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The fall of the Dollar Empire

Fri, 15 Feb 2008 22:19:47

An interview with Hamid Varzi by Monavar Khalaj, Press TV, Tehran

The following is an interview with Hamid Varzi an economist and banker based in Tehran about the US economic crisis:

Q.Please tell us more about the 2007 subprime mortgage financial crisis and why, how and when it began?

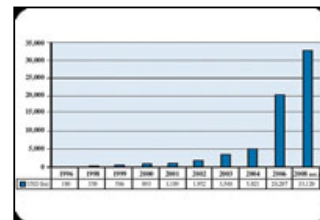
A.The crisis began in 2000 with Bush Jr.'s election that re-established the irresponsible "Supply Side" and "trickle-down" economic policies of the Reagan years. We are wrong to focus only on the subprime crisis, which has been conveniently blown out of all proportion in order to create the convenient and comforting impression that this is a manageable problem solvable through a simple reduction in interest rates and a 90-day government mandated delay on foreclosures (Hillary's recommendation). The subprime crisis presages far greater problems down the road. It is already spreading to other forms of commercial paper, and even if the damage can be contained the relief will be only temporary because a much larger danger is looming on the horizon: The US economy has grown largely on the back of speculative credit derivatives that have risen exponentially to \$ 35 trillion, which is more than double the size of the entire US economy! This is an approaching iceberg, and all you've seen (in the sub-prime scandal) is the tip. To return to your question, the first chart below proves that speculative commercial lending received a major boost with Bush's election, and soared with his re-election.



Credit derivative volumes continue to soar. The notional principal outstanding of credit default swaps (CDSs) grew 33% in the second half of 2006, rising from \$26 trillion to \$34.5 trillion, following 52% growth during the first half of 2006, according to industry body International Swaps and Derivatives Association (ISDA). (Global Finance, June 2007). The ECB confirms the HI 2006 figure of \$ 26 trillion. As you will observe, actual growth has far exceeded even the rapid growth foreseen by the British Bankers' Association Credit Derivatives Report 2006 in which ambitious growth targets for 2008, forecasted below, have already been met. The bulk has been 'created' in and by the United States, and only a small portion of this speculative debt relates to subprime mortgage lending:

The Myth of Reaganomics and the Gratuitous Demonization of Clintonomics

The real root cause of the subprime crisis began with Ronald Reagan. Wall Street 'wisdom' hails Ronald Reagan as the last great saviour of US Capitalism. However, supporters of Ronald Reagan seem unable to explain the unprecedented exponential growth of stocks, during Clinton's presidency, on the back of equally unprecedented (= exploding) budget surpluses, a major



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Which Democratic candidate do you prefer to run in the race for the White House?

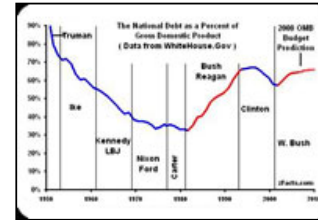
- Barack Obama
- Hillary Clinton

Results

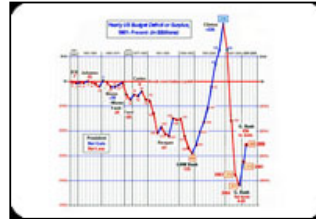
decline in the Federal Debt and a major strengthening of the Dollar.

Bush raised fiscal irresponsibility to new highs. The charts below explain why the subprime crisis did NOT occur on Clinton's watch:

During Clinton's 8 years he turned a \$ 135 billion Bush Sr. deficit into a \$ 526 billion budget surplus, he significantly reduced the National Debt and simultaneously presided over a mind-boggling 240 % rise in the stock market. The perspective of strong fiscal discipline encouraged foreigners to invest in the US and the Dollar rose over 20 % as a result of a combination of the above 3 factors.

