

trillion were in pension fund reserves (much of which is invested in stocks), \$6.6 trillion were in direct stock holdings, \$4.2 trillion were in bank and money market deposits, and \$2.7 trillion were in mutual fund shares.

Of the debt in the household sector, \$4.4 trillion was in home mortgages, and \$1.4 trillion was in consumer credit. The sharp rise in consumer credit in the 1990s, up \$577 billion over the \$793 billion at the end of the 1980s (**Figure 6**), reflects not only heavy borrowing against the fictitious capital flooding the markets, but also the shortfall in household income during the period. Millions of people are living off their credit cards, and when that runs out, they are forced into bankruptcy. Some 10.7 million bankruptcies were filed during the 1990s, more than twice the number filed in the 1980s. That figure includes more than 546,000 businesses and 7.6 million individuals.

But even that is only the beginning. Worldwide, there are some \$300 trillion of financial claims outstanding, and not nearly enough productive economic activity to pay the bills. The gross world product, also known as world GDP, stands at some \$41 trillion, and a large percentage of that figure represents overhead. That puts the ratio of financial claims to productive activity somewhere north of 10 to 1, and getting worse. The global financial system itself is bankrupt, and the United States, with its record debt and derivatives exposure, is sitting at ground zero of the coming explosion.

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# The euro falls, and falls, and falls . . .

by William Engdahl

Just before the euro's official launch as a central bank unit of account on Jan. 3, 1999, many leading European politicians and bankers were boasting that the advantages of the new euro super-currency meant that it soon would challenge the role of the dollar as leading world reserve currency. European politicians, from French Finance Minister Dominique Strauss-Kahn to conservative French President Jacques Chirac, blew this trumpet in the months before January 1999. They were echoed by some of Europe's leading bankers, including Deutsche Bank's Norbert Walter.

But, as of the beginning of February 2000, the euro has fallen to its historic low, breaking the psychologically important parity to the U.S. dollar, and the mood is anything but euphoric. As of this writing, the euro is being traded for \$0.97, a fall of 17% against the dollar. Yet, to date, there is no hint that Europe's political establishment is even considering abandoning the failed experiment.

This, then, leaves the euro in a dangerous "no man's land." Technically, it is too weak to attract the billions in foreign investment its framers had expected a year ago. Politically, it is too entrenched to be abandoned without risking a political and monetary collapse of the entire European Union (EU).

When the European Central Bank surprised observers and raised its central interest rate on Feb. 3, ECB President Wim Duisenberg cited "concern" about the low euro as the reason, adding to market jitters. This worsening crisis of confidence in the euro experiment now has the potential to interact with the global financial fragility, above all in the U.S. NASDAQ stock market bubble and in Japan's debt-bloated economy, to create systemic crises of unimagined dimension.

### Frictions and fracture lines

As the euro declines, the prospect of splits among European Monetary Union (EMU) member-states is emerging, which adds to the growing political instability at a most dangerous time. The unprecedented clash between the other 14 EU member-states, which have threatened to blacklist Euro-land member Austria, because they disapprove of the choice of Austrian voters in putting the party of right-wing populist Jörg Haider into government, is making potential foreign euro investors even more nervous.

As well, disappointment over the attractiveness of the euro in recent days has led to a sharp rise in opposition to Britain's joining the EMU. British Prime Minister Tony Blair has pledged to hold a popular referendum on the issue following the next Parliamentary elections in two years. Yet, the latest U.K. opinion polls show that voters are strongly opposed to British entry into the euro, with the number rising as the euro falls.

On Feb. 2, British Conservative Party leader William Hague announced that former Defense Secretary Michael

## 'Dirigist' measures needed to halt systemic collapse, says LaRouche

Like every other so-called "local" or "regional" question—even as significant as the European currency, the euro—cannot be understood outside the historic global financial crisis, and measures to address the crisis must be devised accordingly. On Dec. 22, 1999, Lyndon LaRouche spoke of the euro, in answer to questions put to him by Long Shih Rome, a journalist for the Malaysia-based publication *Smart Investor*, which circulates in Malaysia, Singapore, and Indonesia.

