

Editorial: Is the dollar ‘Too Big to Fail’?

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On November 12, 2009, ahead of US President Barak Obama’s first trip to Asia, the People’s Bank of China announced that it would consider future discussions over de-linking the Chinese *renminbi* (usually graded in 10 unit amounts, called *yuan*) from the US dollar. Reinforcing the overall level of concern, several days later the chairman of the Chinese Banking Regulatory Commission, Liu Mingkang, stated that a weak dollar threatened a global economic recovery, encouraging asset bubbles in emerging economies and threatening another round of speculative investment, this time more evenly placed across the globe—giving voice to long running Chinese suspicions that the weak dollar is as much the result of US policy as it is the whims of the global markets or the long-term dynamics of shifts in global production structures. Commissioner Liu is likely wrong—though not in his assessment of the impact of the weak dollar. There he is likely right on the money, so to speak. Where he is mistaken is in his assessment that the United States has a weak dollar policy. In fact, current statements on the importance of a strong dollar by US Treasury Secretary Rubin aside, there would seem to be no US policy on the dollar. This ought to frighten the Chinese and everyone else a good deal more than the weak dollar.

The last time the United States had a coordinated approach to international valuations of its own currency that was tied to its domestic lending action was in 1985, when Reagan’s Treasury Secretary James Baker 3rd crafted the Plaza Accord in conjunction with economic leaders from Europe and Japan. The Accord was meant to cartelize international currency valuation through a planned series of cuts in the US Federal domestic lending rate, timed to coincide with similar monetary policies in Germany and Japan, that would result in a gradual devaluation of the dollar against world currencies (especially the German Mark and the Japanese Yen). This was presented as being necessary to expand the money supply in the United

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States, and the supply of dollars outside of the United States, reversing the monetary policies of Paul Volker that had dominated the previous years. While such a move was thought necessary to re-start an American economy that had ground to a halt during the global economic crisis of 1982, the fear in Europe and Japan was that the resulting inflation would both raise the cost of exports to the United States and devalue the dollar holdings of these same governments. Sound familiar? As a result, a planned series of interest rate cuts, known and scheduled ahead of time, was thought to provide those economies most dependent on trade with the United States the ability to plan and adjust their own monetary policy accordingly—softening the blow of the US government’s own efforts to dig itself out of a period of stagnation.

The Accord lasted a little more than two years, failing in 1987 (and prompting the largest drop in US stock prices in history, then or since). The recession that followed Black Monday two years later, however, was remarkably one sided—meaning that it affected the United States far more than any of its trading partners, with the exception of Japan (the original target of the Accord). Japan’s prolonged period of stagflation that followed the recessions of the late 1980s and early 1990s has, since then, redrawn the political map of Asia, as witnessed by how little attention was paid to Japan on Obama’s November excursion.

Behind the Plaza Accord, however, was a second dynamic that largely escaped mainstream comment at the time. By the mid-1980s, it was becoming clear to capitalists outside the United States that the post-Bretton Woods monetary regime—free floating currencies and currency policies set at the national rather than international level—represented a dramatic change in the relationship between local capitalists and national governments that were suddenly in a position that made them perhaps a bit too democratic. This was particularly the case in export based economies where floating currencies threatened to make the state an actual meeting place for capitalist/labor struggles—something it had not been since the end of World War 2. The Plaza Accord with its Kautskian “ultra-imperialist” vision of a centrally planned international currency cartel, seemed, for a time, a kind of solution to that problem and a variety of the other market anarchy problems which had emerged after Bretton Woods. However, like all attempts to rationally plan international capitalism from above during the last hundred and fifty years, it did not last, undermined by the increasingly hegemonic global finance industry and US domestic concerns over that perpetual consumer fetish, inflation. Since that time, finance has played a dominant role in currency policy decisions in the United States, while most national governments, with the exception of China, have returned to reactive and largely uncoordinated monetary policies.

In its approach to the international value of the dollar, the Obama Administration differs little from the policies of either of the Bush or Clinton Administrations. All have been content to let the dollar move with the whims of the international currency markets, and to view federal domestic lending rates as responsible only to concerns of the US economy. This is problematic for US trading partners and is the main source of worry for finance ministers and capitalists in China and virtually everywhere else. The reason for this is twofold. In the first place, many foreign governments hold large amounts of US dollars in foreign reserve accounts (the People’s Bank of China currently holds over 2.3 trillion in reserve US dollars, by

way of example). The second reason is that oil, even more than most other globally traded commodities, is priced in US currency as well. Together, these two factors mean that much is at stake in dollar valuations.