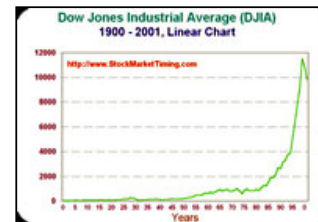


The US economy projected strength. Now the Dollar is tanking as a natural reaction to policies that totally reversed Clinton's fiscal and monetary discipline. America's fate is at the mercy of foreign investors (China, India, Russia and many others with around 10 % annual GDP growth) which are getting stronger by the day and represent the economies of the future.



Q.What was the role of investment banks and mortgage lenders in creating the crisis? Do you think any fraud had happened?

A. No, as far as the investment banks were concerned there was no fraud, just plain greed, ignorance, irresponsibility and stupidity. Even, the SocGen \$ 7.2 billion scandal was simply due to the ambitions of one young man trying to make a name for himself by speculating with his Bank's money. Investment bankers tend to be 'cowboys' and 'gamblers' salivating at the prospect of gigantic bonuses when they succeed, and many of whom simply move on to the next bank when they fail (Nick Leeson of Barings Bank was an exception, but only because he actually bankrupted the bank! But I don't believe M. Kerviel has even been charged; he was arrested and then released!).



As for the US mortgage lenders, their 'irresponsibility' bordered on 'fraud', because they lent money to people who obviously couldn't pay, simply in order to earn higher commissions/fees. If you place a knife in the hand of a 2-year old child and it cuts itself it is you, and not the child, who has been criminally negligent, particularly if you have benefited from the child's discomfort as did the mortgage lenders.

Q. Have the world weathered the crisis? If not what are your predictions and prescriptions?

A. Yes, the world has indeed weathered the crisis, because the US sold only about 20 % of its economic toxic waste to the rest of the world. Most importantly, the nations which bought America's toxic waste have suffered financial losses only among their financial institutions, not among the general population which, in most industrialized countries, has to make a 30 % mortgage cash down-payment and provide solid evidence of regular financial income before being granted a mortgage. Not one home-owner in Germany or France or England faced foreclosure because of what happened in the US.

This actually demonstrates how quickly global economies are decoupling from the US economy. The US has a \$ 9 trillion National Debt and a net \$ 3 trillion foreign debt, so obviously any crisis is going to hit indebted countries far harder than nations flush with cash (Russia, China, India, Japan, the 'Tigers' and Western Europe). The US is in deep fundamental, historical trouble.

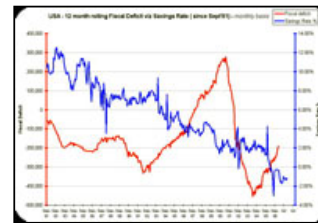
Q.What is its impact on the world economy?

A.Greater controls will be imposed by governments across the globe to discourage financial speculation, which is a 'good thing'. Banks will refocus on trade and export finance rather than on gambling. The world economy will cool off (which will reduce some of the speculative excesses such as the current oil and gold prices).

Q.How will it influence the life of ordinary people across the globe, especially those at the bottom of the economic ladder in the US and Europe?

A.Those at the bottom of the economic ladder in Europe are about 10 rungs above their counterparts in the US, so the effect will be negligible compared with the economic hardships to be faced continually by those at the bottom of the US economic ladder. Even setting aside the subprime crisis for a moment, US households are more in debt, generally, than at any time since the 1930s Great Depression. The US Wealth Gap and the US Household Savings rate are both at Great Depression extremes despite an extended period of global economic growth:

Here is the chart confirming a NEGATIVE savings rate, = - 1.5 %



Q. Do Asian economies including China, India, Malaysia and even Iran expect its ramifications?

A. As mentioned above, this is a US crisis because the US does not currently have the fiscal means, the monetary means or the political will to solve it: Nothing will improve unless and until fundamental measures are adopted by the next US Administration similar to those adopted by Bill Clinton (see charts above).

Q.Why has the US Dollar gone into a spiral of decline?

A.Mainly because it has to borrow \$ 3 billions each and every day from foreigners to finance its massive current account deficit and its war machine. Foreign nations have become nervous at the annual 10 % deterioration in their Dollar holdings. Foreigners don't even need to reduce their Dollar reserves to precipitate a Dollar crisis; they can do so merely by refusing to increase their holdings, i.e., refrain from participating in further US Treasury auctions.

