GOLD & ENERGY ADVISOR

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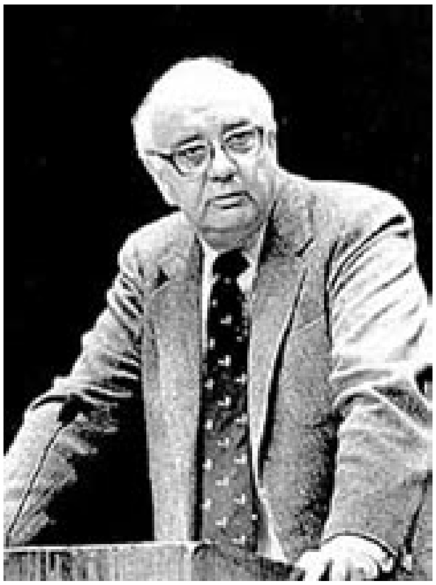
Former Federal Reserve Chairman Warns: US economy is on "increasingly thin ice"... and "dangerous" times are ahead!



Paul Volcker
Former Chairman, Federal Reserve

Even bogus government reports can't hide our economic problems any more. Get ready for rocky times!

- **Rosy government job and inflation reports: A sham!**
- **Iran: Practicing for a nuclear attack on the US**
- **Three new stock recommendations**

Remember Paul Volcker? He was Chairman of the Federal Reserve from 1979 to 1987. He single-handedly rescued the US economy from collapse, back when the Carter Administration had created runaway inflation. You might remember interest rates hitting nosebleed heights at this time: a staggering 20 percent! The pain was excruciating, but he saved us.

Now he's warning we're in serious trouble...even worse now than then! Last month in the *Washington Post*, he wrote about our economy: "There are disturbing trends: huge imbalances, disequilibria, risks – call them what you will. Altogether the circumstances seem to me **as dangerous and intractable as any I can remember**, and I can remember quite a lot…We are skating on increasingly thin ice."

Why is he saying this? And why are other nations also warning us about our economy – like the recent article in India's *Economic Times*: "There is a fear and speculation of **the most severe economic depression that mankind has ever seen**…The world's finance ministers and central bankers are seriously troubled by these structural problems in the American economy."

It's because decades of financial mismanagement in Washington are finally catching up to us. The storm is gathering…and the funnel clouds are forming. Our economic picture is deteriorating almost by the day.

We're headed back into stagflation – an incredibly ugly combination of inflation and a stagnant economy, a situation not seen since the 1970s. Few are willing to admit it, because the prospect is too frightening. But our economy's numbers are grim.

Our last stagflation was caused by the oil shocks of the 1970s. Now, with oil hitting record prices over the last year, pummeling our fragile economy, stagflation is making a comeback.

The signs are everywhere. I'll start with…

Our Crumbling Economy

Retail sales in March were only one-half what economists expected. If you exclude gasoline, autos, and building materials, retail sales actually *declined*. At the same time, the University of Michigan's consumer sentiment index fell again – making four months in a row. And a small-business optimism survey has fallen for three straight months.

Durable-goods orders (orders to US factories for manufactured goods) plunged 2.8% in March. That doesn't sound like much, but on an annualized basis, that's a drop in US industrial production of ***over one-third***. Economists were stunned – their forecasts had been for a small gain. And this was the third straight decline – the last time this happened was September 2001.

March also showed a rise in consumer prices. Excluding oil and food, prices rose at double the rate of the forecasts. Meanwhile, our trade deficit hit yet *another* record in February. And housing starts tumbled.

Then the Treasury tanked the bond market by 4 percent in just a few minutes, by announcing the government might bring back the 30-year Treasury bond. This went "under the radar" for most analysts, yet (as the market itself recognized), the return of the long bond is a sign of serious trouble.

Why does the government want to bring it back? Three reasons…

1. To reduce the number of auctions. Since we aren't paying off any of our debt (instead, we're borrowing over $1 billion *more* every day), maturing notes have to be "rolled over" and paid off with new debt. So each time a note matures, the government has to sell another one to pay it off.

In past issues, I've told you about Treasury auctions where buyers failed to show up. This is a warning sign: if buyers dry up permanently, the dollar will crash, and take our entire economy with it. So the government desperately wants to reduce the number of auctions where we're dependent on buyers for our debt – so it's "better" to sell one long-maturing bond instead of a series of shorter ones.