Long Shih Rome asked, "Now the euro is hovering close to parity. What is the prospect for the euro in 2000?" LaRouche replied, "No one knows; no one could possibly know. The entire world system is in a terminal boundary layer of self-accelerating, leveraged turbulence. We have reached the point, that political decisions, rather than so-called market trends, will determine everything even during the short term."

To the question, "Does the current weakness or future weakness of the euro suggest it is undervalued, given that some European economies are recovering?" LaRouche replied, "No. Every economy in Europe, except the City of London's financial traffic, is currently operating below real economic break-even, and collapsing at a currently accelerating rate. Without a radical shift back to the kinds of 'dirigist' and 'statist' measures remembered from the 1950s and early-1960s Europe, there is no possibility that the present trend of deepening economic collapse could be halted, or even reversed. The collapse is not cyclical, but systemic. Only systemic measures, overturning present political arrangements, could halt the presently ongoing collapse."

Portillo, a "euro-skeptic," would be named "Shadow Prime Minister," responsible for the party's attacks on Blair's euro policy. A defensive Blair replied feebly, "I think to rule out the euro in the next Parliament is foolish, is backward, and I won't have anything to do with it." There is a measurable cooling off of enthusiasm in recent weeks both among the Euroland countries and from the British over its entry into the EMU.

"Initially, the German [Chancellor Gerhard] Schröder government was convinced they needed the power of the City of London, still the world's largest financial center, if the euro was to become a major reserve currency," said City of London economist Stephen J. Lewis. "Now they are not so sure, as they see Blair wants to enter, but not as one of equals." Failure to win British entry would be yet another blow to euro prospects, but one which is too distant to be a factor in today's low price.

### The Maastricht debacle

The basic problem with the euro is one that most people misunderstand. It was rammed down the throats of European citizens—in almost every case without even a referendum, for fear of rejection of such a fundamental surrender of national sovereignty. The euro was in effect *blackmail*, in exchange for allowing German unification.

At an EU heads-of-state summit in Maastricht, Holland in December 1990, French President François Mitterrand handed German Chancellor Helmut Kohl a *fait accompli*: He claimed that Kohl "owed him" for having agreed to German unity earlier that year, in return for which Kohl had to agree to the new supranational euro and its politically independent European Central Bank. If recent allegations hold water, that Mitterrand arranged for the private transfer of perhaps more than \$15 million into the secret Liechtenstein and Swiss warchest of Kohl's Christian Democratic Union in 1992, the reason for unflinching German adherence (with minor differences) to the EMU since 1992, becomes perhaps even clearer. Kohl soon became the most impassioned proponent of the euro project.

The project, however, was fatally flawed from the start. Never in history has a group of nations—always, in the past, empires—created a single currency prior to the creation of a single political entity. Even Hitler, when his armies controlled most of continental Europe in 1940-41, failed to establish a single currency. Moreover, while surrendering control over printing of national currency, a central attribute of any nation's sovereignty, the member-states of the EMU so far have refused to opt for full government fusion into United States of Europe, as Jean Monnet envisioned 30 years ago.

Instead, the ECB created by the Maastricht Treaty has one simple mandate: to control inflation in Euroland. The ECB is forbidden to respond to pressure from governments

facing domestic economic problems because of the one-size-fits-all ECB monetary policy. This straitjacket, a nightmare for sovereign governments, was, in effect, the dream of Bank of England Governor Montagu Norman. During the 1920s and 1930s, Norman fought to create a supranational central bank entirely independent of politicians' meddling, an elite of unelected technocrats ruling Europe, and if possible, the world.

A central flaw in the ECB architecture is the fact that, while there is a single monetary authority that can raise interest rates uniformly across Europe, tax policy is still in the hands of elected national governments. As unemployment climbs above 4 million in a country such as Germany, pressure is sure to grow on elected political regimes to go into deficit financing to spur growth. Under Maastricht, this is strictly limited to a deficit of only 3% of GDP.

