Washington's trade war becomes currency suicide

by David Goldman

If the United States did not have to import net a fifth of its consumption, and *if* it did not have to borrow $150 billion a year from foreigners to do so, and *if* this $150 billion did not also finance the federal deficit, then Washington's decision Jan. 14 to hasten the crash of the dollar on overseas markets, might be excused as a mere act of colossal stupidity, on the scale of the worst Anglo-American blunders of the early 1930s.

Under the given circumstances, it is far, far more serious. In return for the largest subsidy any group of nations has accorded any other (since the Spanish bankruptcy of the 16th century), America has kicked its trading partners in the teeth, first by threatening sanctions against European agricultural products, now by competitive devaluation. The United States appears prepared to dynamite both its own economy, and the Atlantic Alliance, at the same time.

The dollar stood at about DM 1.83 on the morning of Jan. 16, or barely more than half its January 1985 peak of DM 3.47; and there is no reason to believe that it will not fall to the range of DM 1.50 or lower during the next couple of months. *EIR* has played a broken record for the past year, warning that the dollar's collapse constituted a "doomsday machine" for the administration's recovery hoax. By maintaining the growth of consumer credit at over 15% per annum, and importing the goods corresponding to the credit expansion, the U.S. economy has maintained at least the semblance of functioning, despite the utter ruin of steel, nonferrous metals, agriculture, mining, machine tools, and heavy construction, as well as the sharp deterioration of auto, electronics, and homebuilding.

The dollar crash has now eliminated both America's capacity to afford such imports, as well as its capacity to persuade foreigners to continue to finance these imports. November's trade deficit, at an annualized rate of $230 billion, triggered the situation in a sense; it represented the turning point, at which much more of the collapsing U.S. currency would have to be paid out, for a smaller physical volume of imports.

Nonetheless, the White House response to these developments constitutes an act of supreme self-sabotage. Even by the awful standards of the 1930s, the administration's much-discussed intention to let the dollar fall, i.e., to conduct a competitive devaluation against our trading partners, will be remembered as a black spot in monetary history.

The 1930s and the present

There are two principal objective differences between the present and the 1930s.

First, in 1919, the United States economy exported 16.4% of its goods output, and imported the equivalent of 8.3%. That is, our export capacity—prior to the ruinous 1921-23 Depression—was in excess of 8% of our total industrial output, and this at a time when industry still maintained high rates of capital formation, associated with the First World War. That is a good, rough measure of the U.S. economy's capacity to generate surplus product.

Today, we import net goods equivalent to a fifth of general consumption, and a quarter of consumption of capital goods in particular—and this while galloping disinvestment is tearing down our industrial, electrical, and transportation infrastructure. Despite the staggering import volume, we remain sharply in deficit with respect to basic infrastructural requirements. One example: In 1977, the United States spent $230 for every citizen in infrastructural construction (includ-

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ing industrial and utility plants); by 1985, that had fallen to half the previous level.

Our most pressing problem during the late 1920s and, of course, the 1930s, was that the overhang of debt stemming from war reparations prescribed by the Versailles Treaty, strangled our export markets. Exports fell from 16.4% of our goods output in 1919, to only 9.6% in 1929; and without such export markets, America's industry and agriculture could not sustain the rapid buildup of new plant capacity that had begun with, and followed, the First World War. Our problem now is the precise opposite: We are dependent on the rest of the world's output, so much so, in fact, that the road to recovery reminds the analyst of the Maine farmer's quip to the lost traveling salesman: "You can't get there from here." In other words, the United States cannot produce its way out of the present hole with its existing productive capacity, and its existing skilled labor force, in the absence of imported goods, particularly capital goods.

The second objective difference between now and the 1920s and 1930s regards the existence of the Soviet Union, the principal beneficiary of the trade and currency war between Europe and the United States. Since the 1982 imbroglio over the Soviets' gas pipeline to Western Europe, when Helmut Schmidt was still German chancellor, preparations have been underway among a European financier and political faction, to "decouple" Western Europe, economically and politically, from the United States. This faction, centered in the Venice-Zurich-Munich insurance cartel, finally has its opportunity, gratis of Washington's idiotic policy.

In the meantime, the dollar's uneven collapse against different European currencies has produced monetary chaos and political tensions in Western Europe, whose apparent cure seems to be to break with the dollar altogether. After 10 hours of negotiations the weekend of Jan. 10-11, the European Community finance ministers revalued the German mark by 3%, the Belgian and Luxembourg francs by 2%, and left other currencies unchanged. West Germany agreed to the revaluation, to the detriment of its export industries, and two weeks before national elections, after its central bank spent billions of dollars supporting other European currencies.

But the prospects for European currency stability following the realignment are no better, as the London *Financial Times* wrote Jan. 13: "The key question is whether this week's small DM revaluation will do more than buy a little time. . . . The European Monetary System has been under pressure since early 1985 (as it was before 1983) largely because of the dollar's weakness. When investors become disillusioned with the dollar, capital tends to flow disproportionately into the DM because other EMS units play little role as investment and reserve currencies."

As the dollar continues to fall, i.e., as dollar-holders seek refuge in the German mark and, to a much lesser extent, other European currencies, monetary chaos in Europe will be uncontrollable. Talk of exchange controls, which emerged when capital was flowing into the dollar during 1981-83, will be revived with a vengeance, to keep money out. European export industries, meanwhile, will be unable to sell to the United States, because American buyers will either be unable to afford, or not allowed, to buy their products, or both.

The Japanese dilemma

Japan's Nakasone government has even more reason to be distressed than do the Europeans. On Oct. 31, days before the U.S. national elections, Japan agreed to cut interest rates, and (implicitly) to intervene to support the dollar, in what was hailed as a comprehensive economic agreement between U.S. Treasury Secretary Baker, and Japanese Finance Minister Miyazawa. At the time, *EIR* reported that Japanese observers looked ruefully on the result of their investment, namely the Republican rout in the elections, and predicted that the agreement would last no more than two months.

This estimate turns out to have been slightly generous; the current phase of the dollar's slide began a few days before Christmas. Now, U.S. monetary sources are widely quoted saying that circumstances have changed, due to the enormous November trade deficit.

Japan has invested more than the proceeds of its trade surplus with the United States in U.S. securities, picking up well over $50 billion per annum in Treasury bonds. Increasingly, such support for the federal government has been the by-product of foreign-exchange market intervention; the Japanese buy unwanted dollars on the market, and invest them in Treasury securities.

However, Japanese observers warn that this process cannot continue, and that the Japanese objective is to phase out of the Treasury market during 1987.
suggest that the Japanese brokerage houses may sit on their hands during the crucial February government-bond auctions in the United States, which, if true, would cause more than a mild panic on the Treasury market. (Advance reports from the Japanese concerning what they will do in the Treasury market are sometimes designed to keep the competition off balance.)

It is doubtful, in any event, that the Japanese have a timetable for pulling funds out of American markets; Tokyo has probably not recovered from the shock of watching the United States dishonor a "solemn" and "comprehensive" agreement signed only last Oct. 31.

Nonetheless, the point remains that the United States, the world's largest net debtor, is in danger of a mass exodus of foreign capital, leading to a drastic rise in interest rates, and a collapse of all securities markets (not to mention real estate). That is why Federal Reserve chairman Paul Volcker, who has long warned of the potential for such a disaster, is reportedly aghast at the Treasury's handling of the current mess. However, he created the series of disasters that led to this juncture, and it does him little good to repent at the extreme consequences of his own policy.