2. To lock in lower interest rates. With short-term Treasury bills, the government is just like a consumer with credit card debt, or a floating-rate mortgage. When interest rates go up, his payments skyrocket.

Instead, the politicians want to "lock in" today's low interest rates out to 30 years. Which means they know interest rates on their debt are going up in the future...probably *way* up, as I've explained in previous issues.

High interest rates will steamroller us as citizens – even if you don't have credit card debt or a floating-rate mortgage, others do. Foreclosures and bankruptcies will soar, and the markets (stocks, bonds, real estate) will tank. Congress could prevent all this by cleaning up the fiscal mess in Washington, but they aren't. Apparently, they're happy to stiff the consumer with high rates (by creating the conditions

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today for high rates later) – but are unwilling to pay this price themselves. Therefore, they're thinking about longer-term bonds.

3. To continue the wild financial orgy in Washington. Neither of the two reasons above would matter if the government would just straighten out the disgusting financial mess in our capital. It's beyond pathetic that the world's "only superpower" begs for money from lenders every single day – and if Congress would actually show some self-control, we wouldn't have to sell Treasury notes at all.

But I'm just dreaming. Congress is as addicted to spending as a junkie is hooked on heroin…and neither can break the addiction on their own. Just as the junkie can't stop until he winds up in jail (or worse), so we're headed for a financial crash and burn.

Sure, politicians are making all sorts of promises about reducing the deficit (but never this year – it's always off in the future). Treasury Secretary Snow recently promised to cut deficits to less than 2% of GDP, but this is laughable. His budget *leaves out* the cost of operations in Iraq *and* the war against terrorism, includes no reform of the alternative minimum tax, and *doesn't* include any rises in federal spending.

Snow's comments prove our government officials are living in fantasy-land, and they're steering us right into catastrophe…

The *Washington Post* even warned that Snow's comments foretell a "precipitous collapse of the dollar"!

A return to the long bond is an admission that the massive bleed-out of our national wealth will continue until we crash. As the *Wall Street Journal* recently said, "Treasury is finally recognizing that we will have **huge deficits from here to eternity**."

As analyst Jim Jubak said, "The slide toward fiscal irresponsibility just got another coat of grease."

And it's bad enough that the government is preparing for bigger and bigger deficits. But it couldn't come at a ***worse*** time for our economy.

Our government *already* borrows $1.1 billion per day just to pay its bills. And we're groaning under the weight of the interest from past borrowing – interest payments are now more than $321 billion per year. That's more than the government spends on education, agriculture, law enforcement, federal courts, homeland security, international aid, veterans' aid, transportation, parks and wildlife services, scientific research, international trade, energy, and space exploration…**combined!**

Even Greenspan – the master of "see no evil, hear no evil" – is scared of our deficit. As he recently told the Council on Foreign Relations, "Unless we address it [the deficit], there's a **major disruption** out there… Our fiscal prospects are a significant obstacle to long-term stability." As he said this, the government was just reporting the largest monthly budget deficit ever: a record $113.94 billion. That's an annual rate of almost $1.4 trillion!

No wonder other nations are getting more and more skittish about lending to us any further, as I've discussed in past issues. The *Financial Times* recently warned India is diversifying further from the dollar, and this will have terrible consequences for us. "Asian reserve diversification could be **disastrous** for the dollar – with the US needing to attract $2 billion a day to fund its current account deficit – if central banks were to stop buying Treasuries and actively sell dollars instead." The greenback would plummet.

Meanwhile, US businesses are sinking. Standard & Poors just downgraded bonds from Ford and General Motors to "junk" status. Their outlook is "negative" on both companies. (Ford has $161.3 billion in debt, and GM has a staggering $291.8 billion.)

This is a death-knell for both companies. Many investment firms are required to own investment-grade bonds, and can't own junk: so GM and Ford will see their borrowing costs shoot way up.

Many other companies will be affected as well. Smaller companies often borrow in the debt markets to fund their growth, but have to sell high-yield ("junk") bonds because of their size. Now they'll be competing for dollars with GM and Ford – by one estimate, GM and Ford will be 13 percent of the junk market. Smaller businesses will be far less attractive now, will have to offer far higher yields, and many will go bankrupt as a result.

