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Oil Goes Up, Euro Goes Down: It's the Same Deadly Disease

by Lothar Komp

A growing sense of alarm prevails in Europe's capital cities. The talk is that the combined effects of the oil price shock, and the decline of the euro, are bound to devastate Europe's economies. Even such export industries as the chemical industry, whose expenditures for organic substances have doubled over the past 12 months, won't escape. And on top of this, in Great Britain, blockades of oil depots by truck drivers and farmers have brought large parts of the country's infrastructure and industrial production to a standstill within only a few short days, so that supermarkets have had to ration staples, when bread and milk were hit with panic buying. The French and British have already been forced to enact cuts in the taxes on petroleum products.

Thus, it appears that the days are past when German Chancellor Gerhard Schröder could get away with just issuing some breezy commentary on how the euro is coming along as best as could be expected. Instead, a growing number of voices are demanding that Europe's central banks take decisive countermeasures to prop up the euro's value. While European Commission President Romano Prodi, French Finance Minister Laurent Fabius, and similar officials are still cautious, pointing out that direct intervention into the currency markets is always an option if required, others are quite openly calling for a complete sell-off of Europe's dollar reserves. In numerous interviews, Norbert Walter, chief economist at Deutsche Bank, has been emphasizing that the $250 billion of reserves currently in the euro zone's central banks, have become largely superfluous, and that therefore they could be thrown into the battle for the euro. And C. Fred Bergsten, director of the Institute for International Economics in Washington, has been calling for a "shock treatment" for the euro, with the help of interventions into the currency markets by Group of Seven countries—even if the United States refuses to join in.

On Sept. 14, the European Central Bank began to act. It announced that, even though it would not sell the dollar reserves outright, it would be selling the interest earnings on its dollar-denominated paper—an immediate intervention of about 2.5 billion euros.

But it's not going to work: All of the usual rules of currency behavior no longer hold true, and haven't for some time now—just as the recent tripling of oil prices cannot possibly be explained by popular conceptions of supply and demand. In both cases, these are symptoms of one and the same deadly disease afflicting the world financial system, which is now entering its terminal phase. And as long as governments and central banks refuse to admit the existence of this deadly disease, and to draw the right conclusions, these symptoms will end in death.

Oil in the Grip of Speculators

Take oil, for example: A monotonous media drumbeat gives the impression that the evil Organization of Petroleum Exporting Countries (OPEC) oil sheikhs are turning off the oil spigot, and driving gas prices sky-high. The truth is, almost all OPEC countries have increased production to record levels. And, to use the example of Germany, only 26% of its crude oil imports come from OPEC, whereas its biggest oil suppliers are Russia (29%), Norway (17%), and Great Britain (14%). And even though demand hasn't exactly decreased, have the industrialized nations had such explosive growth recently, that the oil price had to climb from $10 per barrel in December 1998 to $35 in September 2000, solely to meet increased demand?

Obviously not. The fact is, that the oil market, just like the currency markets, has long been solidly in the grip of speculators. Prices are not being set by the producers, but by the commodity futures markets in London and New York. Anyone who wants to secure a large physical shipment of oil, must first go, for example, to the International Petroleum

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Exchange in London, and purchase a futures contract for delivery in October or November. These contracts can, without any problem, be bid up to an insanely high price, many times their original value, within the course of a month. The speculative gains are then extracted from the real economy, from the refineries, or at the gas pump.

Just how this functions, has been spelled out in a lawsuit filed by Tosco Corp., the largest independent U.S. oil refiner, against the London-based trading firm Arcadia Petroleum. According to documents filed with a New York court, Arcadia Petroleum bought up September contracts for considerably more North Sea Brent oil, than could have possibly been physically delivered during that month. In this way, Arcadia Petroleum was able to drive up the oil price by $3.33 between Aug. 21 and Sept. 5. But since the price for North Sea Brent on the futures markets is a guideline for all oil shipments to Europe, Africa, and the U.S. East Coast, these manipulations, according to Tosco Corp., influenced the overall price of a daily volume of 25 million barrels of oil shipments.

