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Dollar remains the weak link

by Chris White

There is no especial mystery to the apparent success of efforts to keep the international financial system afloat over the last year. Nor should there be any confusion about what the price that ultimately has to be paid will be. Both the apparent successes, as well as the future day of reckoning are pivoted, in form, on the U.S. dollar.

The willingness of foreign creditors to maintain the flow of incoming funds to finance U.S. deficits has kept the ball bouncing along over the months. Most likely the decision of the same foreign creditors to withdraw their support, or reduce the same, will be what triggers the next phase of the crash now in progress. Since there are upwards of $15 trillion in unsecured dollar assets floating around out there, in the so-called markets, compared to about $3 trillion in nominal value of stocks, the effects of the day of reckoning, when it does come, will be proportionally greater than what happened when the stock market flirted with melt-down last Oct. 19.

For the creditors, single-minded in their insistence on the sanctity of their debts and maintaining the money value of the debt service, the prime question is the deficit of the federal government of the United States. For the still sane, the problem is another. The U.S. economy, increasingly over the last six years, has become a deficit economy, incapable of producing but between 65% and 75% of what is required to maintain its annual functioning.

The federal deficit has grown as the economy has collapsed around the activities of the federal government. Federal revenues are based on tax payments. Tax payments whether in the form of payments of households and individuals, or of corporations, are directly related to the level of economic activity. A flourishing economy, comprised of a majority of its workforce employed in high-paying productive activity, generates revenues for the government's account. An economy which does as the United States has done increasingly in recent years, shifting its employment into relatively lower-paying service jobs, and shifting the composition of its investment accordingly, is less productive, and the tax revenues are not there. To then demand that the budget be cut, and that taxation be increased, is actually to demand that the deficit be further increased and the revenue be further diminished.

The sane would insist that the opposite course be followed. Reorganize credit to permit the expansion of productive employment in capital-intensive and technology-intensive workplaces, thereby to increase the government's revenue flow, through increasing overall productivity.

Beginning shortly after this November's election in the United States, there will also be beginning a showdown over which of these two approaches will prevail. The chief instrument in this showdown will most likely be the exchange value of the U.S. dollar. Grudgingly, at the end of the first quarter, and again grudgingly at the end of the second quarter of 1988, when 90-day commercial paper and other outstanding liabilities came up for rollover, European financiers, typified by