And many companies – small and large – were already teetering on the verge of failure. As *The Times* recently wrote,

"The US is heading for a surge of bankruptcies and a dramatic increase in corporate debt default…

"…as the number of companies with bonds rated at the lowest end of the junk bond scale reaches record levels.

"More than 45 percent of newly issued junk bonds are rated CCC…a dramatic increase since 2003 when [only] 30 percent of the junk bond market was made up of companies that were a notch away from default…If a company's debt is rated at CC or CCC, there is a 30 percent likelihood that it will fail within a year."

Latest prices as GEA goes to press—May 19, 2005

Comex spot contract: silver $7.14, gold $419.85
Nymex spot platinum: $864.00, palladium $188.00
Nymex Light Sweet Crude Oil $47.60

Silver coins			Dealer will buy at this price	Dealer will sell at this price
100 1 oz. silver American Eagles			$810	$920
100 1 oz. common rounds			$730	$810
$1,000 face value US pre-1965 coin bag (circulated)			$4,650	$5,500
$1,000 face value US circulated silver dollar bag (VG or better)			$8,000	$8,900
US Morgan silver dollars		PCGS MS64	$42	$55
		PCGS MS65	$110	$160
		PCGS MS66	$300	$360
Platinum coins				
U.S. Platinum Eagle:		1 oz.	$870	$970
		1/2 oz.	$440	$550
		1/4 oz.	$220	$300
		1/10 oz.	$90	$140
Gold coins				
Australian Kangaroo			$415	$470
British sovereign (Kings)			$96	$135
(Elizabeths)			$97	$135
Canadian Maple Leaf			$415	$480
Credit Suisse 1 oz. gold bar			$410	$480
Mexican 50 peso Centenario			$490	$560
South African Krugerrand			$410	$470
US Gold Eagle:		1 oz.	$423	$480
		1/2 oz.	$200	$250
		1/4 oz.	$98	$140
		1/10 oz.	$44	$57
US $20 double eagle:				
Liberty	Raw	MS60	$490	$570
	NGC	MS63	$700	$850
	NGC	MS64	$1,150	$1,750
	NGC	MS65	$4,150	$4,850
Saint Gaudens	Raw	MS60	$500	$600
	NGC	MS63	$600	$725
	NGC	MS64	$650	$780
	NGC	MS65	$1,100	$1,350

Prices courtesy of Finest Known, Boca Raton, FL. (800) 806-3468.

Companies on the edge of collapse or default include such well-known names as Levi Strauss and Mitsubishi Motors. They would join other well-known companies in bankruptcy, such as United Airlines, Conseco, Adelphia Communications, and Kmart.

The markets themselves are predicting grim times ahead. Even though the Fed has raised short-term interest rates 8 times during the past year, the 10-year note yield has actually *fallen*.

In a healthy economy, the 10-year note rate averages .75 points above the 2-year rate: but now, the spread has fallen to .54. Investors apparently believe that the economy is going to tank, and the Fed will be forced to lower short-term rates again in a desperate attempt at reviving it.

The *Wall Street Journal* described this as "ominous behavior." Not only is it a gloomy forecast for the future, but it's also stressing our banking system.

Banks "borrow" short term (by paying interest on deposits from customers), and lend long-term (mortgages, car loans, etc.). The spread between the two interest rates is how they profit. But the spread has shrunk, and their profits are being squeezed. Not only are they more likely to fail now, but troubled banks can make fewer loans, reducing liquidity in our financial system.

If the spread shrinks too far, our whole financial system could lock up.

So there's economic stress on the national government level, on the corporate level, and in our financial system. But that's not all – there are catastrophes building even on the state level.

This year, state governments have been faced with huge deficits. California has a $9 billion shortfall. New York and New Jersey each have a $4 billion deficit. At the $1 billion range, there are Connecticut, Indiana, Ohio, Oregon, Washington, Wisconsin, Illinois, and Massachusetts.

Louisiana has a gaping $1.9 billion hole just in its Medicaid bills alone. Other states with huge Medicaid problems include Mississippi, Alabama, Arizona, Idaho, Iowa, Kansas, Maine, Maryland, Michigan, Missouri, New Hampshire, North Dakota, Texas, Vermont, and Virginia.

