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Is the dollar eliminated as a reserve currency?

After two weeks of inactivity, the foreign exchange markets began to boil Nov. 7, with a substantial fall in the foreign value of the dollar (except in Tokyo). After a long plateau of 1.80 to the West German mark, the dollar fell at deadline to 1.7850. Sterling recovered from $2.07 to the British pound to $2.1050. In a parallel development, gold reached $395 at the morning London fixing, a $19 jump in the past two days.

To a certain extent, the renewed attack on the dollar may have been triggered by the Iranian developments,

FOREIGN EXCHANGE

although a shortage of oil would more seriously affect Western Europe than the United States (and markets have been sensitive to this fact for some time).

There is, however, a deeper tone to the dollar's momentary problem. It is now evident that the Federal Reserve and Treasury are taking the advice of the "Group of 30" and other financiers who want to knock out a big portion of the dollar's reserve role. Whoever held out against diversifying dollar holdings into other currencies now has an incentive to do so.

The week's key event was the U.S. Treasury's DM 4 billion issue on the West German market, similar in appearance to the foreign currency bonds the United States issued at the time of the dollar support package of exactly one year ago.

This time, a different context puts a different interpretation of the issue's importance. In this case, the Federal Reserve did not need foreign exchange for intervention purposes, since most of the $30 billion defense fund established a year ago is still intact. (Nor is the Bundesbank pressing the United States to convert short-term "swap" borrowings for intervention purposes into longer-term obligations. On the contrary, the West German financial community was displeased to have an additional burden on its already-tight financial markets).

Fed Chairman Paul Volcker is taking the advice of "Group of 30" Executive Director Geoffrey Bell, a senior vice-president of Schröeders Bank. Reiterating what the group discussed at its meeting outside Belgrade, Yugoslavia at the beginning of October, Bell testified on Nov. 5 before Rep. Henry Reuss's Banking Committee field hearings in New York City. Rather than wait for attacks against the dollar to appear on the foreign exchange markets, Bell said, the central banks should "preempt" diversification of dollar assets. In particular, the United States should issue foreign-currency bonds to official or private dollar holders off the foreign exchange market if possible.

The Group of 30, known as the "Consultative Group on Monetary Affairs," was created as an unofficial adjunct of the International Monetary Fund by Bell and former IMF Managing Director Johannes Witteveen.

Bell is only one of a larger number of economists who have promoted this means of eliminating the dollar's reserve role. Others include Morgan Guaranty Trust's international economist Rimmer de Vries; Robert Triffin and Guido Carli.

In fact, after months of apparently heated academic debate over the so-called substituion account for dollar reserves at the International Monetary Fund, in which Special Drawing Rights were to be swapped for dollars, the issue has come down to the Group of 30 formulation: a central bank management scheme for wiping out dollar reserves through the creation of other reserve assets in West German marks, pounds sterling, and other currencies. Among the governments and financial institutions who oppose the European Monetary System, this has become the proverbial "party line."

The European Monetary System and projected European Monetary Fund would handle the dollar problem by absorbing dollars into a gold-backed reserve pool (expanding the current European reserve system of combined gold and foreign exchange reserves).

The Gameplan

When the Treasury's foreign currency bonds first appeared one year ago, critics warned that their issue might only give holders of dollars a good opportunity to dump their existing holdings of dollar-denominated U.S. Treasury obligations in favor of DM-denominated obligations. At the time, the Treasury brushed such objections aside.

Inevitably, the market's perception that the American monetary authorities are actively promoting the elimination of the dollar as a reserve currency will weaken its position on the foreign exchange markets. Although that is not yet stated U.S. policy—the official view is that the International Monetary Fund should accomplish the same job through Special Drawing Rights issues instead—the correspondence between the Group of 30's words and the movements of Mr. Volcker's hands and feet is clear enough.

—David Goldman

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