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MuseLetter #229 / June 2011 by Richard Heinberg

This month's article comes again from from Chapter 5 my new book 'The End of Growth', which is set for publication by New Society Publishers in August 2011. This chapter 'Shrinking Pie: Competition and Relative Growth in a Finite World' looks in greater depth at the prospects for the developing economies of Asia.

Currency Wars

Since the economic crisis began, stresses in trade between the U.S. and China have led to unfriendly official comments on both sides regarding the other nation's currency. Some financial commentators suggest that "currency wars," which might also embroil the European Union and other nations, may be in the offing, and that these could eventually turn into trade wars or even military conflicts. The U.S. dollar, as the world's reserve currency and as the national currency of the country leading the world into the post-growth era, appears to be central to these "money wars."

It takes a little history to understand what currency conflicts are about.[1] Prior to the 20th century, most national currencies either consisted of gold or were tied to gold; therefore the currency of one nation was fairly easily convertible to that of another. National monetary reserves consisted of gold, and balance of payments deficits were settled in gold. Limited supplies of gold kept public spending within fairly tight bounds. Inflation through the debasement of a currency resulted in the refusal of other nations to accept that currency in trade. Typically the financing of wars presented the only exigency strong enough to overcome disincentives to debase money.

World War I, a conflict that engulfed at least 17 nations, was the first occasion when several countries simultaneously abandoned a hard money policy. Britain took on long-term war loans while Germany issued short-term bonds. Deficit financing arguably prolonged the war, resulting in millions of needless casualties.

Though Germany had entered the war with a thriving economy, its short-term debt, compounded by the harsh post-war terms of the Versailles Treaty, resulted in economic ruin through hyperinflation, leading to the destruction of its middle class and to the rise of Hitler, setting the stage for World War II.

At the Conference of Genoa in 1922, a partial return to the gold

standard came about as the central banks of the world's powerful nations were permitted to keep part of their reserves in currencies (including the U.S. dollar) that were directly exchangeable by other governments for gold coins. However, under this new Gold Exchange Standard, citizens could not themselves redeem national banknotes for gold coins. Now dollars and pounds were effectively equivalent to gold for the currency issuer, but not for most currency holders. This was an inherently inflationary development from a monetarist point of view (in that it meant that money could be issued substantially beyond the amounts of gold on deposit); however, the world's growing energy supplies and manufacturing capacity required an increase in the money supply, so for most countries and in most years measurable rates of price inflation remained relatively low.[2]

As World War II neared its end, Japan and the European powers lay in ruins; the United States was relatively unscathed. At the Bretton Woods monetary conference of 1944 the Allied nations laid the groundwork for a postwar international economic system that included new institutions such as the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), which today is part of the World Bank. The U.S. would assume a dominant role in these institutions, and the (partially) gold-backed dollar became, in effect, the world's reserve currency. Throughout the next half-century and more, citizens and businesses in nations around the world—even in the Soviet Union—who wanted a hedge against instability in their own national currency would hoard U.S. greenbacks.

In the early 1970s, as the U.S. borrowed heavily to finance the Vietnam War, France insisted on trading its surplus dollars for gold; this had the effect of emptying out U.S. gold reserves. President Nixon's only apparent option was to ditch what remained of the gold standard. From then on, the dollar would have no fixed definition, other than as "the official currency of the United States."[3]

After 1973, many currencies kept a fixed exchange rate with the dollar. As of 2008, there were at least 17 national currencies still pegged to the U.S. currency, including Aruba's florin, Jordan's dinar, Bahrain's dinar, Lebanon's pound, Oman's rial, Qatar's rial, as well as the Saudi riyal, Emirati dirham, Maldivian rufiyaa, Venezuelan bolivar, Belize dollar, Bahamian dollar, Hong Kong dollar, Barbados dollar, Trinidad and Tobago dollar, and Eastern Caribbean dollar.

While the U.S. dollar now had no gold backing, in effect it was being backed by the oil of several key Middle East petroleum exporting nations, which sold their crude only for U.S. dollars (thus creating and maintaining a worldwide demand for greenbacks with which to pay for oil) and then deposited their enormous earnings in U.S. banks, which in turn made dollar-denominated loans throughout the world—loans that had to be repaid (with interest) in dollars.[4]

Meanwhile exchange rates for most currencies (including those of the European countries) floated relative to one another and to the dollar. This provided an opening for the emergence of the foreign exchange (ForEx) currency market, which has grown to an astonishing four trillion dollars per day in turnover as of 2010.