FIGURE 12
West German deutschemark
D-marks per dollar

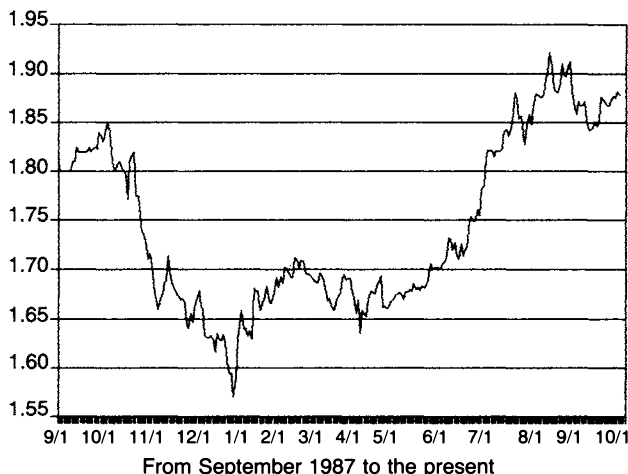

FIGURE 13
Japanese yen
Yen per dollar

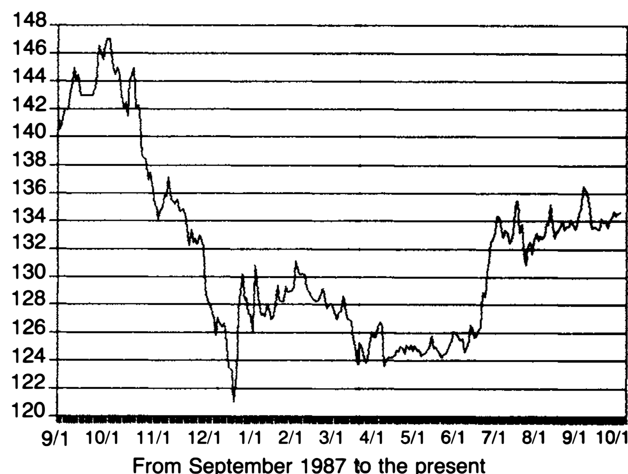

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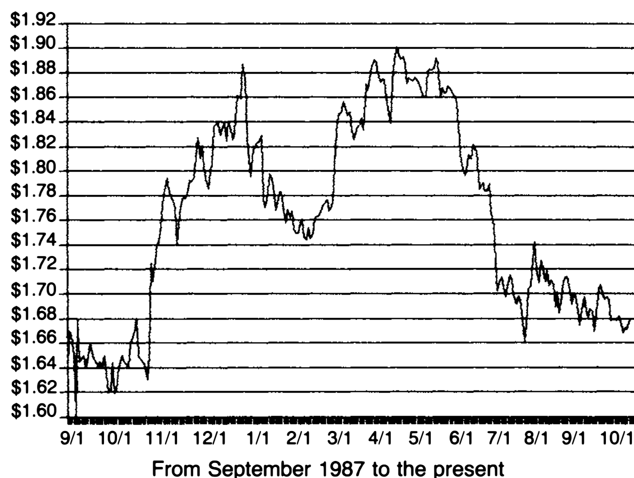
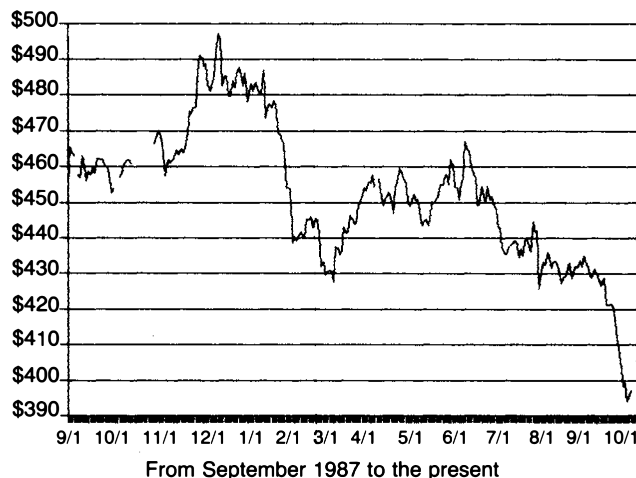
FIGURE 14
British pound sterling
Dollars per pound



From September 1987 to the present

FIGURE 15
Comex gold
Dollars per troy ounce



From September 1987 to the present

Hans-Jörg Rudloff, agreed to the rollover—understanding, they said, that circumstances this year were somewhat peculiar, given the U.S. elections, and therefore recognizing that prior to those elections, it would indeed be difficult to do anything else, but still insisting that this will be the last time such treatment is permitted the United States.

Reviewed from this standpoint, **Figures 12** and **13,** which show the German mark in dollars, the Japanese yen in dollars, tell their side of the tale. Currencies have moved relatively sharply, around each quarterly refinancing, to establish some kind of new plateau, before the next refinancing. The December 1987 Versailles Agreement on exchange instability, which asserted that the Group of Seven Finance Ministers would act together against exchange rate fluctuations which "could be counterproductive" set the tenor for the agreements.

Indeed, the United States, in letting the dollar go into free-fall leading into the agreement, blackmailed everyone else into doing their bit. The price of maintaining that agreement over the succeeding quarters has been the pattern of interest rate increases inside the United States which has taken the prime rate back into double digits, and increased all classes of interest rates commensurately. So much so that comparable rates around the world have increased to the point that it is indeed a question whether the differential between U.S. rates of interest, and those in money market centers elsewhere, is sufficient to continue to attract the necessary flow of foreign funds.

The next such three-monthly rollover is scheduled for the last week of October and the first week of November. Part of the price was conservatively estimated in August as a flow into the U.S. credit system of anywhere between $50 and $100 billion. Attracted by the relatively higher interest rates inside the United States, which prevailed through June and July, those funds did not end up in the stock market, as is attested by the continued stagnation in market volume, nor in the bond markets, witnessed by the continued pressures on bond prices.

To keep the system afloat, its managers permitted the arming of another time-bomb. A borrowed pile of speculative hot money—re-lent through money market and other means, into yet more vulnerable parts of the system, such as the staggering savings and loans, and other parts of the banking system—has to be rolled over, and can be withdrawn just as easily as it entered.

If the behind-the-scenes discussion at the recently concluded annual conference of the International Monetary Fund is any guide, the second week in November may well be when this shift is kicked off. If not then, surely sometime before the inauguration of the next President. The word is that the principal participants at the International Monetary Fund conference agreed to maintain what the call "stability" through the U.S. elections, but after that, the United States is to be compelled to get its fiscal and budgetary house in order.

The same point, albeit in slightly different language, was made recently on Mexican television, by none other than David Rockefeller, when he recommended that the United States emulate what he called the "Mexican Model." On the one side, Mexico has drastically butchered its government's spending, reduced consumption of individuals and households, and stripped out the economy to service the rapacious appetites of its creditors. This butchery is called in the language of financial technocrats who impose it on national governments, "restructuring." On the other side, the "restructuring," as imposed on Mexico, Brazil and Argentina, among others, is the policy shift which is left in place after a

