

Asia Ponders ‘Exit Strategy’ From the Dollar

by Kathy Wolfe

While the world is asking for the truth about Vice President Dick Cheney’s allegations of weapons of mass destruction (WMD) in Iraq, Asia’s elites are asking: What is the truth about the state of the U.S. dollar? The dollar has so shrunk that during 2003 alone, Asian central banks had to buy over \$500 billion worth, just to support the U.S. currency’s falling price. Their holdings of dollars ballooned to \$1.9 trillion, a growth of over 35% during the year. That money goes directly back into support of the U.S. bond and stock markets, effectively financing the American war and its trade deficit. This is an obscenity for Asia, since these dollar-support hundreds of billions could be used for domestic investment to raise the living standards of billions of people in the Far East.

The region’s politicians and economists are charging their governments with mismanagement of the national savings, particularly now that U.S. Treasury Secretary John Snow has said that he wants to let the dollar drop further in Asia. This means every dollar will be worth far less tomorrow, than the price paid today. Since 2002, the dollar has already dropped 22% against Japan’s yen, falling 12% just in the four months from September 2003 to January 2004. Japan now has an amazing \$741 billion in dollar reserves—which have *lost \$111 billion in value*, compared to the amount of machinery, for example, which the same cash bought 15 months ago inside Japan.

‘Sword of Damocles’ Over Dollar

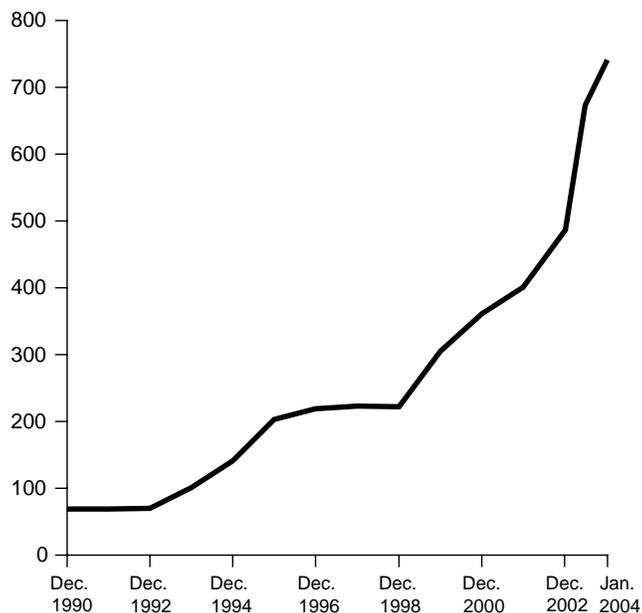
“Japan and the EU are concerned about the current weakness of the dollar, but the U.S. is quite satisfied with it,” Eisuke Sakakibara, former Japan International Finance Vice Minister, told the *Japan Times* on Feb. 3. “We can’t let this situation continue. We will not be able to maintain the same level of intervention for a few more years. . . . [We] will eventually have to think about how to exit from such a strategy.”

Paper dollars are piling up so fast that the current strategy is simply unsustainable. The four top Asian central banks alone had to buy \$300 billion in 2003, and were holding \$1.5 trillion by end January 2004: Japan \$741 billion, China \$403 billion, Taiwan \$207 billion, and South Korea \$157 billion. This is double the amount the top four had just two years ago, and it will double again sooner. **Figure 1** shows, as an example, the almost logarithmic rate of rise of Japan’s dollar reserves.

FIGURE 1

Near-‘Logarithmic’ Growth of Japan’s Foreign Reserves

(\$ Billions)



Source: Bank of Japan.

The dollar in Asia, relative to real economies, is depreciating like the German Mark in 1923, which reached the point that a wheelbarrel full of paper Marks was needed for a loaf of bread. Without these Asian dollar purchases growing logarithmically, and reinvested back in the United States markets, the dollar will nosedive. This means that the Asians who are buying it, already know that they are throwing their money down the toilet bowl, since they can't continue this rate of growth in buying.

But so far there is no exit strategy, just threats of one. In fact, Asian officials continue buying dollars hand over fist. Rep. Edward Royce (R-Calif.) did, however, raise a warning in the U.S. Congress Feb. 11, asking Federal Reserve Chairman Alan Greenspan what would happen "if central banks in Japan and China, which are buying record numbers of U.S. Treasury bonds, began to sell." Greenspan laughed. "This is unlikely to create a particular disruption. Even though there are very significant holdings of U.S. Treasury instruments [in Asia] . . . it's still a relatively small proportion of aggregate competing securities, including private securities, which these markets integrate with." Greenspan is bluffing, but who will call his bluff?

No one yet, but the tension is building and for good reason. Japanese Finance Minister Sadakazu Tanigaki was grilled about his office's management of these huge sums of money

by opposition parliamentarians in the Diet Jan. 27, and again on Feb. 3, after it was announced that Japan spent a record Y20 trillion (\$189 billion) supporting the dollar in 2003—and another Y7.15 trillion (\$68 billion) during January alone, a record intervention for a single month. Tanigaki agreed "that it is necessary to study the future composition of reserves"; in other words, to consider holding fewer dollars. Tanigaki even added that "this might include a review of bringing Japan's gold reserves into line with much higher levels elsewhere."

"This occurs when Asian central banks are expressing strong interest in gold," the *Business Times* of Singapore said Feb. 2, calling the threat a "Sword of Damocles for the dollar."

At a press conference Feb. 6, Chief Cabinet Secretary Yasuo Fukuda was also asked how long this bailout of Washington would go on. "There are now concerns about an excessive increase in dollar reserves, since the depreciation of the greenback will result in exchange losses on assets held in dollars," the conservative *Yomiuri News* complained. First, we need to keep the yen low to sell Japan's exports, Fukuda replied, but further, "The U.S. government's procurement of funds for the Iraq war, and a huge tax cut, resulted in a sharp rise in U.S. debt, so if Japan cuts purchases of U.S. Treasuries, the U.S. must raise interest rates, which could seriously harm world markets." Thus, Japan appears stuck.

"This is an absurd situation," as the *Business Times* noted Feb. 3, "like a shopkeeper lending ever larger amounts of money to an important customer who is also a profligate spender, so that he can maintain consumption. The customer signs ever-increasing amounts of IOUs, and the shopkeeper has decreasing faith in these. But he cannot sell them so long as he retains his dependence on keeping the customer happy."

End Region's Love Affair

"All the Asian countries hold dollars for security reasons, but at some point, this has to end," Zhu Min, general manager and advisor to the President for the Bank of China, China's largest and oldest foreign-exchange bank, told the Davos World Economic Forum Jan. 23. *China Daily* quoted him: "There is a love affair. But everybody knows that this love affair has to end. The United States is benefiting from China using its trade surplus to buy U.S. Treasury paper as a reserve currency, along with other Asian nations. But in the long run, this is not sustainable. . . . China will focus more and more on domestic demand, which is growing fast. Then we won't be able to finance the U.S. deficit. We cannot keep exporting our goods at a growth rate of 30%."

China, like Japan, is talking big but doing nothing to rock the boat so far, as Russian Presidential candidate Sergei Glazyev noted in taking the initiative Feb. 6 (see page 6). U.S. Treasury data show China's purchases of U.S. bonds rose in the last quarter of 2003. Beijing plans to use about \$85 billion of this U.S. debt to recapitalize China's state banks; but while the ownership of the bonds will move from the Finance Minis-

try to the banks' books, they still can't be sold, without placing a huge upward pressure on China's currency.

South Korean, Taiwanese, and Thai officials, however, are quoted in the *Wall Street Journal* Feb. 5 describing concrete plans to diversify foreign reserves into other investment, especially domestic improvements. "Korea needs to invest its foreign currency reserves more effectively," said a top Seoul Finance Ministry official. Next year the ministry will establish the Korea Investment Corp. (KIC), to which it will start diverting \$20 billion a year of its foreign reserves. KIC, in turn, will place the funds with private Korean firms which manage foreign assets, which would be allowed to move the cash into other currencies and instruments to earn a better return.

In Taiwan, the central bank "has accumulated too much in dollars," a minister told the *Journal*, "which may not be an efficient use of our resources." Taiwan plans to start converting the dollars back into domestic currency to help local companies buy machinery and patents overseas to build up new industries. Even Thailand has begun a program to use \$7 billion in dollar reserves annually to pay off its debts.

Eurasian Alliance Needed

"Countries in the region might take a fresh look at their management of reserves and foreign exchange policy," the Asian Development Bank wrote in a December report. At the BIS Special Governors Meeting of Asian Central Banks in Hong Kong Feb. 7-9, this question was repeatedly raised.

The last time debate about the ruinous effects of the dollar-based IMF system broke out, during the 1997-2000 "Asia crisis," governments acted to create the "Chiang Mai Initiative" for a new regional currency regime. But all this was silenced on Sept. 11, 2001, since which time Cheney and the neo-cons have insisted that all criticism of the dollar system is treason to the "war on terror." After the Iraq invasion, many Asian nations have felt it best to shut up and act like well-behaved piggy banks, rather than risk ending up in the next war zone, somewhere near the Korean Peninsula.

The only exit strategy grand enough to work, would be not an East Asian, but a Eurasian-wide alliance for a system of new financial and trade treaties, including Russia, India, and Western Europe. The initiatives from Russia and Italy for a New Bretton Woods monetary system need careful study in Asia. American Presidential pre-candidate Lyndon LaRouche, author of the New Bretton Woods plan, says that only if all Eurasia acts together can a change be effectuated. LaRouche presented Eurasian initiatives to reorganize the bankrupt IMF system, in Moscow last year (see *EIR*, Oct. 23, 2003); the dollar crisis' effects have drastically worsened since then.

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