In 1999, most members of the European Union opted into a common currency, the euro, that floated in value like the Japanese yen. One of the motives for this historic monetary unification was the desire for a stronger currency that would be more stable and competitive relative to the U.S. dollar.

For decades, China has been one of the countries that kept its currency pegged to the dollar at a fixed rate. This enabled the country to keep its currency's value low, making Chinese exports cheap and attractive—especially to the United States.

However, for smaller countries, fixed exchange rates have meant vulnerability to currency attacks. If speculators decide to sell large amounts of a country's currency, that country can defend its currency's value only by holding a large cache of foreign reserves sufficient to keep its fixed exchange rate in place. This reserve requirement effectively ties the country's leaders' hands during the attack, preventing them from spending (for example, to prop up banks); if the pegged exchange rate is abandoned under such circumstances, the currency's value will plummet. Either way, the nation faces the risk of economic depression or collapse—as occurred in the cases of the recent Argentine and East Asian financial crises.

Altogether, the world's currencies could hardly even be said to comprise a coherent "system": harmony and functionality are maintained only at great cost (with most of that cost ending up as profits to currency traders and speculators). But as world economic growth shifts into reverse, stresses within the global community of currencies may become unbearable.

With its enormous levels of public and private debt and its continuing trade deficits, the U.S. has something to gain from a lower-valued dollar. This would make its export goods more attractive to foreign buyers; meanwhile, by making imports more expensive, it would help encourage savings and investment in domestic production. It would also enable the country to pay back its government debt with currency of lower value, effectively wiping out part of that debt. Maintaining low interest rates helps reduce the dollar's value, and the United States has kept interest rates low since the start of the crisis. But the U.S. doesn't want to announce to the world that it is seeking to trash the dollar, because this could reduce the dollar's viability as the world's reserve currency—a status that yields multiple advantages to America's economy, and one that is increasingly being challenged.[5]

Investment money tends to "chase yield," which has the effect of driving up the value of the currencies in countries where investment opportunities and higher yields are to be found—currently, the young, industrializing countries of Asia. China and the other industrializing nations are responding by doing everything they can to keep exchange rates for their currencies low relative to the dollar so as to maintain trade advantages and reduce the impacts of an influx of yield-seeking money.

China has led the way in the international competition to weaken national currencies, but Japan and the U.S. are seeking to lower the value of the yen and the dollar, respectively. According to Bill Black,

writing in *Business Insider* on December 13, 2010,

> The E.U., taking its lead from Germany, has allowed the Euro to appreciate against many currencies. Germany's high-tech exports can survive a strong Euro, but Greece, Spain, and Portugal cannot export successfully under a strong Euro and their already severe economic crises can become much worse. The Irish will have serious problems, and their export problems would have been crippling if they were not a corporate income tax haven. Italy's, particularly southern Italy's, ability to export successfully is dubious.[6]

If U.S. dollar tumbles, that hurts China and other countries with fixed exchange rates; they feel pressured to drop their peg or revalue their currencies higher. Countries whose currencies are pegged to the dollar have had to resort to currency interventions and a massive buildup of foreign reserves to stop their currencies from appreciating. This is inflationary for those countries, and is one reason for the housing and equities boom in Asia.[7] China's way of pushing back against a lowering of the dollar's value is its threat of ceasing to purchase U.S. Treasury debt (which it has in fact partly done). If neither the United States nor the industrializing nations back down, the result could be a final refusal of the latter nations to continue funding deficits in the U.S.[8]

As the U.S. dollar has weakened, it has done so only against those currencies that are free floating. This has meant that countries like Japan and Germany have had to endure upward pressures on the value of their currencies. German Finance Minister Wolfgang Schäuble, interviewed in November 2010, had harsh words for his American counterparts, noting that "The U.S. lived on borrowed money for too long," and adding that

> "The Fed's decisions [to buy U.S. Treasury debt] bring more uncertainty to the global economy. They make it more difficult to achieve a reasonable balance between industrialized and emerging economies, and they undermine the U.S.'s credibility when it comes to fiscal policy. It's inconsistent for the Americans to accuse the Chinese of manipulating exchange rates and then to artificially depress the dollar exchange rate by printing money."[9]

