Foreign Exchange by David Goldman

The end of the dollar bloc

The colonial currency arrangements which propped up the U.S. dollar have come to an end.

On Dec. 12, 1986, this column announced, "The 'dollar bloc' crumbles," noting that the link between the U.S. dollar and the currencies of the emerging Asian nations was about to end, with disastrous consequences for the United States, on two grounds.

First, "the so-called 'dollar bloc,' including such diverse nations as Canada, Brazil, and Taiwan, provides us with a subsidy of physical goods at still-affordable prices," despite the devaluation of the United States dollar against leading trading currencies like the Japanese yen, we wrote.

Second, speculation in the Taiwan dollar provided an enormous rush of funds into that currency, enabling the Taiwanese to become the largest overseas purchasers of United States Treasury securities during 1986.

Foreign exchange reserves of trade-surplus countries increased as follows during 1986: Taiwan + $17.5 billion; Japan + $14.6 billion; France + $6.7 billion; Britain + $5.5 billion; West Germany + $4.2 billion; Italy + $3.5 billion; Spain + $3.5 billion; Korea + $1 billion. Taiwan's reserve increase was more than half its Gross National Product.

The Taiwanese, to maintain export competitiveness, sold their own currency into the market, buying dollars, and putting those dollars into Treasury securities—building up a net creditor position vis-à-vis the United States.

Seven months after *EIR*'s report, Wall Street has begun to notice that the end of the dollar bloc may have consequences for the American economy.

"Now the U.S. dollar is declining against the NIC's [newly industrialized countries]," reports Salomon Brothers in its July inflation monitor.

"While the financial markets continue to focus on the modestly strengthening U.S. dollar versus the Japanese yen and the deutschemark, inflationwatchers should take note of its recent declines against the currencies of the Asia's NICs. During the past year, for example, the dollar has depreciated by more than 18% against the New Taiwan dollar and by 4.4% against the Korean won. Together, these moves signal a greater pass-through of exchange rate movements to U.S. import prices in the months ahead.

"The restraint that the price-competitive NICs have placed on Japanese export prices of consumer electronics and other goods should begin to wane. . . . We expect non-oil import prices to be increasing by more than 10% by year-end."

The nature of the problem still has not dawned upon Salomon's army of analysts.

Taiwan's trade surplus reached a record $15.6 billion last year, up from $10.62 billion in 1985. In January, Taiwan cut import tariffs on some 1,700 foreign products by up to 50%.

Washington has been pressing Taiwan to open its market to American products as a way of cutting its deficit with the island.

Washington's brilliant trade diplomats announced a new agreement with Taiwan late last year, of which the White House said proudly, "This agreement will provide significant access in Taiwan for these U.S. commodities, and should mean close to $150 million in the first year for the beer, wine, and cigarette industries of the United States."

The revaluation of the Taiwan dollar alone, however, will cost the United States over $3 billion a year in higher import prices for Taiwanese goods, or $250 million per month—and the Taiwan dollar has much farther to rise.

The United States Treasury, of course, pressed for this revaluation as hard as the trade officials pressed for the opening of markets.

Political instability in South Korea has limited the rise of the Korean currency, but that may also rise much further.

Another consideration is America's trade subsidy from South America. According to a 1985 study published by *Executive Intelligence Review*, the continent's export prices to the United States fell by almost 60% during the period 1981-83, when most of the region's economies fell under International Monetary Fund dictatorship.

But Brazil's debt moratorium, announced last February, amounts to a decision to limit the flow of cut-priced exports to the United States, for which Brazil has bled its internal economy dry.

Added to the continuing effect of the devaluation-to-date of the U.S. dollar against the leading industrial nations' currencies, the collapse of the dollar bloc implies a much higher import-price increase than Salomon suggests, likely in the range of 30% for 1987 as a whole, adding perhaps 5% to the overall U.S. inflation rate—even in the unlikely event that the dollar were to stabilize at current levels.

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