EIR Economics

Lira crisis: another turning point for the dollar?

by Christopher White

U.S. monetary policy, under the control of Paul Volcker, chairman of the Federal Reserve System, may well have reached another turning point with the July 19 devaluation crisis of the Italian lira. Italian markets were closed early Friday with the currency in a free-slide 20% devaluation against the dollar. Over the weekend, European central bankers met in Basel, Switzerland, and agreed to devalue the lira against the currencies that are part of the European Monetary System. (See *Report from Italy,* p. 18.) Monday, July 22, the lira recovered three-quarters of the ground it had lost against the dollar, but not against the West German mark.

Twice in the days immediately preceding the collapse of the lira, Volcker had told committees of the U.S. Congress that, in his view, monetary developments were moving beyond the control of monetary policy, and possibly beyond the control of U.S. policy as a whole. The weekend reversal of the lira's slide against the dollar perhaps indicates the same.

Since the current slide of the dollar against especially the West German mark began at the end of March, the U.S. currency has been on a two-track course. While the dollar has plummeted downward against the major European currencies, it has done exactly the reverse against the currencies of weaker nations subjected to the criminal brutality of IMF austerity policies. The pesos of Mexico and Peru, and the sol of Bolivia, are representative examples. For against those currencies, the dollar has hyperinflated enormously, as in the successive Mexican devaluations of recent days, which have produced a further 40% reduction of the peso against the dollar. The currencies of Bolivia and Peru have meanwhile been blown out by the massive appreciation of the dollar.

This two-fold, hyperinflationary and deflationary tendency in the dollar, was projected in *EIR*'s *Quarterly Economic Report,* datelined April 15, by leading economist Lyndon LaRouche, who further specified that efforts to avoid the deflationary alternative would fuel hyperinflationary tendencies, and the reverse. Volcker reported that he was in this identified bind during the course of his recent testimony, when he told Senate committee members that efforts to correct what he called "imbalances and disequilibria" in current U.S. economic performance, may well "aggravate," other such "imbalances and disequilibria."

At the same time, there has been a faction in the United States, encouraged by certain of the technocrats at the International Monetary Fund, which has maintained that the United States can bull its way out of the present crisis in its internal credit system and economy by continuing to run the currency up against those of its allies and trading partners.

In this view, the depletion of internal capital assets, typified by second-quarter losses of Bank of America, unparalleled earnings drops for General Motors and General Electric, and the ongoing liquidation of agriculture- and energy-related industries, would be offset by capital flight into the United States, sucked in by the ever-higher face value of the dollar.

Proponents of this view, as represented outside the United States by Samuel Brittan of the *Financial Times,* have argued that the United States could suck in between $30-50 billion from the economies of Western Europe and Japan. Doing so would require crushing the currencies of those countries with treatment as brutal as that meted out to the nations of Ibero-America.

Others inside the United States, like Malcolm Baldrige, in Herbert Hoover's old job at the Commerce Department, and James Baker III argue, against this, that the dollar should be allowed to fall by perhaps as much as 25% against the West German mark.

The current developments may well prove to have demonstrated that both are victims of the same megalomaniacal pipe-dream. The lira has long been known as the weak link in the European monetary system, almost as bad as Mrs. Thatcher's politically buffered pound sterling. But Donald Regan's bloated dollar could not crush the Italian lira, and, as the lira recovered, the dollar began to slide again to the low end of its present trading range of 2.80-2.90 DM. The lira, devalued against the deutschemark, was held up against the dollar by the deutschemark.

To continue the hyperinflationary course, the dollar would have to be run back up to well above the level of 3.50 DM reached in late winter, early spring. Not surprisingly, the lira slide on July 19 took that currency back to its low level against the dollar from that period. But the U.S. currency, which must, under current arrangements, be the vehicle for raising foreign funds to finance the U.S. current account and federal budget deficit, is still over-valued more than two-fold against the West German mark. This reality dictates that if the dollar can no longer crush the currencies of Europe, its slide will not be halted at the level of 20-25% demanded by Baker and Baldrige.

Under present policies, the dollar, and world monetary and credit system, are doomed, either way. And waiting in the wings stands the Soviet Union, ready to take over in the wake of the collapse of the Western economies.

The deal with the Russians

As the dollar was pulled from its highest level, reached at the end of March, in the wake of the collapse of the Ohio privately insured savings and loans system, the Basel-based Bank for International Settlements, the central bank of central banks, announced that it had agreed with the Russians, that the ECU of the European Monetary System would be an instrument for financing activity between East and West.

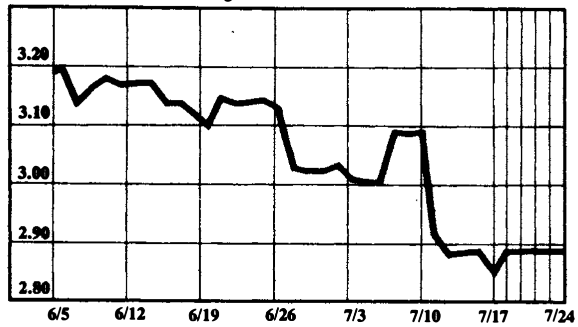
The rebounding of the lira against the dollar may well prove to be the first flexing of the muscles of that new arrangement, a prelude to the deflationary wipeout of over $2 trillion worth of paper assets in the U.S. economy that is still to come.

Thanks to Volcker, and his friends like Donald Regan, the United States and its allies in Europe have been locked into a course in monetary policy which is destroying the economies of both. It is a policy which only the Soviet Union can benefit from, as the austerity-ravaged economies of the United States and Western Europe sink beneath a mass of depreciated dollar paper. For this reason, Fidel Castro praised the "heroism" of Volcker in his recent conference on the subject of Ibero-America's debt.

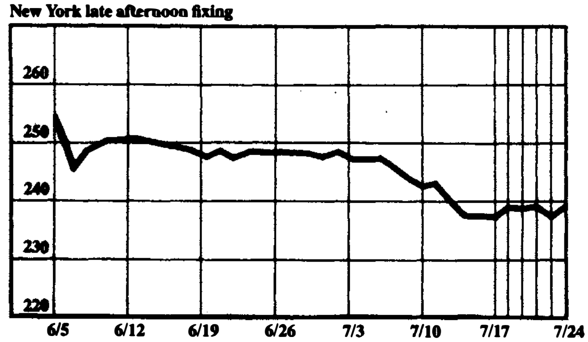
Those who want the dollar to appreciate against the currencies of its allies and trading partners, like those who argue for the reverse, are playing foolish, and criminal games, with the future of the United States, and also with the future of our very civilization. There are no choices of the indicated sort within the present policy configuration, for they lead to the same result. Therefore, the policy as a whole must be replaced.

Currency Rates

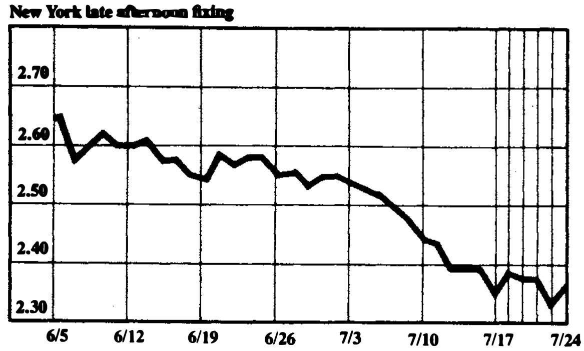
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing