why the markets continue to collapse, David Coxe, the chairman and chief strategist for the Bank of Montreal's Harris Investment Management in Chicago, says correctly that one can't blame all of the financial markets' current problems on nervousness over an Iraq war. "Iraq is the excuse everyone is using," Coxe said. "But I would assign it no more than a 10% weighting of what is really wrong with our economy and our stock market."

Living Off the Rest of the World

The U.S. current-account deficit—what the United States owes the rest of the world because of trade and financial imbalances—is the largest in world history. It is officially estimated at \$500 billion for 2002, and anticipated to rise to \$600 billion in 2003. (*EIR* regards these official estimates as understated.) Presently, financing this deficit requires a capi-

tal inflow of at least \$1.9 billion *every trading day*.

Prior to the scuttling of the Bretton Woods monetary system in 1971-72, no country was permitted to run up such a huge imbalance; a much smaller imbalance would trigger what was then called a "balance of payments" crisis, and the offending country would have to settle up. But since the dollar is no longer linked to gold, nor pegged to a fixed exchange rate, the United States has been free to run up a massive deficit and flood the world with dollars.

The physical reality underlying this, is that the post-industrial United States economy produces far less—in real terms—than it used to. About 80% of the current-account deficit consists of the trade deficit, the excess of imports over exports. What we used to manufacture, we now import. We have been living off the rest of the world, much of which produces the things that we consume, under slave-labor conditions. And American consumers have been paying for this flood of imports, with the greatest consumer debt bubble ever created. Now, the day of reckoning is rapidly approaching.

A fitting metaphor for this mess—as well as a demonstration of the absurdity of President Bush's so-called "stimulus" program—was what happened when he was scheduled to give a speech at a warehouse in St. Louis on Jan. 22, touting the supposed job-creating benefits of his tax cuts. The President's remarks were to be delivered against a backdrop of a huge stack of cartons, as befitting a warehouse. But before the television cameras could be turned on, someone had to put tape on all the boxes, to cover over the "Made in China" markings.

Now, let's look at recent developments. The dollar is down, by some estimates, about 20% when measured against a basket of currencies over the past year. (It is far more, if properly measured against hard commodities, and about 30% against gold.) For foreign investors, this depreciation magnifies their losses in the U.S. stock market; for example, while

the Dow is down about 18% over the past year in dollar terms, that represents a loss of 27% in Japanese yen, and 35% in euros.

Now, consider again the \$1.9 billion needed every day to finance the U.S. economy's profligacy. Where is it going to come from? Europeans have become net sellers of U.S. securities over the past year. Taking note of this phenomenon, the *Wall Street Journal* ran a major story on Jan. 20 entitled, "Sliding Dollar's Fate May Be Decided in Asia." The *Journal* noted that Japanese, Chinese, and other Asians have now become the largest overseas investors in U.S. securities, in terms of net new money pumped into U.S. stocks and bonds. Last year, Asians accounted for 40% of the foreign-investment flows into the United States, somewhat counterbalancing Europe's pullback.

The question asked by the *Journal* is, how much longer can this Asian support for the dollar last? Asian central bankers are beginning to move into other currencies, especially the euro, and also into gold, whose price has jumped by 31% since Sept. 11, 2001. "If Asians pull back from investing in the U.S., there isn't much else to support the dollar," warned an economist at Morgan Stanley investment bank.

Russian, Chinese, Other Warnings

Meanwhile, ominous signs for the future of the dollar have come out in statements by both the Russian and Chinese central banks. On Jan. 25, the Russian Central Bank announced that it now has "no less than 50%" of its reserves—which amount to almost \$50 billion—invested in dollar assets. But this is going to change: The Central Bank said that it will cut its share of dollar-denominated assets, and instead buy euros, British pounds, or Swiss francs.

Two days earlier, Zhu Min, general manager of the Bank of China—one of the world's top 30 banks, with \$400 billion in assets—warned that the purchase of dollar-denominated investments on a large scale, by China and the nations of Asia, may not be sustainable. Because of its huge trade surplus with the United States, China is paid for its American exports in dollars, and then normally buys U.S. Treasury securities (and other instruments), bringing the dollars back into the United States. China has become one of the world's five largest holders of U.S. Treasury securities.

