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EIR Economics

Questions for Secretary James Baker III

by David Goldman

Warned that the next ratchet-decline of the U.S. dollar would make him look worse than his television-evangelist namesake, U.S. Treasury Secretary James Baker III officially ended his campaign to drive down the U.S. dollar on April 15. At a meeting of the Japan Society, Baker said, "Our currencies are within ranges broadly consistent with economic fundamentals, and all of us favor stability around current levels," adding that a further fall of the dollar would hurt the economies of America's trading partners.

Following the announcement April 14 of a $15 billion, near-record U.S. trade deficit, it seems strange that Baker's admission that a decrease in the U.S. trade deficit *at the expense* of America's trading partners—which is what the dollar collapse was supposed to have produced—is not desired, should encourage speculators to buy the dollar. Until now, Baker's only policy to deal with the $170 billion-plus deficit was to talk the dollar down, in order to make foreign goods harder to sell here, and our goods easier to sell abroad. Now that the deficit has climbed to an annual rate of $180 billion as of February, the United States has no policy at all.

Nonetheless, the Bank of Japan herded foreign-exchange dealers into a rally for the dollar, which rose from 142 yen to 143 yen, and from DM 1.80 to DM 1.82, in response to the news.

A front-page warning that Baker's days in office were numbered in the April 15 *Wall Street Journal* might have persuaded the bemused treasury secretary that an abrupt shift into reverse was needed. The dollar collapse "poses serious risks for the U.S. economy and serious problems for Secretary Baker, the architect of the administration's dollar policy," wrote the *Journal*.

More to the point, somebody in the administration might have figured out, perhaps with the help of somebody in the Federal Reserve, that a continued collapse of the dollar meant the pullout of Japanese funds from the U.S. market; that the mere threat of such a pullout had pushed long-term rates up by more than 1%, and short-term rates by .5% percent, since April 1; that a continued pullout of such funds would push rates back up to where they stood in the first year of Volcker's tenure, i.e., over 20%; and that a mere 1.5% additional increase would collapse the thrift industry, leaving the federal government with a $100 billion bankruptcy at the Federal Savings and Loan Insurance Corporation (see *Banking*).

At an "Atlantic Bridge" conference earlier the same week in Berlin, bankers, economists, and government officials clashed so sharply on national policies, that some participants were left apprehensive that "the world economic crisis was moving beyond the control of governments and would result in an economic disaster," according to an April 13 report in the *New York Times*. It quotes one attendee, Walter Eberstadt of Lazard Frères, warning, "The roof will fall in."

That is the brink from which Secretary Baker shied, at least in his remarks April 15. But what, after all, has changed?

Is the deficit curable?

Remarks by finance ministers and central bankers may affect the timing of major changes in currency rates, but America's ballooning trade deficit made a collapse of the dollar inevitable, and a continuation of that deficit will continue to collapse the dollar at some near future point, whatever officials say. What does Baker have to say about the trade deficit?

In September 1985, when the Group of Five major industrial nations first met at the Plaza Hotel in New York to announce their intention to drive the dollar down, *EIR* warned, alone among all economic commentators, that a lower dollar

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would *worsen,* rather than *improve,* the deficit. It has taken such slow learners as *Business Week,* the *Washington Post,* and the economists of Salomon Brothers, to recognize that the United States has what is euphemistically called a "structural deficit," i.e., we cannot produce anything that other industrial nations might want to buy. Even in that most important of consumer-goods fields, the U. S. car-buyer has been persuaded to accept Detroit products only by slapping a quota on Japanese cars, and then increasing their price by 40%; and when the Koreans came in under the quota, their Hyundai became the fastest-selling import car in U. S. history.

In fact, Japanese exports to the United States have grown more rapidly in the field of capital goods, particularly at the most sophisticated end of the spectrum in electronics, steel, machine-tools, pharmaceutical-packaging, and other industries, than in the consumer field. The United States imported 24% of all capital goods in 1984, against only 10% in 1975; of our 1984 imports, $20 billion came from Japan, along with $15 billion from the European Community, and about $12 billion from Asia excluding Japan. In 1972, capital equipment made up only 26% of Japan's exports; by 1984, the total had risen to 48%.

In this context, America's "get tough" policy toward Japanese trade has the earmarks of vintage British film comedy. Punitive sanctions against Japanese electronics imports are scheduled for April 17; meanwhile, U. S. chip-importers are complaining that America cannot survive without Japanese imports.

Supposedly, the Japanese are hurting American manufacturers of computer chips by selling at below cost in U. S. markets. Under threat of trade sanctions, the Japanese have ordered their chip manufacturers to cut production by 30%, in order to placate the Reagan administration.

But American computer makers, who cannot produce without imported Japanese chips more reliable than the American competition, and irreplaceable at any price, are complaining that the Japanese cut back production to damage American computer makers!

The *New York Times* on April 7 wrote, "Japan's moves to cut the production of computer chips could lead to a shortage of the vital semiconductors, some computer and semiconductor industry executives said today. . . . They thought Japan's MITI was deliberately choking off the supply of chips to hurt American computer makers. . . . Others were skeptical a shortage would arise soon. . . . The production cuts have been ordered by the Japanese government in an attempt to mollify American critics. . . . [They] amount to more than 30% of production and are aimed at raising prices and denying supply to so-called gray marketeers, distributors who sell chips for low prices in Asian countries. . . . Some American chip makers think the slowdown of exports of chips is an attempt by the Japanese to put pressure on the U. S. to back down from its decision to impose trade sanctions on Japan. . . . [They] charge that Japan wants to cut the supply of chips in order to hurt American computer makers and turn them against the trade agreement."

The making of a trade deficit

There is nothing America can do overnight to improve its trade deficit with Japan. Special Trade Representative Clayton Yeutter was reduced April 15 to complaining before a business audience that American firms have failed to take advantage of their new competitive edge. Investments in better technology may accomplish this over time. James Baker's economic program, culminating in a tax-reform bill that eliminated investment incentives for basic industry, has so depleted America's industrial base, that net imports now account for one-fifth of everything we consume, and one-quarter of all capital goods we install.

The $15.06 billion trade deficit reflects $33.72 billion in imports and $18.66 billion in exports; that represents a much lower actual volume of both imports and exports, since our exporters have raised prices for shipments to Europe and Japan as the dollar has fallen, and our importers pay much more for their goods.

The deficit is composed of:

Japan	$5.1 billion
EC	$1.9 billion
Canada	$1.9 billion
Taiwan	$1.5 billion
OPEC	$1.2 billion
Mexico	$0.8 billion
Korea	$0.7 billion

Note that Mexico's trade surplus with the United States—formerly a multi-billion-dollar deficit—exceeds that of Korea, yet the administration is upset at Korea (which can afford to export surplus output), and happy about Mexico (which is literally starving itself to export output desperately needed at home).

Baker's "adjustment" plan for austerity, "free-market" reform and equity swaps among the debtor countries, amounts to a policy to *increase* the trade deficit, by forcing economically harmful trade surpluses upon debtor countries, where we should provide long-term financing to allow them to run deficits with us, reflecting capital-goods exports.

At the risk of sounding repetitive, *EIR* must emphasize, once again, that nothing short of a massive export program directed toward the southern hemisphere, concentrating on agricultural equipment, earth-moving equipment, power-generating equipment, heavy transportation equipment, and other means to improve those nations' infrastructure, can reverse America's trade deficit. Contributing Editor Lyndon H. LaRouche, Jr., put that program on the nation's agenda in his 1982 book, *Operation Juárez.* Now that Baker's plan has, by his own admission, collapsed in the most humiliating fashion, what does Baker propose to do?