Meanwhile, also in November 2010, China and Russia ceased using the dollar in bilateral trade, with Russian Prime Minister Vladimir Putin declaring that his country might eventually adopt the euro. Even though Russia is not one of China's top trading partners and is unlikely to be welcomed into the eurozone anytime soon, its leaders' hostility to the dollar helps exacerbate discontent elsewhere. If China excludes dollar trades with other primary non-U.S. trade partners there may be a reason for Washington to worry. For now, Beijing appears merely to be letting off steam with no serious intent of isolating the United States, or of causing its nearly $3 trillion in U.S. foreign exchange reserves to lose a significant portion of their value.

Thus for the time being, pundits who warn of wider and worse

currency wars leading to trade or military conflicts may be exaggerating the threat.[10] Currency and trade wars are not in anyone's interest. A trade war between the U.S. and China, for example, would reduce the GDP of both countries—and China would have more to lose than the United States. As long as cool heads prevail, currency conflicts are not likely to get out of hand. Of course, there is always the possibility that cooler heads may *not* prevail—especially in the politically volatile U.S., where members of Congress posture by threatening to refuse to raise the debt ceiling.

Over the longer term, the ecosystem of world currencies faces increasing dangers if growth fails to return in the U.S., and if the Chinese economic juggernaut falters.
Debt-based currencies that are traded without any clear international exchange standard create an inherently unstable situation. The so-called "goldbugs," economists who advocate a universal return to the gold standard, have plenty of grounds for criticizing free-floating currencies, but their alternative is simply not a realistic option: there isn't enough gold in the world to support anything like current levels of trade and investment, and much of the gold that exists is held in enormous reserves where it can do little good as a medium of exchange. The transition from the present system back to a gold standard would be intolerably chaotic, if it is even theoretically possible. Other kinds of fundamental national and global currency reforms (such as we will touch upon in the next chapter) may have better practical prospects over the long run, but are currently outside the realm of serious discussion among policy makers.

Without a return to economic growth, there is no sufficient remedy for the rapidly worsening stresses between and among the world's currencies. The lid can probably be kept on this boiling kettle in the short term, but over the course of the next decade it becomes more and more likely that something will give way.

Post-Growth Geopolitics

As nations compete for currency advantages, they are also eyeing the world's diminishing resources—fossil fuels, minerals, agricultural land, and water. Resource wars have been fought since the dawn of history, but today the competition is entering a new phase.

Nations need increasing amounts of energy and materials to produce economic growth, but—as we have seen—the costs of supplying new increments of energy and materials are increasing. In many cases all that remains are lower-quality resources that have high extraction costs. In some instances, securing access to these resources requires military expenditures as well. Meanwhile the struggle for the control of resources is re-aligning political power balances throughout the world.

The U.S., as the world's superpower, has the most to lose from a reshuffling of alliances and resource flows. The nation's leaders continue to play the game of geopolitics by 20th century rules: They are still obsessed with the Carter Doctrine and focused on petroleum as the world's foremost resource prize (a situation largely necessitated by the country's continuing overwhelming dependence

on oil imports, due in turn to a series of short-sighted political decisions stretching back at least to the 1970s). The ongoing war in Afghanistan exemplifies U.S. inertia: Most experts agree that there is little to be gained from the conflict, but withdrawal of forces is politically unfeasible.

The United States maintains a globe-spanning network of over 800 military bases that formerly represented tokens of security to regimes throughout the world—but that now increasingly only provoke resentment among the locals. This enormous military machine requires a vast supply system originating with American weapons manufacturers that in turn depend on a prodigious and ever-expanding torrent of funds from the Treasury. Indeed, the nation's budget deficit largely stems from its trillion-dollar-per-year, first-priority commitment to continue growing its military-industrial complex.

Yet despite the country's gargantuan expenditures on high-tech weaponry, its armed forces appear to be stretched to their limits, fielding around 200,000 troops and even larger numbers of support personnel in Iraq and Afghanistan, where supply chains are both vulnerable and expensive to maintain.

In short, the United States remains an enormously powerful nation militarily, with thousands of nuclear weapons in addition to its unparalleled conventional forces, yet it suffers from declining strategic flexibility.