Speaking at the World Economic Forum in Davos, Switzerland, Zhu explained that "Asia has been exporting to the U.S. and buying U.S. Treasury bills, and so far everybody has been happy. But I don't think it [the U.S. current account deficit] is sustainable. Dependence on Asian flows to sustain the deficit is not healthy." "I think this year the foreign exchange regime will be very much volatile," he added.

A City of London financial source told *EIR* that the Russian and Chinese statements were not statements of intent, but announcements of ongoing operations; he called this is a chief reason for the dollar's dive. "The dollar will continue to weaken," the source said. "There are central bank sellers about. My reading, is that what we heard the other day from

the Russian Central Bank, is not something for the future, but was a statement made, after they have begun to move out of the dollar. That is probably one of the reasons for the dollar loss in respect to the euro. The Russians know the Iraq war is brewing, and, by doing this, they can exert some pressure, while making moves to ensure that their holdings are not hostage to an American action in event of war. All this suggests that the Russians are taking a harder line respecting [war in] Iraq than some had thought. The same goes for the Chinese."

The Danger for President Bush

This brings us to the recent warnings about the effect that a unilateral U.S. launching of war on Iraq, will have on the dollar's fortunes. This point was made with particular force in the Jan. 26 Sunday *Observer* of London, by its senior commentator Will Hutton. Because of the weakness of the U.S. economy and the threat to the dollar, the United States needs multilateral support for an Iraq war even more *economically* than militarily and diplomatically, Hutton wrote. "The United States' military capacity may allow unilateralism; its soft economic underbelly . . . does not." He argued, that "The multilateralism that Bush scorns is, in truth, an economic necessity," and noted that while the United States may be a military superpower, "it is a strategic position built on economic sand."

Hutton noted the massive U.S. indebtedness to the rest of the world, citing net liabilities of more than \$2.7 trillion—nearly 30% of GDP—which puts the United States at a Latin American, basket-case level. Pointing out, as we have shown above, that this makes the United States dependent on a substantial flow of foreign capital into American markets, Hutton noted with some irony: "The Old Europe that Donald Rumsfeld mocked last week has been helping to prop up the U.S. economy."

Hutton's commentary concluded that if the United States and Britain go to war without support of key members of the UN Security Council like France and China, the flow of dollars from abroad into America will slow down dramatically, and there will be a stampede of foreigners trying to sell. If the war is prolonged, or the post-war situation unstable, the pressure on Wall Street and the dollar would be severe, and "Bush might even have to turn to his despised European allies to ask for a multibillion-euro support package for the dollar, because they hold the only currency capable of shouldering the burden."

Another version of the same scenario was posed in a Jan. 25 Dow Jones story, which warned that a prolonged Iraq war could set off a vicious downward spiral in the markets, in which foreign investors liquidate their dollar holdings. The story noted the fact that Russian and Asian central banks are already beginning to dump dollars.

Business Week Online on Jan. 31 predicted that the biggest danger facing the U.S. economy "is that war could turn the dollar decline into a rout." It noted that the economy "is ex-

tremely vulnerable to a dollar decline, since America has never been so dependent on foreign capital,” and added, “The threat that war may spark a run on the dollar is the largest macroeconomic threat to the economy.”

President Bush, take heed.

Global Jobless Rise Is Grim Sign of Depression

by Paul Gallagher

“The world employment situation is deteriorating dramatically,” announced the International Labor Organization’s general secretary, Juan Somavia, on Jan. 24; he released a new ILO report which made his somber judgment into an understatement. “A full-scale global recession,” said Somavia, “could have grave consequences for the social and political stability of large parts of the world.” Joblessness is growing so quickly worldwide that a depression is clearly under way and deepening. *Only* a planetary mobilization of great projects of new economic infrastructure—from continent-spanning land-bridges to sewage treatment facilities and hospitals—could bring the job-creation Mr. Somavia estimated was necessary over the next decade to reverse the employment collapse.

“While tens of millions of people are joining the ranks of the unemployment or working poor,” Somavia said, describing the period since early 2000, “uncertain prospects for a global economic recovery make a reversal of this trend unlikely in 2003. . . . Unemployment began to grow when the information and computer technology (ICT) bubble burst in early 2001.”