Our economic "recovery" doesn't look like a recovery at all. And while all this is going on, we're also seeing…

The return of inflation!

I'm not alone in recognizing inflation in our economy. The Fed is terrified of it – that's why they've hiked rates up 8 times in the last year.

Fed governor Donald Kohn recently said, "We need to be vigilant for signs of inflation pressure." Fed governor Susan Bies also said, "The Federal Reserve needs to be more alert to monitoring incoming data." In its April survey of business districts, the Fed admitted that "Price pressures have intensified in a number of districts."

But despite what the Fed says, the government claims inflation is low. What's going on? Do we have high inflation or not? The answer is simple…

The government's numbers are rigged!

There are lots of examples, but I'll focus on two: the jobs report, and the inflation report.

The Bureau of Labor Statistics (BLS) puts out monthly employment numbers. According to the BLS, in the last 3 months 720,000 new non-farm jobs have been added to the economy.

But this number is bogus! The measured number is only 184,000. (By the way, this is less than one-quarter of the people added to the labor force in the same period: 783,000. This implies that of all the people joining or returning to the job market, <u>less than one out of four</u> found work. That's an unemployment rate of over 75 percent in this group!)

Here's how this process works. The BLS has a nice little trick called the "birth/death adjustment." They reason that each month, some businesses start up (are "born") that aren't part of the Unemployment Insurance Program yet. So the BLS has no way of knowing how many new jobs these new businesses are creating.

To figure out how many businesses are born each month, the BLS measures how many businesses failed (this is the "death" part). It's created a theoretical calculation that says, "If X number of businesses died, then Y must have been born, creating Z number of jobs in the births."

Does this sound like a good method to you? The number of businesses failing has nothing to do with the number starting – the BLS just ***assumes*** that a previous measurement of this ratio will be valid in the future. (Huh?)

And that's not all – even if the BLS knew how many businesses were formed (which they don't), how can they tell how many people were hired by these businesses? Brand-new businesses typically have few if any employees. Plus, as soon as they hire people, they're supposed to join the Unemployment Insurance Program anyway. Has anybody at the BLS ever thought that maybe, just maybe, these businesses aren't in the Program yet because…they don't ***have*** any employees?

So the "strong jobs report" you hear about every month is a sham. In fact, the numbers for the last two months are even worse than the three-month numbers above. For March and April, the BLS reported 420,000 new non-farm jobs. But the birth/death adjustment was 436,000…so the actual measured number was a ***loss*** of 16,000 jobs!

So much for the jobs report. But the BLS's monthly inflation report is just as bogus.

For example, according to the CPI (Consumer Price Index), for the 12 months ending in March, prices went up by only 3.1%. Apparently the BLS bureaucrats haven't tried to buy groceries, gasoline, or any of dozens of other items lately…because prices are up <u>much</u> higher than that.

The PPI (Producers Price Index) tells us the true story. In the same twelve month period, we've seen:

Gasoline prices up 31.9 percent…

Intermediate material prices up 8.7 percent…

Nonfood crude materials up 19.5 percent…

Natural gas up 20.1 percent…

Petroleum up 50.8 percent…

And I could go on and on. You get my point.

So why are the CPI numbers so low? It's easy – the game is rigged. The BLS uses "hedonic price adjustments" to adjust inflation numbers downwards.

There's been a growing scandal about this in the last 6 months or so. The *Wall Street Journal* just run a great front-page article about it. It started out showing that, according to the government, the same 27-inch TV cost $329.99 two months in a row, but the BLS said its price had ***fallen*** by 29%!

Here's how it works. When a manufacturer improves a product, the BLS assigns a dollar amount to the improvement, and subtracts this number from the product's price. In this case, the manufacturer was now using a nicer screen on its TV, which the BLS had decided was worth an additional $135. So even though the price didn't change…even though consumers were paying the <u>exact same price</u> for a 27-inch TV…it's **cheaper** now, according to the BLS.

This insane methodology is used across a variety of categories. About 46 percent of items used for the CPI are subject to hedonic adjustments. In many cases, the BLS claims items have gotten cheaper <u>even though their prices went up</u>! Take this to an extreme, and you'll have items that get so "inexpensive" that consumers can't afford to buy them anymore!

