

Has the US Dollar Lost its Credibility? Legitimate Concerns for the World's "Reserve" Currency

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The confidence in the US dollar as the world's reserve currency since the US government shutdown has continued its rapid decline. On October 14th, started the third week of a US government shutdown reported that the US dollar fell against the Euro. A deal involving a spending bill would most likely happen between both Democrats and Republicans by the October 17th deadline. But the damage was already done to the credibility of US dollar in the long-term. The world has no confidence in Washington. It is fair to say that they are holding the global economy hostage because of their political brinkmanship.

According to Olivier Blanchard, the IMF's chief economist recently warned that there could be major financial disaster throughout the world if the United States did not increase their "Debt Ceiling" to avoid a default on its financial obligations as it is in the midst of running out of money. Raising the debt ceiling by October 17 only means they can continue to borrow money to fund its operations and pay interest on government securities held by China, Japan and other investors. Blanchard stated

"Failure to lift the debt ceiling would, however, be a major event. Prolonged failure would lead to an extreme fiscal consolidation and almost surely derail the U.S. recovery. But the effect of any failure to repay the debt would be felt right away, leading to potential major disruptions in financial markets, both in the United States and abroad."

The United States government continues to borrow money to pay its debts is already at \$16.7 Trillion. Raising the debt ceiling can go over the \$17 Trillion mark. How long can this go on for? The US government will continue to borrow money at the expense of many nations who hold US Treasuries that are worthless due to the Federal Reserves endless money printing.

There should be a concern for international investors that include governments, big and small businesses and individuals who own U.S. treasuries. The Federal Reserve Bank's endless Quantitative Easing (QE) continues to devalue the US Dollar as Fed chairman Ben Bernanke promised to continue buying \$85 billion a month worth of US treasuries and mortgages that will lead to high inflation. It's an economic policy that is bound for failure.

China, the largest creditor to the US government has been purchasing assets in Africa Asia, Europe and Latin America to diversify out of the US dollar due to the Federal Reserve's reckless monetary policy. The International Business Times, an online news publication based in New York City published an article last month called 'China Steps Up Farmland, Oil and Mining Assets Acquisitions Abroad' about how countries in Africa benefit with Chinese investments in infrastructure and from much needed capital:

In 2013, Chinese companies have acquired minority mining-sector stakes in 16 deals totaling \$696m outside China, according to Dealogic. The majority of the deals are located in Australia and the rest in Indonesia, Canada and the UK.

Africa is often regarded as the most attractive destination for Chinese outbound mining acquisitions. Chinese firms are benefiting from their reserves of cash unavailable to western competitors to scoop up assets at steep discounts.

"China needs access to natural resources while African countries need a lot of capital and infrastructure support. Therefore, it is very easy for Chinese businesses to gain access to the abundant natural resources in African countries by providing them with capital and infrastructure aid," a respondent told accountants Deloitte during a 2010 survey.

The report also said that China has been acquiring oil and gas assets worth over \$100 billion dollars. China needs oil and gas for its manufacturing sectors.

Chinese companies have completed 83 overseas oil and gas purchases worth \$100.7bn in the past five years, according to data compiled by Bloomberg. Cnooc's \$15.1bn acquisition of Canada-based Nexen early in 2013 was China's largest overseas acquisition.

Over the last five years, Sinopec and CNOOC, the country's second and third-biggest oil and gas producers, spent \$41bn and \$26bn, respectively, on overseas assets.

China National Petroleum Corp has invested more than \$9bn to purchase overseas assets in 2013, including the \$4.2bn purchase of a stake in Mozambique's Rovuma fields in July. The company is planning to double its overseas output by 2015.

PetroChina, China's biggest oil and gas producer, is looking to invest \$60bn on overseas acquisitions over the period to 2020. By that time, the company intends to raise its production abroad to more than 50% of its total.

