Debt crisis behind the dollar's rise

by William Engdahl

The cause of the relentless upward climb of the U.S. dollar against other currencies over past months, according to the usual commentary in the financial press, is that President Reagan's defense spending has created a budget deficit whose financing requirement is sending the dollar through the stratosphere. The President himself is being lied to by his economic advisers that the dollar rise—now topping 3.30 deutschemarks from a range of 2.60 a year ago, up more than 25%—reflects the "strength of the U.S. recovery" compared to Europe.

Nonsense. The dollar rise at this juncture bears no relation to the U.S. economy. The dollar rise is a simple manifestation of the global debt crisis.

The extraordinary foreign-exchange demand for dollars is the central feature, and is directly proportional to the rise of interbank transactions on international banking markets over the 15 years since the Aug. 15, 1971 decoupling of the dollar from gold.

According to a study carried out by Ivor Pearce, George McKenzie, and S. H. Thomas at the University of Southampton in England, the global volume of foreign-exchange transactions grew 2,500% between 1970 and 1984. During the same period, world trade increased only five-fold. Estimates today are that barely 5% of international foreign-exchange transactions are generated from trade and investment. The remaining, approximately 95% are principally interbank transactions necessitated by the requirements of maintaining some $3 trillion in international debt (including interbank debt).

Behind the 'magic of the market'

The daily value of foreign-exchange transactions is estimated by the Pearce group at $300 billion dollars, equal to the world's entire spendable stock of dollars. Why do international banks carry out such a phenomenal scale of daily currency trade? The answer lies in the usurious nature of the international banking system.

No ordinary increase of loans against sound productive investment would, by itself, provoke such an avalanche. The crux of the problem lies in what the Pearce group calls "maturity mismatch." Put simply, over recent years, a pyramid of hundreds of billions in dollar-denominated international debt has had medium-term maturities, say 5 to 10 years. But most of these loans are financed by three-month bank deposits. In other words, the bank must refinance that portion of its loan portfolio every three months.

Multiply this process on an international scale and the present problem of the soaring dollar begins to become demystified. The cluster of recent dollar rises at the end of financial quarters is indicative.

The Pearce group has done calculations which show that fully one-third of the total international debt of $2,900 billion dollars could fall due for repayment in one to eight days, or $100-120 billion dollars *per day* to feed the debt payment demand of the banking system! The international banking system has become one global chain-letter scheme.

So, any crisis of non-payment of sufficiently large scale, such as the Continental Illinois case, threatens the entire dollar-denominated debt structure with domino-style collapse.

As debtors' terms of borrowing and terms of trade have deteriorated, "roll-overs" have ballooned the debt, and the demand for dollars to refinance it has grown exponentially. By direct policy intent, key financial institutions in New York, London, and Basel have imposed policies such as IMF "conditionalities" which destroy productive long-term investment and trade in favor of short-term dollar obligations. Thus, the gap between the debt and the payments base in industrial and agricultural production has grown exponentially.

International banks, short of declaring bankruptcy, must come up with the money to refinance short-term debt obligations regardless of what they must pay in interest. Otherwise, the entire monetary system crashs down on a scale dwarfing the 1931 Austrian Kreditanstalt collapse.

U.S. Comptroller of the Currency C. Todd Conover told a meeting of international banking regulators in Rome last September that the controversial U.S. government bailout of Continental Illinois was done to prevent the entire international banking system from collapsing, not merely one bank. During the peak of the run on Conti last summer, the U.S. government pumped money into that bank at a rate equal to the financing needs of the entire U.S. federal budget deficit!

Now, compare the daily need to come up with some $100-120 billion simply to keep banks' doors open, to the U.S. budget deficit, which requires $500 million per day—less than 0.5% of the total for the international banking system! So much for the defense-budget cutters.

The roots of this latest "dollar crisis" internationally lie in Paul Adolf Volcker's October 6, 1979 Federal Reserve "revolution," which launched what Volcker himself had earlier characterized as "controlled disintegration of the world economy," imposing unpayable borrowing costs onto nations, farmers, and industries.

The collapse of the dollar in this context would most likely occur when the Fed drastically reverses policy to flood the banking system with liquidity in a default crisis. Otherwise, only emergency executive action by the President to reorganize the impossible world debt burden will resolve "the dollar problem."