

City of London by Stephen Lewis

Baker dollar policy in Phase Two?

After George Bush won the March 8 primaries, the U.S. currency went spiraling down on the foreign exchanges.

'Super Tuesday," March 8, left Mr. George Bush in a commanding lead over his rivals for the Republican Party presidential nomination. It also sent the U.S. dollar lower on the foreign exchanges after a period of two months during which the major central banks had been able to enforce stability in the markets.

The U.S. vice president is widely seen as bad for the U.S. currency.

Mr. Bush and his supporters are expected to continue the economic policies of the current U.S. administration. These policies have weakened the U.S. productive sector's ability to compete in the world. They have favored the proliferation of low-grade dollar-denominated securities, such as junk bonds and equity warrants.

They have also facilitated questionable financing practices by U.S. corporations, through leveraged buy-outs and heavily geared takeovers, which have cast doubt on the long-term viability of significant sections of U.S. industry.

All of these consequences of the Reagan administration's policies have undermined international confidence in the dollar. The prospect of these policies being continued for another four years from January 1989, dampens confidence in the recovery of the U.S. currency.

The foreign exchanges are apprehensive on another count about Mr. Bush's successes. They have recognized for some months that the pace of the presidential election campaign will determine the shape of United States economic policies this year.

It could hardly be otherwise with

Mr. James Baker III, a leading partisan of Mr. Bush, as Secretary of the Treasury.

Mr. Baker's first objective was to ensure that Mr. Bush secured the Republican Party nomination. Another stock market crash was identified by Mr. Baker as the chief threat to a Bush success, since this would have damaged Republican Party fundraisers.

Consequently, he strove to ensure that the stock market would hold up well above the 1,750 level that the Dow Jones Index reached on Black Monday. This policy required that the U.S. dollar be stabilized at least temporarily so that no fallout should hit the stock market from disruption in the foreign exchanges.

The question now is whether Mr. Baker feels confident enough in the position of his political associate to swing into the second phase of his game-plan for 1988.

This phase assumes that Mr. Bush is the Republican candidate in the presidential election and aims to gain advantages for him against his Democratic opponent.

The priorities of economic policy, therefore, shift from financial market stability to maintaining a stream of good-looking economic statistics, Mr. Baker's hope being that these statistics will sway significant numbers of industrial workers to support Mr. Bush as they have supported President Reagan.

He would achieve this partly by prevailing upon the Federal Reserve to pump credit into the banking system, irrespective of whether this would upset confidence in the dollar.

Operators in the foreign exchanges had been expecting this shift in Mr. Baker's policies to take place around the time of the party conventions.

Mr. Bush's early victories in the primaries have led many observers to look for a much earlier switch to Phase Two of the strategy.

Probably, Mr. Baker does not yet feel assured of Mr. Bush's capturing the nomination. A collapse in the market could still overturn the Bush bandwagon.

Nevertheless, the foreign exchanges are apprehensive that the U.S. Treasury Secretary could be preparing to change policy-course much sooner than had been anticipated.

One pointer to Mr. Baker's current thinking came in his testimony to the congressional Joint Economic Committee on March 8.

He said that the Group of Seven (G-7) agreement to seek currency stability last December did not prevent G-7 participants from setting interest rates in the light of domestic considerations.

He made this comment in the context of the United Kingdom government's decision to allow sterling to rise above the targeted level consistent with G-7 arrangements (itself an episode in a furious struggle going on in the United Kingdom to determine that country's foreign policy orientation as between the United States and a pan-European grouping of nations).

Even so, Mr. Baker's words suggest that he is reserving his position. He is clearly signaling his willingness to engineer a cut in interest rates if that is what is required to boost a Bush-led Republican Party's chances in the November elections.

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