How long before countries that hold a large amount of US treasuries such as China and Russia. Can they start dumping US treasuries in the near future? It won't likely happen this year but within the next 2 years, it is possible. China has been making crucial decisions to solve their economic problems concerning their \$1.2 trillion in US treasuries they hold. China has been accumulating multiple assets by investing in numerous regions in the world. For example, China has made arrangements to swap Yuan's for other currencies with Japan and Russia for their bilateral trade agreements. China also has arrangements with Australia, Iceland, South Korea, Malaysia, Brazil, India and South Africa who will use their own currencies for trade. China has built relationships with many countries in Africa for its much needed resources for its economy. China has even invested in numerous infrastructure projects that spur economic opportunities for the African people that create jobs for both short and long-term projects. It is a strategic move for China by building business relationships with African governments that seek to improve economic conditions for its own people. China National Offshore Oil Corporation (CNOOC) acquired the Canadian energy giant Nexen for \$15 billion.

China also invested in oil and gas pipelines in Central Asia and mineral mines in Australia and Africa. China also signed deals worth up to \$5 billion for a 600-mile long railway to

transport goods with the Kenyan government who recently suffered from a terrorist attack in Nairobi. An online website dedicated to procurements and supply chain professionals worldwide called www.supplymanagement.com stated that *"the line will stretch from the border town of Malaba in the west to the busy port of Mombasa, carrying Kenyan goods as well as freight from Uganda, Rwanda, Burundi and the Democratic Republic of the Congo."*

Chinese investors have been snapping up vineyards in Bordeaux, France. A Chinese meat producer recently purchased one of the world's largest pork producers *Smithfield* for \$4.7 billion to meet the Chinese public's demand for pork. With \$1.2 trillion in reserves, China would only be irresponsible if it did not to purchase hard assets for its future economic growth. The world is closely paying attention to Washington's political charade at the expense of its own public and the world's investors. With uncertainty breeds distrust.

With distrust of a government's inability to assure investors that their purchases of US treasuries are fundamentally secure, then the confidence the world once had in the US dollar is lost. Reuters just reported that the Japanese Yen is a safe-haven (at least in the short-term) until the US Congress come to an agreement before the October 17th deadline. *"The U.S. dollar fell broadly early on Monday while the yen gained across the board as investors sold the U.S. currency in favour of the safe-haven yen as a deal to avoid a government default remained elusive ahead of a crucial deadline this week."* China continues to buy gold as the US dollar continues its decline. A Xinhua editorial in 2011 stated that

"Should Washington continue turning a blind eye to its runaway debt addiction, its already tarnished credibility will lose more luster, which might eventually detonate the debt bomb and jeopardize the well-being of hundreds of millions of families within and beyond the U.S. borders."

The dollar has lost 95% of its value since the Federal Reserve Bank was established in 1913 to control the money supply (See chart below).



Governments around the world are trying to ditch the dollar as an instrument for trade. However, the US and its Western allies has declared wars and instigated coup d'états in the past against governments who were willing to use other forms of money including gold for trade. One example was Iraq under Saddam Hussein (Once a US Patsy) tried to replace the petrodollar with the Euro. Time magazine published an article in 2000 that openly admitted that Iraq's president wanted to use the Euro instead of the dollar. It was one of the main reasons that Bush administration invaded Iraq besides oil resources. The article titled 'Foreign Exchange: Saddam Turns His Back on Greenbacks':

Europe's dream of promoting the euro as a competitor to the U.S. dollar may get a boost from SADDAM HUSSEIN. Iraq says that from now on, it wants payments for its oil in euros, despite the fact that the battered European currency unit, which used to be

worth quite a bit more than \$1, has dropped to about 82[cents]. Iraq says it will no longer accept dollars for oil because it does not want to deal "in the currency of the enemy.

The assassination of Muammar Gaddafi is another example. Gaddafi's idea was to create a single African currency known as the "Gold Dinar" that would have undermined the US Dollar in Africa for all oil traded in petrodollars. It was a proposal that made Washington and its Western partners nervous. It was also a concern that Gaddafi also called for the African Investment Bank that would have been an independent institution that would have given interest-free loans to African nations, eliminating the role of International Monetary Fund (IMF).

