

## Foreign Exchange by David Goldman

### Tough luck, Mr. Baker

*With the worst-ever trade deficit reported for June, what will Treasury Secretary Jim Baker do now?*

**W**e at *EIR* argued, virtually alone among economic analysts, that Treasury Secretary James Baker III's dollar-devaluation strategy would worsen, not improve, the trade deficit.

Economists live in a world where last decade's facts still clutter the computer data-base. Since ex-Federal Reserve chairman Paul Volcker "cured" inflation by chopping out America's industrial base, this country has been able to produce only four-fifths of its consumption requirements. It has to import the rest. Devaluing the dollar raises the costs of imports many times faster than it stimulates exports.

That is what Mr. Baker found out in June, when the trade deficit reached the \$196 billion per annum level, against last year's \$164 billion.

According to a survey released by Money Market Services, the median forecast among banking analysts for the June U.S. trade deficit was \$13 billion. The geniuses at Goldman Sachs expected \$13 billion, while Merrill Lynch expects \$12.5 billion.

The nature of the problem was addressed last week in this space, where it was noted that Taiwan's revaluation against the U.S. dollar would cost America more than \$3 billion a year—many times more than the Taiwanese trade concessions might bring American exporters.

The Treasury's efforts to limit Taiwan's \$15 billion trade surplus with the United States, and similar surpluses of other industrializing countries, have merely worsened the financial

cost of the deficit, and affected the underlying physical trade deficit only marginally.

Last year's semiconductor agreement, whose supposed violation by the Japanese motivated sanctions last spring, illustrates the point. The Semiconductor Industries Association complains that its share of the Japanese market was 8.4% in January and 9% in June. But Japanese figures, including sales by the Japanese subsidiaries of U.S. firms, show it up to 12.6%, a record. The American companies chose to take advantage of the agreement to increase their output at their more profitable Japanese plants, rather than from home production facilities.

Their additional output is not, of course, reflected in American export statistics, since it represents Japanese production under American ownership.

Fidelity Bank's economics report for July-August 1987 provides some clues to Jim Baker's wishful thinking, that trade policy could give the economy a quick fix through the 1988 elections. It argues that a sharp short-term improvement in U.S. trade—to a trade deficit of \$100 billion p.a. during the 4th quarter of 1987 from \$164 billion p.a. in 3rd quarter 1986—will result "as countries with large persistent surpluses with the U.S. attempt to head off a major thrust in protectionist legislation."

The thrust of U.S. trade policy was to shove sufficient additional exports down the throats of American trading

partners, to show temporary results for the U.S. economy, Fidelity implies:

"Anecdotal evidence and the progress of several well-publicized 'buying missions' touring the U.S., point to an imminent upturn in orders for agricultural and capital goods products. However, these . . . represent a one-time response to a political threat. . . . Supplies that are pre-ordered for political reasons may simply be stockpiled until they would have been ordered normally; or they may serve as temporary substitutes for the cheaper (or higher-quality) inputs from from other sources."

Fidelity enthused, "It becomes easy to justify at least a 2% acceleration in real GNP growth for the rest of 1987, and perhaps into early 1988."

The quick fix has failed. Fidelity's report otherwise contains data presented by *EIR* since 1983, showing why Baker hoped for the fix in vain. The fraud of recovery is based on a consumer-debt bubble (which brought such debt up from 14% to 20% of household income in only three years), leading to a \$64 billion deficit of consumer-goods imports.

"Slowing trends in domestic consumer demands will be necessary to cut the growth in imports," Fidelity writes, because a growing portion of such goods come from developing nations, whose currencies have not risen sharply against the dollar.

U.S. capital goods exports, our former strength, have no hope in a world where there is no capital investment, and where "increases in U.S. capital goods exports will be constrained by heightened competition from the newly industrialized countries of the Pacific Rim and others (such as Canada) whose currencies have moved downward with the dollar" and "provide formidable competition for U.S. producers in all competing markets."