Global Unemployment Rate Incalculable

The trend which the ILO refers to has actually had the sudden characteristics of a collapse. Between measurement points in the second half of 2000 and the second half of 2002, the number of *officially* unemployed workers counted in the world jumped from 160 million to 180 million, increasing 6.5% each year; the official number could easily reach 200 million by the end of 2003. At the same time, the depression reversed a previous slight reduction of “working poverty”: the ILO’s count of workers earning less than \$1 per day, around the world, grew to 570 million—not including the 180 million officially unemployed—by 2002.

Official unemployment has risen the fastest, of all regions of the world, in Latin America and the Caribbean: the ILO’s estimated unemployment rate for that entire continent is now at 10%. Estimated unemployment rates for major regions of the world (**Table 1**) show that only in Asia are there groups of nations below 6% official unemployment—and the ILO

TABLE 1

Worldwide Official Unemployment Rates

Region	Unemployment Rate
Asia Pacific	3.8%
East Asia	3.2%
Southeast Asia	6.0%
South Asia	3.4%
Industrial Countries	6.1%
Latin America	9.7%
Mideast/North Africa	17.9%
Sub-Saharan Africa	13.7%
Transition Economies	13.5%
World	180 Million Unemployed

Source: International Labor Organization, *Global Employment Trends*, January 2003.

warns that for many Asian countries including China, these rates greatly understate real unemployment.

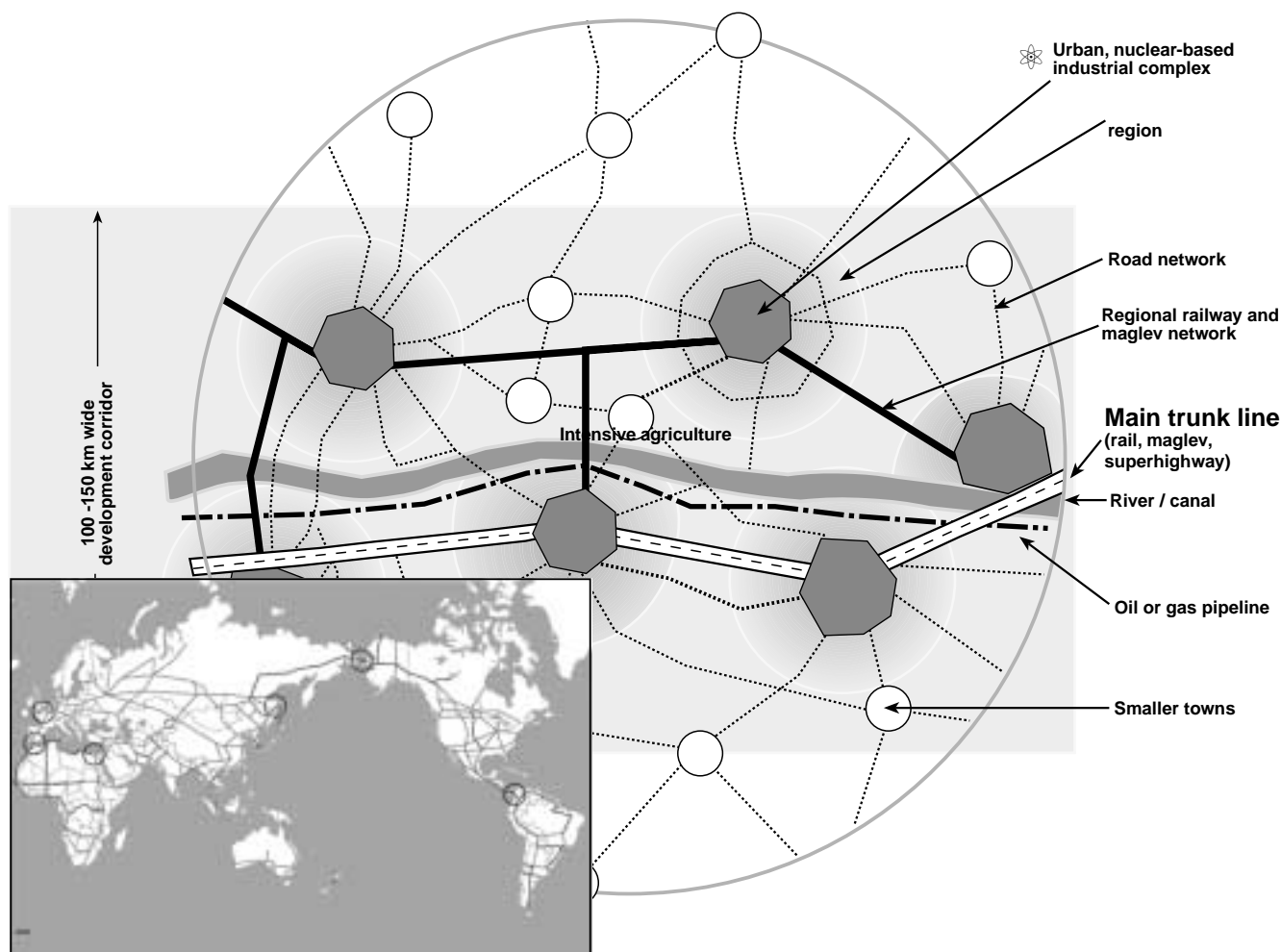
Such increases in unemployment and poverty in the world’s workforces completely give the lie to reports of economic “growth,” no matter how small, coming from the International Monetary Fund and other agencies. They show that the 1997-98 so-called “Asian Crises,” followed by the Russian GKO and Brazil crises, the Long Term Capital Management hedge-fund crisis and other supposed “episodes,” actually tracked the descent of the world economy into a deepening depression.