British Petroleum was also recently accused of similar manipulation of the oil futures markets.

These machinations, in turn, are isolated examples of the looting of real economies, which occurs on the basis of the snowballing indebtedness of global firms which are now madly buying each other up. Someone has to pay the bill for the $3.397 trillion that was spent last year alone, for such mergers and acquisitions. This year, the figure is expected to top $4 trillion. In 1999, the indebtedness of U.S. firms grew by $1.684 trillion, three times what it had been five years earlier. And fully $1.088 trillion of that was new debt acquired by the U.S. financial sector. During the same period, Europe and Asia also built up similar debt mountains which are not backed up with any corresponding income stream.

But, the interest payments on these debts have to be extracted from somewhere, and nothing is better suited to do that, than the futures markets for the world's most heavily traded commodities: petroleum and petroleum products.

Global Financial Meltdown

The worldwide debt pyramid would have collapsed sometime during the past five years, had central banks not begun, in 1995, to open their money spigots, thereby creating, out of nothing, ever newer sources of cash, such as the international "yen carry trade." This hyperinflation-vectored money creation created the stock market and real estate market bubbles, especially in the United States. And here, the euro comes into play. The illusion of America's "New Economy," which, in turn, underlies hundreds of billions of dollars in worldwide financial obligations, can only be maintained by the continual draining of at least $400 billion annually out of Europe, Asia, and elsewhere. Ever since the Nasdaq crash in March and April, this could only be accomplished through covert currency wars, such as that, most prominently, against the very vulnerable euro. The highly speculative currency markets can, on the basis of their own internal logic, be easily misused to that end; and in this regard, faked economic data on the "New Economy" have a great deal to do with it.

And yet, despite all these desperate efforts, these illusions are about to collapse very soon, such as indicated in the remarks made by Harvard economist Ken Rogoff at the annual August symposium sponsored by the Federal Reserve in Jackson Hole, Wyoming. According to Rogoff, given the huge U.S. trade deficit, any disruption in capital flows into the United States could very quickly lead to a crash of the dollar by 50%. The International Monetary Fund (IMF) annual report on the capital markets, says that in 1999, three-fourths of all capital exports from all countries with surpluses, flowed into U.S. markets, up from one-fifth in 1992. Meanwhile, U.S. financial obligations to foreigners have grown to $6.5 trillion. This is why David Ignatius wrote in the Sept. 3 *Washington Post* that the main issue of the U.S. Presidential election is: Who will have his finger on the monetary "red button," when the next global financial crisis breaks out? Even back in September 1998, when the highly reputed Long Term Capital Management fund, with $100 billion in credits and billions in financial derivatives transactions outstanding, was on the verge of bankruptcy, then U.S. Treasury Secretary Robert Rubin feared a "financial meltdown," with Wall Street's "mountain of debt and speculation" collapsing entirely.

Back to Bretton Woods

Unless the problems are attacked at their root, worse is yet to come. Any true solution must include a global reform of world debt, whereby, as when an individual firm goes bankrupt, many unpayable obligations will simply be written off. This will pertain especially to all short-term, speculative financial titles. Furthermore, through the reintroduction of a world monetary order, a sound basis for international trade can be re-established, as well as credit mechanisms for the renewal and expansion of infrastructure and goods production. These are the chief requirements set forth in Lyndon LaRouche's initiative for a "New Bretton Woods."

Europe's governments could make the first step in this direction almost overnight, with a set of regional agreements, in which they would declare that the supplanting of national currencies by the euro, planned for January 2002, will not take place, and that instead, the recalculation rates that have already been in effect for the past 20 months, will serve as the basis for a return to fixed rates. These rates would be periodically adjusted with the aid of verifiable, real-economy parameters, such as the price level of a given basket of commodities, and the rates would then be defended with plentiful supplies of currency reserves, and, in emergency situations, with capital controls. Other countries would then be invited to join in with this system of fixed currency rates. All member-countries of the system could then, on the basis of the predictability of their mutual currency valuations, enter into long-term trade contracts for delivery of goods of equivalent quality, such as for petroleum, without ever having to go to some commodities furtures speculator to get a right price.