The CPI is bogus in other ways too. For example, the CPI ignores the skyrocketing prices of real estate across the country. Instead, it measures rents. So even as house prices have doubled, even tripled in some areas, the home buyers aren't actually paying more for their houses…at least not according to the CPI. Nor has the CPI included skyrocketing medical expenses, and other soaring daily costs.

Why would the government falsify inflation numbers like this? Easy – to hide the disastrous bungling in Washington. Also, it reduces the government's cost of expenses indexed to inflation: Social Security benefits, veteran's benefits, military and government employee salaries, etc. A low CPI reduces the "raises" the government must pay out to compensate for rising inflation.

The net effect is that Grandma and our soldiers are getting cheated, just so the politicians can cover up their fiscal mismanagement.

But now inflation is getting so bad, even the government can't cover it up. Even after the hedonic flim-flam, the CPI went up .6 percent in March – that's an annualized inflation of 7.2 percent, far above what it's supposed to be for a healthy economy. (And of course, the real level is much higher.)

The public might be fooled by these numbers, but the Federal Reserve isn't. The Fed knows how bad inflation really is – that's why they've been jacking up interest rates to fight it.

But the Fed is caught in a squeeze. They can't let inflation run away, but jacking up rates too far will crash the real estate market and tank our economy anyway. How this will work out is anybody's guess.

The real source of our problems is Congress. If Washington would stop the borrow-and-spend orgy, inflation would quiet down. Trying to control it through interest rate hikes is fighting the symptom, not the cause.

High inflation and a deteriorating economy mean stagflation is back!

And stagflation, once in place, can turn into a vicious downward spiral for our economy. That's why Alan Greenspan just warned the Senate Budget Committee: if Congress doesn't get its act together, our economy will sink into stagnation – "or worse," he said. But they ignored him.

Instead, the Senate just voted 67-33 to impose a 27.5 percent tariff on all Chinese goods, to "fix" our trade deficit. But this is the height of stupidity.

We'll still be running a trade deficit with everybody else, and a budget deficit overall. So we'll still be borrowing money to buy stuff from China, it will just be at a <u>much higher price</u>. And inflationary fires will roar through our economy. Idiots.

And all this doesn't even include the threat of…

War!

I've been warning you about Iran since last summer. Now the major media are starting to carry the story more prominently.

On March 18, the *Wall Street Journal* said Iran has adapted its Shahab-3 missiles for nuclear warheads. (I told you about this in the September 2004 issue of the *GEA*.) Plus, Ukraine just admitted it sold nuclear-capable cruise missiles to China and Iran four years ago: 18 Soviet-era X-55 air-launched cruise missiles (12 to Iran and 6 to China). These have a range of 2,175 miles, bringing major European cities within range of Iranian weapons.

But what payload do these missiles carry? Do the mullahs have nukes yet?

The Iranians are still denying it, but we've caught them lying over and over. Way back in 2000, we knew they were buying nuclear technology on the black market from Pakistani scientist A.Q. Khan. They denied it up and down, but recently Khan himself confirmed it was true.

Then there's Natanz, 150 miles south of Tehran. In 2002, Iranian exiles said the mullahs were building a massive uranium enrichment facility there. The mullahs denied it, but IAEA inspectors went there and found it anyway. Recently a few reporters were allowed in, and they were stunned at what they saw.

Natanz turned out to be a massive complex, ringed by mountains containing at least 10 anti-aircraft batteries. Over a thousand acres in size, it has two enormous halls over 54 feet underground. It was built to contain a staggering <u>50,000 enrichment centrifuges</u>. Natanz *alone* could produce enough material for 25-30 nuclear bombs per year.

And if that wasn't enough, Russia just agreed to give Iran *more* nuclear fuel. As I told you in a previous issue, Russia has finished building an $800 million nuclear reactor complex at Bushehr in southwest Iran. Now Russia has agreed to supply nuclear fuel as well.

Just a couple of weeks ago, the mullahs admitted they've already converted 37 tons of uranium into gas. Once enriched, this can produce 200 pounds of weapons-grade uranium: enough for five nuclear bombs.