Gerald Pereira, an executive board member of the former Tripoli-based World Mathaba once said that *"Gaddafi's creation of the African Investment Bank in Sirte (Libya) and the African Monetary Fund to be based in Cameroon will supplant the IMF and undermine Western economic hegemony in Africa."* The United States can no longer sustain their dollar policy, whether by force or economic coercion. The US Dollar has lost its credibility due to the government's actions. Since World War II, the US government has increased its military spending over the years along with the Fed's unlimited money printing with forever low-interest rates creating cheap money. With the loss of its manufacturing base that produces products for export is a recipe for disaster. With a U.S. government shutdown added to the mix, projects a negative image on the world stage. The Qatar based QNB Group (Qatar National Bank) issued a press release this past Sunday on what a default by the US government would mean for the American economy and the world. It stated the following:

A default on US government debt would be catastrophic for the US and world economy. Ratings agencies would automatically need to classify all US government debt in default. This would force institutional investors around the world, including central banks, to sell their holdings of US government bonds, as they have statutory requirements to hold only investment-grade assets. The US government would then no longer be able to rollover a large portion of its debt, let alone issue new ones. For the US economy, the lack of debt instruments to finance government spending would mean reneging on its other obligations, including Social Security, medical payments, military deployments and food stamps. A large portion of the US economy would therefore grind to a halt. For the world economy, it would imply a loss of the reserve currency that anchors the global financial system, with severe instability in exchange and bond markets. This would inevitably result in a sharp global recession.

In light of these catastrophic consequences, QNB Group expects that Congress will pass a new budget and increase the debt ceiling in the coming days. Nevertheless, the political deadlock over the last couple of weeks has created an atmosphere of uncertainty that could affect confidence, investment and growth in the US. More importantly, the credibility of the US dollar as the world's reserve currency could be affected, as global investors seek to mitigate the risk of a future political deadlock. Overall, without political collective commitment, it is unlikely that the US dollar will continue to remain the world's reserve currency.

The US government's charade over the Republicans and Democrats failure to enact appropriations or a government spending bill and funding for the Patient Protection and Affordable Care Act (Obamacare) is seen as anything but dysfunctional. The republicans want Obamacare defunded. The irony is that Obamacare is similar to Romneycare which

had the same mandate to force you to buy health insurance.

It was admitted by Jonathan Gruber, a professor at Massachusetts Institute of Technology (MIT) who advised both Mitt Romney and Barack Obama on how to create their healthcare plans was upset to learn that Mitt Romney lied about how his plan was different than Obama's. He was interviewed by an online news website called *Capital New York* and said "The problem is there is no way to say that," Gruber said

*"because they're the same f***ing bill. He just can't have his cake and eat it too. Basically, you know, it's the same bill. He can try to draw distinctions and stuff, but he's just lying. The only big difference is he didn't have to pay for his. Because the federal government paid for it. Where at the federal level, we have to pay for it, so we have to raise taxes."*

We are facing global economic crises by Washington's political theater. It will allow countries to lose confidence in the US Dollar in the long-term.

It is a dangerous economic formula that can lead to a global economic depression.

China, Russia, Iran, Brazil and many others are diversifying out of the US Dollar monopoly. There will be a global sell-off of US Treasuries if these political shenanigans continue in any future political crises between both Democrats and Republicans. Confidence is waning as investors seek a way out. It will be difficult period in time. The world must seek a better economic system that is not reliant on the US Dollar.

A gold-backed currency or a basket of various currencies backed by either gold or silver would be a good start. Right now the world is waiting to see what comes out of Washington. No matter what happens, confidence in the US Dollar is at an all-time low regardless if the spending bill passes and they raise the debt ceiling. The Question is how will they convince the world to re-invest in the US Dollar once again?

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