FIGURE 16
Comex silver
Dollars per ounce

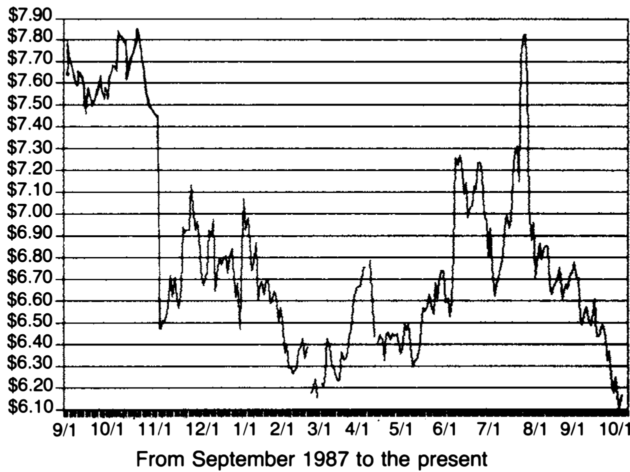
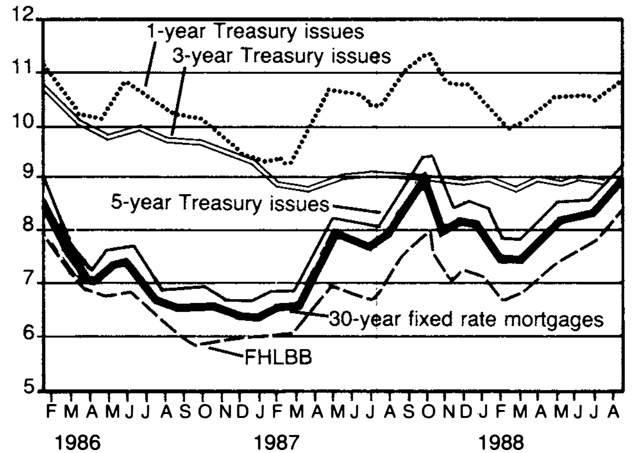


FIGURE 17
Common indexes for adjustable-rate mortgages



country's government and other leadership layers have been softened up by what is called "shock" tactics.

This generally takes the form of capital flight, of massive proportions, and savage devaluations of a nation's currency by 50-100%, to create the conditions for the implementation of the "restructuring." Those who organize the capital flight turn out to be the very same forces which then turn around to demand the implementation of the brutal restructuring policy. And, it makes things worse.

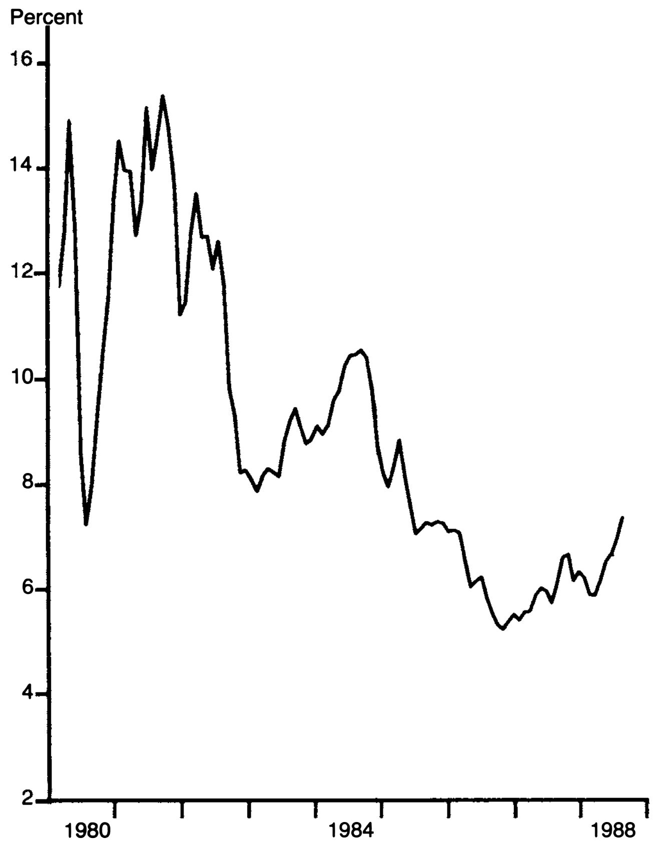
Something like that is what is being prepared for the United States. There is one problem, however. There were not $15-20 trillion of liabilities dependent on the Mexican, Brazilian, or Argentine credit systems as there are on that of the United States. Impose that kind of shock on the United States and the liabilities are effectively devalued by the amount the currency is devalued. There won't be too much of the world banking and credit system left after that kind of shock.

No doubt, some then calculate that prime U.S. assets will be on the auction block for less than a nickel on the dollar. The question is, who will then be the auctioneer, under such brutal deflationary conditions?

Under such conditions, government has the power to act and no one else. And government has the capability to reorganize credit, to crank up production and employment, so that through the creation of wealth, some order and purpose can be brought out of the financial mess.

Over this year it was decided, by the so-called powers-that-be, that their system would be held together until after the U.S. elections. By so doing, the powers-that-be deprived themselves of the option of minimizing the damage that would follow from financial collapse, and acted to ensure that the crash, when it did come, would be worse than it otherwise had to be, and so to speak, unstoppable.

FIGURE 18
Six-month Treasury bill rate



Source: Federal National Mortgage Association; Federal Home Loan Mortgage Corp.