What will they do with nukes once they have them? Two things. Iran's Supreme Leader Ayatollah Khamenei has said many times he'll "vaporize the Zionist entity" (Israel) once Iran has a nuclear bomb. Then, according to an article in an Iranian military journal, they'll attack the United States. (But not in the way you're thinking. More on this in a moment.)

So it's no surprise we're planning a pre-emptive strike…

Scott Ritter (the former UN Special Commission weapons inspector) recently said President Bush has "received and signed off on" orders to attack Iran in June!

Is he right? We'll have to wait and see. I think unless something changes fast, we're going to be involved in an Iranian action of one sort or another—maybe not in June, but soon enough.

And we won't be the only ones. A top leader of the Israeli military recently said, "Israel will not, I repeat, will not allow Iran to go nuclear."

The Times recently reported the Israeli government has given "initial authorization" for an attack. Israeli forces have even made a mock-up of Natanz to practice destroying it. The plan is for a two-pronged attack: simultaneous raids by *Shaldag* (Kingfisher) commandos, and airstrikes by F-15 jets from 69 Squadron with bunker buster bombs.

As Israeli Foreign Minister Silvan Shalom said, "The idea that this tyranny of Iran will hold a nuclear bomb is a nightmare, not only for us but for the whole world"—and they aren't going to accept it.

So war is coming. And the United States itself is at risk – in a surprising way.

An Iranian military journal recently ran an article called, "Electronics to determine the fate of future wars." It recommended a new form of attack on the US – an EMP (electro-magnetic pulse).

EMP bursts are produced when a nuclear bomb explodes. (This is a separate effect from the blast and fireball – it's mostly a burst of high-power radio waves, but also contains some microwaves and X-rays.) The EMP travels at the speed of light, out to the horizon. If such a bomb was to explode high enough – 400 km or so – the EMP would cover the entire continental US.

Any wire hit with electro-magnetic energy converts it to electrical current inside the wire: that's how your radio antenna pulls radio signals out of the air. But a nuclear EMP would be much higher power than that. It would instantly fry all unshielded electronics across the country, and blow out our electrical power grid. Computers, radios, power stations, the phone system, anything electrical or electronic – all burned out, instantly.

Sound farfetched? It's not. Back in the Cold War, the USSR even thought about building nukes specially-made for EMP attacks against us. We knew about it, but didn't pay much attention: after all, when hundreds of nukes are being thrown at you, an EMP is the least of your problems.

New Stock Recommendations For This Month

Energy prices are down, but wild volatility is expected now, as I discussed last month. Long-term, the energy bull is unaffected.

Energy stocks have been hit hard; they're at the lowest level for the year, as my weekly updates have been discussing. Let's use this weakness to add to some of our positions.

I'm recommending three new stocks. Two of them are small cap stocks that comparatively have a small amount of float, and as investors have moved out, these stocks have become extremely oversold. These stocks will be more volatile than our other holdings.

The first stock is **Berry Petroleum (BRY)**. The company had the best earnings growth and beat expectations significantly as mentioned in my May 11, Update #43. The stock has only about 22 million shares outstanding, so it moves easily up and down. Buy or add to your current position at these lower levels, the $42 to $43 area.

Bill Barrett Corp (BBG) has 43 million shares and has also been beaten up in the current downdraft. The stock is currently trading in the $27 to $28 range and this would be a good price to initiate a position or add to your current holdings.

The last stock is a large cap: **Occidental Corp. (OXY)**. This stock is currently trading in the $66 area – a good price to get in.

All the above stocks are undervalued in terms of their market capitalization to reserves. We'll add these three to our existing positions in the *Gold and Energy Advisor* portfolio and average our costs down.

But now it's different. Terrorists and terrorist states (like Iran) can get nukes, but (unlike the USSR) don't have hundreds of them to throw at our cities. But an EMP attack is much easier – if the terrorists could rig up a missile to fire from a freighter, they could anchor off our coast, shoot one high up in the air over the land, and take out our entire power grid, along with our computers and electronics-based infrastructure.