The European Union, traditionally allied with the U.S., is increasingly mapping its priorities independently—partly because of increased energy dependence on Russia, and partly because of economic rivalries and currency conflicts with America. Germany's economy is one of the few to have emerged from the 2008 crisis relatively unscathed, but the country is faced with the problem of having to bail out more and more of its neighbors. The ongoing European serial sovereign debt crisis could eventually undermine the German economy and throw into doubt the long-term soundness of the euro and the E.U. itself.[11]

The U.K. is a mere shadow of its former imperial self, with unsustainable levels of debt, declining military budgets, and falling oil production. Its foreign policy is still largely dictated in Washington, though many Britons are increasingly unhappy with this state of affairs.

China is the rising power of the 21st century, according to many geopolitical pundits, with a surging military and lots of cash with which to buy access to resources (oil, coal, minerals, and farmland) around the planet. Yet while it is building an imperial-class navy that could eventually threaten America's, Beijing suffers (as we have already seen) from domestic political and economic weaknesses that could make its turn at the center of the world stage a brief one.

Japan, with the world's third-largest national economy, is wary of China and increasingly uncertain of its protector, the U.S. The country is tentatively rebuilding its military so as to be able to defend its

interests independently. Disputes with China over oil and gas deposits in the East China Sea are likely to worsen, as Japan has almost no domestic fossil fuel resources and needs secure access to supplies.

Russia is a resource powerhouse but is also politically corrupt and remains economically crippled. With a residual military force at the ready, it vies with China and the U.S. for control of Caspian and Central Asian energy and mineral wealth through alliances with former Soviet states. It tends to strike tentative deals with China to counter American interests, but ultimately Beijing may be as much of a rival as Washington. Moscow uses its gas exports as a bargaining chip for influence in Europe. Meanwhile, little of the income from the country's resource riches benefits the populace. The Russian people's advantage in all this may be that they have recently been through one political-economic collapse and will therefore be relatively well-prepared to navigate another.

Even as countries like Venezuela, Bolivia, Ecuador, and Nicaragua reject American foreign policy, the U.S. continues to exert enormous influence on resource-rich Latin America via North American-based corporations, which in some cases wield overwhelming influence over entire national economies. However, China is now actively contracting for access to energy and mineral resources throughout this region, which is resulting in a gradual shift in economic spheres of interest.

Africa is a site of fast-growing U.S. investment in oil and other mineral extraction projects (as evidenced by the establishment in 2009 of Africom, a military strategic command center on par with Centcom, Eucom, Northcom, Pacom, and Southcom), but is also a target of Chinese and European resource acquisition efforts. Proxy conflicts there between and among these powers may intensify in the years ahead—in most instances, to the sad detriment of African peoples.[12]

The Middle East maintains vast oil wealth (though reserves have been substantially overestimated due to rivalries inside OPEC), but is characterized by extreme economic inequality, high population growth rates, political instability, and the need for importation of non-energy resources (including food and water). The revolutions and protests in Tunisia, Egypt, Libya, Bahrain, and Yemen in early 2011 were interpreted by many observers as indicating the inability of the common people in Middle Eastern regimes to tolerate sharply rising food, water, and energy prices in the context of autocratic political regimes.[13] As economic conditions worsen, many more nations—including ones outside the Middle East—could become destabilized; the ultimate consequences are unknowable at this point, but could well be enormous.

Like China, Saudi Arabia is buying farmland in Australia, New Zealand, and the U.S. Nations like Iraq and Iran need advanced technology with which to maintain an oil industry that is moving from easy plays to oilfields that are smaller, harder to access, and more expensive to produce, and both Chinese and U.S. companies stand ready to supply it.

The deep oceans and the Arctic will be areas of growing resource interest, as long as the world's wealthier nations are still capable of

mounting increasingly expensive efforts to compete for and extract strategic materials in these extreme environments.[14] However, both military maneuvering and engineering-mining efforts will see diminishing returns as costs rise and payoffs diminish.

Unfortunately, rising costs and flagging returns from resource conflicts will not guarantee world peace. History suggests that as nations become more desperate to maintain their relative positions of strength and advantage, they may lash out in ways that serve no rational purpose.

Again, no crisis is imminent as long as cool heads prevail. But the world system is losing stability. Current economic and geopolitical conditions would appear to support a forecast not for increasing economic growth, democracy, and peace, but for more political volatility, and for greater government military mobilization justified under the banner of security.

Access previous chapters here.

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