Foreign Exchange by David Goldman

The new 'malign neglect'

The Treasury's pool of foreign exchange is unencumbered by agreements with other central banks.

Following the mid-April Treasury Department announcement that the United States will no longer practice intervention on foreign exchange markets, it cannot be excluded that some time in the forseeable future the United States may begin to disgorge $6 billion worth of foreign exchange holdings onto the open markets.

The signal that such an invitation to complete foreign exchange pandemonium might occur was delivered May 4 by Treasury Undersecretary for Monetary Affairs Beryl Sprinkel in testimony before the Joint Economic Committee of Congress. Sprinkel noted that now that the U.S. has returned to the 1976-78 posture of restricting interventions only to extreme crisis situations—a policy then dubbed "benign" or "malign" neglect—it no longer has need for the foreign exchange resources it has at its disposal on the basis of an assortment of agreements with central banks around the world.

During his testimony, Sprinkel also noted that once central banks get out of the market, the way will be paved for a more active role for the International Monetary Fund in "monitoring " Western governments' foreign exchange rate and interest-rate policies. As *EIR* subsequently learned from leading IMF officials, the IMF bureaucracy is delighted with the Treasury's return to "neglect" of foreign exchange rates, and is prepared to take full advantage of the crisis scenario which U.S. dumping of its foreign exchange holdings would unleash.

Jacques Pollack, a veteran IMF executive and former head of the IMF's research division, stated recently, "I fully agree with Sprinkel; let the market tell us what it feels the value of currencies should be. . . . A few years ago, the French and Germans were concerned that wild fluctuations not occur. . . . [But] what is happening now is not new. For example, the dollar-deutschemark rate fluctuated wildly in the first quarter of 1980 . . . and the Germans lived through it."

The threat of a sudden outburst of extreme foreign exchange instability arises from the fact that in the final months of the Carter administration, the Treasury squirreled away about $6 billion in foreign currency reserves, allegedly to finance broad intervention agreements quietly worked out by the world's largest central banks.

This $6 billion is a separate pool from the more than $10 billion in reciprocal swap agreements the U.S. Federal Reserve has maintained with the German, French and other central banks. During his testimony, Sprinkel revealed that both the Treasury and the Fed have been assigned to work up independent assessments of how these reciprocal swaps can be terminated. The swaps are two-way, standby credit lines which have allowed the Federal Reserve to borrow foreign currency only when needed for intervention, in return for dollars. Since the participating foreign central banks, such as the German and French, have large permanent dollar reserves, termination of the swaps will not formally hurt their ability to intervene, since they can draw dollars down from their reserves.

The Treasury's $6 billion pool, however, is different. The Carter administration bought up the foreign currencies without linking them to any agreements with other central banks. Now the monetarist ideologues in the Reagan administration, whose latest round of interest-rate tightening sent the German mark and French franc plummeting this week with a velocity reminiscent of the 1976 currency storms, no longer want them.

As Pollack dryly commented, "Well, the Treasury bought that currency on the open market . . . why not sell it on the open market?" Asked whether this might not suddenly weaken the German mark, he answered, "Sure, it might have some impact for the mark. Conceivably Washington would talk to the Germans," but the danger of a mark collapse would in no way influence Treasury's decision. In 1976, the "benign neglect" maneuver drove the dollar down to 1.70 marks before a gradual recovery began. On May 5, 1981 the mark plummeted 5 pfennig in a single day of trading, hitting 2.28 to the dollar at one point.

A leading Treasury official recently justified the reactivation of "benign neglect" by telling an interviewer, "It's not the dollar which is in trouble this time, it's everybody else."

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