A Congressional report last July noted that "EMP is capable of causing catastrophe for the nation…The high-altitude nuclear weapon-generated electromagnetic pulse (EMP) is one of a small number of threats that has the potential to hold our society seriously at risk and ***might result in defeat of our military forces***…

"Unprecedented cascading failures of our major infrastructures could result…The primary avenues for catastrophic damage to the Nation are through our electric power infrastructure and thence into our telecommunications, energy, and other infrastructures. These, in turn, can seriously impact other important aspects of our Nation's life, including the financial system; means of getting food, water, and medical care to the citizenry; trade; and production of goods and services…

"It is possible for the functional outages to become mutually reinforcing until at some point the degradation of infrastructure could have *irreversible effects on the country's ability to support its population*." [emphasis added]

Then, on March 8, the Senate Committee on the Judiciary's Subcommittee on Terrorism, Technology, and Homeland Security heard testimony that the Iranians have been **practicing** for such an attack. They've been launching (non-nuclear) missiles from freighters in the Caspian Sea, blowing them up mid-air, but claiming their tests are fully "successful." One of the Senate's experts noted that the apparent contradiction would make sense "if Iran were practicing the execution of an EMP attack." And what else would such a test be good for?

You might think I'm being alarmist about this, but this subject is deadly serious. I'll end this issue with a March 14th press release from Senator Jon Kyl (R-AZ), who chairs the Senate Subcommittee on Terrorism, Technology, and Homeland Security. Here's what he wrote…

One Way We Could Lose the War on Terror

by U.S. Senator Jon Kyl

Last week the Senate Judiciary Committee's Subcommittee on Terrorism, Technology and Homeland Security, which I chair, held a hearing on a major threat to the United States, not only from terrorists but from rogue nations like North Korea.

An electromagnetic pulse (EMP) attack over American soil, one of the expert witnesses at the hearing said, is one of only a few ways that America could be essentially defeated by our enemies, terrorist or otherwise. A single nuclear weapon, detonated at the right altitude, would produce an electromagnetic pulse that – depending on its location and size – would knock out power grids and other electrical systems across much of the country, for months if not years.

Few if any people would die right away. But the long-term loss of electricity would essentially bring our society to a halt. Communication would be almost impossible. Powerless refrigerators would leave food rotting in warehouses, marooned by a lack of transportation as those vehicles still operable simply run out of gas (which can't be pumped without electricity). The unavailability of clean water would quickly threaten public health, not to mention leave the inevitable fires raging unchecked. As we have seen in areas of natural and other disasters, this kind of scenario often results in a fairly rapid breakdown of social order.

Our society has grown so dependent on computer and other electrical systems that we have created our own Achilles' heel of vulnerability, ironically much more so than less developed nations. Deprived of power in occasional blackouts, we are in many ways helpless. Typically, power is restored relatively quickly, but a large-scale burnout caused by broad EMP attack would create a much more difficult situation. Not only would there be nobody nearby to help, it could take years to replace destroyed equipment. Transformers for regional substations, for example, are huge and are no longer manufactured in the United States.

Essentially those in the affected area would find themselves transported back to the United States of the 1880s, for months if not years – a threat that might sound straight out of Hollywood, but is very real. FBI Director Robert Mueller has confirmed new intelligence that suggests Al Qaeda is trying to acquire and use weapons of mass destruction. Iran has surprised intelligence analysts by describing the mid-flight explosions of missiles fired from ships on the Caspian Sea as "successful" tests. North Korea exports missile technology around the world; SCUDs can easily be purchased on the open market for about $100,000 apiece. And Russia's rusting nuclear arsenal is highly vulnerable.

The attraction of an EMP attack to a terrorist organization is in its simplicity. Hitting a particular target, like a city, is difficult with a SCUD. But it is relatively simple to simply launch one, off a seagoing freighter for example, and detonate it at the right altitude.

Fortunately, preparing key infrastructure systems and stockpiling backup equipment like transformers is both feasible and relatively inexpensive, according to a comprehensive report on the EMP threat by a commission of prominent experts. But it will take leadership by the Department of Homeland Security, the Defense Department, and other federal agencies, along with support from Congress, all of which has yet to materialize.

The landmark 9/11 Commission report stated that our biggest failure was one of "imagination." No one imagined that terrorists would do what they did on September 11. Today few can conceive of the possibility that terrorists could bring American society to its knees by knocking out our power supply from several miles in the atmosphere. But this time we've been warned, and we'd better be prepared to respond.