EIR Economics

IMF in brawl over future of dollar empire

by David Goldman

The International Monetary Fund's Annual Meeting, starting Sept. 29, has been widely advertised as a brawl between the United States, which wants Germany and Japan to print money to delay a financial crash, and Germany and Japan, which do not want to mortgage their currencies to the collapsing U.S. banking system. The roughly 10% decline in the price of long-term U.S. government securities since early September reflects the German and Japanese reluctance to continue funding an American balance of payments deficit likely to exceed $150 billion in 1986, and a fiscal deficit likely to approach $300 billion.

If the Germans and Japanese, as is likely, agree to a mere cosmetic agreement to ease monetary conditions, the foreign-exchange market will chop it apart within days. If they agree to America's terms, it is most probable that a generalized financial collapse will be postponed until sometime in early-to mid-1987. If not, a crash, involving the major institutions, and a funding crisis for the U.S. deposit-insurance agencies, will probably emerge before the end of the year.

Federal Reserve chairman Paul Volcker spent the week prior to the IMF meeting warning that the depreciation of the American dollar—by roughly 40% since mid-1985—had already gone far enough. Volcker's statements contrasted to those of Treasury Secretary James Baker III, his partner in the U.S. delegation to the IMF talks, who has warned that if Germany and Japan do not reflate their economies and thus absorb more U.S. imports, the dollar will have to fall further. Baker's statement is nonsense in economic terms; the United States has no hope of exporting products that it has stopped producing. It amounts to a threat to blow up the world financial system, unless Germany and Japan pick up the bill for bailing it out.

Volcker has made the threat of withdrawal of foreign funds a major theme of his public statements before congressional committees, and, in early September, before an ultra-elite financiers' gathering at the Cini Foundation on the Venetian island of San Giorgio Maggiore. To the Europeans, he may appear somewhat less rabid than the Houston real estate lawyer whom Don Regan re-treaded as America's Treasury Secretary; nonetheless, they will remember him as the man who got them into this mess in the first place, starting with his role, as Treasury undersecretary for monetary affairs, in the closing of the gold window in 1971.

In October 1979, Federal Reserve chairman Paul Volcker interrupted his attendance at the International Monetary Fund's annual meeting then in progress in Yugoslavia, and returned to the United States to make the monetary proclamations that began the present Great Depression. The U.S. dollar had sunk to barely DM 1.80, slightly over half the level it later attained, and none of the dollar-support packages adopted by the Carter administration had bought time against the impending disaster. Volcker "solved" the problem by pushing U.S. interest rates up to 20% by the following February, crashing the world economy. The dollar became the world's creditor currency, and the sudden shortage of dollars to cover interest-payments pushed the dollar to DM 3.40 by early 1985.

Mr. Volcker reminds us of the destitute vaudevillian who offered to commit suicide on stage for a substantial fee. His agent said: "What do you do for an encore?" The dollar has

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fallen to barely DM 2.00, and threatens to fall to indeterminately low levels. Unlike 1979, when Volcker sacrificed world trade to the cannibal-gods of the Eurodollar market, the world is already in deep depression, and in the first stages of a general financial breakdown crisis.

Foreign subsidies

America's payments balance current account fell from positive $1.9 billion in 1980 and $6.3 billion in 1981, to well over $150 billion projected for 1986, thanks to Volcker's putative solutions of 1979. The ruined United States economy "recovered," or at least circumstances were created under which federal agencies could fake a statistical recovery, because our trading partners consented to send the United States goods equivalent to a full fifth of America's total consumption, in return for unsecured dollar paper.

During 1986, the foreign subsidy to the United States increased out of all bounds, at least in financial terms, since the collapsing value of the U.S. dollar made America's foreign purchases corresondingly more expensive in dollar terms. Japan, Germany, and other nations with large surpluses with the United States were willing to keep exporting their products, and investing the proceeds in American securities, but not to trust the American dollar. A paragraph buried in the International Monetary Fund's just-released Annual Report makes clear why:

"During 1985, the diversification of the currency composition of foreign exchange reserves accelerated. The proportion of identified foreign exchange reserves denominated in U.S. dollars, which had been approximately 80 percent in the mid-1970's, fell to 71 percent at the end of 1984 and to 65 percent at the end of 1985. This decline in the U.S. dollar component of identified foreign exchange reserve had, as its counterpart, increases in the proportions of reserves denominated in deutsche mark (from 9 percent in 1977 to 16 percent in 1985), and in Japanese yen (from 3 percent in 1977 to 8 percent in 1985). The decline in the relative importance of U.S.-dollar-denominated reserves was greater for the industrial countries (whose dollar holdings fell from 89 percent in 1977 to 65 percent in 1985) than for the developing countries (whose dollar holdings declined only from 71 percent in 1977 to 66 percent in 1985)."

As the cost of non-dollar reserves increased, the Japanese apparently switched to gold-reserve accumulation, and at a rate probably above $25 billion per year. That is roughly half of what the Japanese have to spend each year on foreign investments, and implies a drastic reduction in their purchases of U.S. government securities.

Interest rates and world disaster

Any discussion emanating from the IMF about payments deficit, exports, and so forth must be tossed into the wastebasket at once. The IMF's death-grip on the economies of the developing sector have already forced a spiraling collapse of world trade comparable to that of the 1930s. In 1980, all the world's nations exported a grand total of $1.9 trillion in physical goods. By 1983, the volume had fallen to $1.67 trillion, or about 12% less than the 1980 total. At the height of the supposed "recovery," in 1985, world exports were only $1.72 trillion, still 10% lower than the 1980 level. During the 1975-80 period, world trade had *grown* by 5% a year.

In fact, the picture is much worse. In earlier periods, world trade reflected economic growth; now much of world trade reflects economic parasitism. America's $170 billion trade deficit is a function of our economic decay, and the looting of other economies in the service of that decay. If we deduct only this parasitical element from total world trade, what is left barely exceeds $1.5 trillion. World trade has fallen by a fifth.

Under these conditions, the belief that America's $200 billion per year or higher trade deficit could be corrected by more domestic consumption in Japan, verges on the occult. The issue is much simpler. Massive inflows of Japanese and other funds enabled the Fed to bring short-term rates down to the 5-6% range currently. Low interest rates enable bankrupt Houston commercial banks or California savings and loan associations to continue to carry bad assets on their books, by lowering the carrying-cost of such bad assets.

For example, Salomon Brothers estimates that the decline in interest rates staved off a crash in office-building prices earlier this year, by reducing the mortgage and related interest-costs of owning commercial real estate. At least $150 billion of commercial real-estate loans are in danger, on top of perhaps $100 billion already gone bad, but not yet written down.

However, 6% interest on dollar deposits presents meager incentive to overseas investors, who in any case have seen their dollar paper depreciate by 40% in the past 18 months. It is not so much the financial incentive, especially in the Japanese case, that causes reluctance to throw more money in, but rather, the imbecilic quality of American policy. Our trading partners, who also happen to be our military allies, have already bent over backwards to prevent the collapse of the superpower that guarantees their security. However, at the point where no amount of cooperation will improve matters, our trading partners will be forced to take independent steps to secure their economies against financial disaster.

At the moment, their efforts to prevent a further collapse of the dollar, and reduction of their exports to the United States, forces them to print money, since they buy dollars on the foreign-exchange market with newly created national currency. Japan's $20 billion of intervention during the second quarter also represented a major injection of funds into the world banking system, for example. However, without a drastic change in American policy, the Japanese and German central banks will no longer be able to throw good money after bad.