### 'To the exits'

However, the image of an ever-falling euro, and the December efforts of the Schröder government to defend its German Mannesmann firm from a hostile takeover by British Vodafone-Airtouch, have reportedly made foreign investors even more leery of the profit potentials of investing in Euro-land companies.

"Funds of European companies continue to leave Euro-land," said Lewis. "This flight of investment capital out of the euro, continuous and steady, and lack of any offsetting reason to invest against risk of a falling currency, are the fundamental reason the euro falls." Indeed, Euro-land economies were hit by huge capital flight of \$154 billion during the first ten months after the euro's launch. If anything, the trend has accelerated in recent weeks.

According to Lewis, after weeks of secretly trying to intervene via selling the dollar reserves of member national central banks of the 11-nation euro zone, the supranational European Central Bank in early February finally threw in the towel and let the currency break below dollar parity. The ECB intervention had to be kept secret because the euro does not become an official currency of circulation with coins and bills until sometime in 2002. In the meantime, the ECB has the precarious job of managing a "virtual currency." Were word to leak out to financial markets that the ECB had been intervening to hold up the value of the euro, that would unleash a torrent of speculation and possible panic flight out of the euro.

Certainly, whether the euro is at \$1.004, as it was for several weeks, or at \$0.97, where it is today, makes little difference in economic terms to Europe. "What it does, however," stressed Lewis, "is add to the perception among foreign investors that the euro is a 'loser.' Few pension or mutual fund managers can defend investing new billions of dollars in a currency which has dropped 17% in a year."

There is one gaping irony in the euro's present weakness:

It is largely being caused by capital flight out of Euro-land and into U.S. and, to a lesser extent, Japanese, stocks. So long as the U.S. economy continues to post "official" GDP growth rates of 5.8%, and European economies show feeble stock market gains, the gamblers rush to the tables in America. European and other large fund managers will continue to pile into the U.S. stock market to cash in on the biggest bubble in history—the \$14 trillion in market valuation of all U.S.-traded stocks combined, a whopping 180% of GDP. For the past five years, or so the argument goes, U.S. stocks have risen through thick and thin by rates on average of some 26.3%.

However, these capital outflows from Euro-land into the dollar, which have helped weaken the euro and boost the dollar, have a defect, namely, that all this is about to come to a crashing halt. Precisely when, is impossible to forecast. But even Federal Reserve Board Chairman Alan Greenspan, in recent public statements, has begun to sound ever clearer warnings that the present booming U.S. consumer economy is "unsustainable."

Indeed, the Fed has now raised rates five times in recent months, and its latest 0.25% rise in Fed Funds cost for overnight money, was announced with an ominous statement that future inflation was a growing concern, suggesting that further rate hikes will continue to be made until consumer spending slows significantly. Greenspan even estimates that a full quarter of recent U.S. GDP growth can be attributed to the so-called "wealth effect." With 43% of American households now invested in stocks, and their investment, on paper, rising by more than 26% per annum, families have been taking out home equity loans and credit card debt to buy everything from cars, to washing machines, to more stocks.

"I have been told by friends in Washington," London investment banker Tim O'Dell told *EIR*, that "the Fed and Treasury are privately working out their response to a 'significant,' i.e., 20% or more, fall in the dollar, i.e., a euro at \$1.20. This is why [U.S. Treasury Secretary Lawrence] Summers is trying of late to talk the dollar up by pointing to the structural problems of the European economies. At the moment, the concern is not high, but it is very much in the background of their thinking. If there were a rush of capital flight out of the dollar, that would lead to large interest rate increases in bonds. The likelihood that Greenspan can pull off a 'soft landing' this time is extremely small."

Yet, a dollar collapse caused by capital flight would not only weaken the United States and pop the stock bubble there, but it would also force liquidation of hundreds of billions in long-term stock and bond assets held by U.S. pension funds and mutual funds in Europe, to cover losses at home. That in turn would plunge Europe into a new crisis of the euro, as well as raise interest rates. This self-reinforcing downward spiral would pull both Europe and the United States into depression, and worse.