What percentage of the world’s workforce is now unemployed? The ILO did not attempt a global estimate for obvious reasons, since the *rate of increase* was the key. Obviously the *absolute number* of the unemployed is actually much larger than 180 million. In the United States, for example, real unemployment is likely double the official rate because workers who have dropped out of the workforce, or are working part-time, are not counted; worldwide, and especially in the Third World, much larger portions of working-age populations are outside the officially counted workforces, trying to survive in this depression. Under those grim conditions, the size of the human workforce, internationally, is not known. As Somavia put it, “Our measures of unemployment largely address the jobless who have some form of social protection. . . . Even more disturbing is the evidence of worsening conditions in the informal economy of the developing world, where the struggle to survive on poverty wages is getting even tougher.” Certainly the real global unemployment rate, as a percentage of the economically active population, must be approaching 10%; and when the workers earning \$1 per day or less are added, the “working poverty” rate near 40%.

Great Projects of Job Creation

Most important was the estimate given by the ILO for the rate of job *creation* which is needed in order to turn around

A Land-Bridge Corridor Of Development



50-100 million new jobs a year needed? “Development corridors” along new continental land-bridges, are the only economic-infrastructure context in which this could take place. Agreements among nations for large-scale credit creation for job creation—a New Bretton Woods system—are the way to launch such projects.

this collapse, over the decade beginning now. Simply in order to reverse the recent sharp rise in global unemployment and absorb new workers into employment over the next ten years, 500 million new jobs will be necessary—50 million per year. But to tackle the vast problem of “extreme working poverty,” as the ILO terms it—the 570 million working for \$1 per day or worse—requires much more. The Organization forecasts that to reduce world unemployment and “get on track for the UN goal of halving extreme poverty by 2015,” the creation of *1 billion jobs in a decade* will be required.

There is only one possible path to creation of 100 million new jobs per year which increase labor skills and reduce poverty. That path is a “New Bretton Woods” agreement among nations to issue large-scale, low-interest and long-term credits for great projects of infrastructure development. The many state rail and water projects initiated, almost si-

multaneously, by China in the past few years, may be taken as an exemplar: The new magnetic-levitation railroads it is putting on the map are mobilizing new workers and require new skills.

Scale those efforts up to the development of the required new Land-Bridges for the entire world (**Figure 1**). Each can be a development corridor, not merely a new railroad, and be combined with the urgent development of new water resources worldwide with the most modern water management and reclamation methods. New cities will grow in the corridors.

The Chinese projects have been done, to now, by mobilizing the country’s national savings—the global mobilization requires job creation through credit-creation by treaty and trade agreement, in Presidential candidate Lyndon LaRouche’s widely-circulated policy.