Q.There are two views about the impact of the dollar decline on the US economy: one holds that it would eventually benefit the US economy through boosting exports while others believe that it damage the US economy. What is your opinion?

A.The export view is sheer unadulterated nonsense. The Dollar has been in fundamental decline since the end of WWII, as has its trade deficit!!! A weak currency is not a panacea for economic health. It merely delays the inevitable drive to increase competitiveness, as demonstrated by Germany which has again become the world's No. 1 exporter despite an 80 % appreciation in the Euro since 2001! The drop in the Dollar has, on the contrary, caused only a minimal reduction of its annual \$ 750 billion trade deficit, which proves that US lack of competitiveness is truly endemic and not a function of exchange rates.

A weak currency also boosts inflation as imports become more expensive. In America's case it represents a 'double whammy' because, while imports become more expensive they are unavoidable since the US doesn't produce many of the consumer goods it needs.

Q.Would the dollar's depreciation lead other countries to switch to other main currencies and given that the US Dollar is a fiat currency could such a move further fuel the dollar's decline?

A.They already have! Countries are realizing (ours a little late, but better late than never!) that the US Dollar is in fundamental imperial decline: From a peak of 121 shortly after Clinton left

office the Dollar index has been swooning with no end in sight. Yes, Reagan boosted the Dollar temporarily, but only by raising the Prime Rate to a massive 21.5 % to attract foreign aid (sorry, foreign 'capital')! Here is another chart, this time of the Dollar's seemingly unstoppable decline against a basket of international currencies (trade-weighted index):

Q.What will be the impacts of the US dollar decline on Iran's economy?

A.Not much. Iran's own economic policies (or lack of) influence our nation's economic health far more significantly than the Dollar exchange rate.

Q. What will be the impacts of the US presidential elections on the US economy?

A.There will definitely be a massive change, with a return to the much maligned 'Clintonomics' if either Hillary or Obama wins, as I personally predict. The Dollar will strengthen, by which I mean that it will reverse some of its losses, but not that it will re-emerge as the fiat currency. The deterioration in the US fiscal and current account deficits will be stemmed as the US increases taxes, reduces budget wastage, redistributes wealth more fairly and severely reduces military spending on the back of a partial or withdrawal from Iraq which has already cost \$ 2 trillion according to 2001 Nobel Economics Prize Winner Joseph Stiglitz.

If McCain wins, after a brief relapse the Euro will strengthen to \$ 2.00 from its current rate of \$ 1.48, because McCain will be just another Republican spendthrift unable to offload the party baggage (the "special interests"), no matter how 'fiscally responsible' he sounds on the surface. But I doubt he will win.

Q.Do you think the Iranian decision to cut its ties with the greenback and Tehran's call on its importers of crude to pay in non-dollar currencies have adversely contributed to the Dollar nosedive?

A.Definitely, because it was not so much the nominal sums involved, which are paltry by global comparison, but the psychological effect of the move which encouraged others to follow suit.

Q.Should one consider the US crisis as an opportunity for booming economies like India and China to assume a more important role in the world's markets?

A.They already have. The US is totally dependent on China's goodwill. If the US were to ban all imports from China tomorrow morning the US economy would suffer a heart attack as it would have to import those same goods more expensively from elsewhere. In retaliation, the Chinese would sell their surplus Dollar mountain and precipitate a global economic depression. The emerging economies would be better able to withstand such an Armageddon scenario because they are accustomed to hardship, while decadent US consumers are already bankrupt despite an environment of extended global economic growth. The US would probably suffer riots, internal conflict and starvation for the first time in 80 years. Emerging economies are used to economic hardship and even war. The US is much more fragile than its leaders and economic pundits admit. There is a huge fundamental and conceptual difference between a) going from recession to depression (the USA), and b) going from 10 % + economic growth to a more reasonable 3 % economic growth (Russia, India, China,).

MK/RE



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