How this came to be so is actually quite familiar. Following the collapse of the Bretton Woods fixed valuation agreements, the US dollar became the de facto measure of world currencies, the *paribus* in the economic *ceteris* of everyone else’s economic ups and downs. Its total volume in relation to other currencies (as well as the size of the economy it represented) created the parallax effect necessary for traders and economists to measure change in other, smaller worlds. The problem with such a system is that the US dollar has been leaking like a sieve since the 1970s, losing value against other major world currencies, mainly as a result of the large and nationally self-serving budget deficits incurred by the US Government since.¹ Outside of the US, such economic profligacy would typically lead to big problems. Deficit spending requires governments to pay interest to attract lenders. This in turn creates inflation as more money enters the economy in the form of the deficit itself, and the interest paid. But inflation means that the debt held by lenders falls in value, despite the interest they are collecting on their loans (this is usually why budget balancing and spending cuts are such a big deal when lenders renegotiate national debts—as victims of structural adjustment know well). If deficits continue, the falling value of debt already held by lenders usually means that, when the same government goes to borrow money again in the future, they have to pay even higher interest to attract those loans. And this simply feeds the cycle, redoubling inflation and setting in place the whole spiral of hyper-devaluation. Such stories are common in the last three decades—coming under titles like “hyper-inflation”, “runaway inflation” or “massive devaluation” and are usually seen as an economic death knell, ringing out the need for IMF intervention; everywhere but the United States, that is.²

In many ways, this is what has led to the current discussions about the crisis for the Euro, since the relative costs of production in Greece, Spain, Portugal and other similarly situated economic regions are far higher than those of Germany (to date, the 21st century’s industrial export champion). However, Greece cannot simply devalue its currency to address this dynamic—tied as it is to the “Euro-cartel”—and thus finds it difficult to attract lenders. In such a situation, the ordinary cash-flow problems (ironically called “liquidity problems”) become currency crises over night. And despite the punitive “lending” and sanctimonious verbiage from Merkel and the big private lenders—the so-called bailout raises the question whose ship is really sinking? Germany has a lot more riding on the future of the Euro than the average Greek citizen, hence the appropriate popular Greek response.

What separates the United States from either the Euro-harmonized-near-basket-case economies of the Old World and the just-as-economically-profligate-but-

¹ There is also, of course, the issue of high production costs—the ghost in current German Greek comic/tragedy—which we return to only briefly below.

² Though the resolution of Argentina’s default crisis of 2005 (that allowed Argentina to shave vast amounts off its debt) suggests that the difference between a death sentence and a haircut is sometimes difficult to distinguish from outside the barbershop window.

smaller New World banana republics, in this regard, is its ability to borrow well below the rate normally required to attract lenders. This is because other governments frequently lend the United States large amounts of money at well below market rates. They do so in order to keep the value of the dollar higher than it would be otherwise, and thus to increase US consumer/business spending power on goods and services produced in the countries of those lending governments. The result of this, however, is that economies and governments across the planet have become doubly dependent on the US dollar. A drop in value in the dollar means that US consumers can afford fewer imported goods and services (slowing economies dependent on exports to the United States), while the debt holdings of those same governments simultaneously decline in value against their own currency—usually at a rate in excess of the low interest they agreed to when giving the loans.

Most investors would see such a situation as a major impetus to disinvest in the United States, but few governments are willing to do so. After all, should anyone begin selling dollars on a large scale, the value of the greenback would drop, further imperiling those still holding large dollar reserves.³ Instead, in order to try to prop up the value of the dollar on world markets, debt holders/exporters are pressured into buying more dollars, in order to shorten supply and thus drive up the price. This, of course, heightens their exposure to the dollar. And usually it offers only a short-term solution. But governments do it anyway: in December 2009, despite Chairman Liu's announcement, governments across the world (including his own) did just this, and non-US government currency purchases of US dollars on the open market topped \$150 billion in the month—far more, we might note, than anyone is talking about spending on Greece.

Further adding to this are the very high “current account” surpluses run by many of these same countries, many of which are held in US dollars as well. The current account of a country is a measure that combines trade surplus/deficits with returns on capital invested abroad and other transfers of assets from foreign sources. Because US markets play such a large role in many export economies, and because the trade is largely one way (US buyers of non-US products) most current accounts feature high amounts of dollars. These, like US dollar reserves, the possession of US government debt and the purchase of US currency on the open market, make exporting countries hostage to the valuation of the dollar. For example, oil exporting countries, which run high current accounts almost entirely in US currency, bring in large numbers of US dollars only to see the value of those dollars fall in value, even while the value of the oil exchanged for those dollars continues to rise (more on this below).

³ The Greek debt crisis and the consequent hand-wringing over a potential collapse of the Euro that may or may not result, occurred during the final publication stages of this editorial. Two points of note as regards the argument here: (1) were the Euro as central to the world economy as many in the press seem to feel, fears of collapse would be far less pronounced—to wit, no one outside of Europe is rushing to save the Euro. And (2) should the Euro undergo the sort of precipitous fall that the dollar has been prevented from making, those countries exporting in dollar-based commodities (like oil) and holding large dollar reserves would stand to benefit. For this reason, exporters to the United States outside of Europe would seem to have much to cheer for in the Greek crisis—all the more if it threatens to pull Spain, Italy or Britain into the vortex with it.

In many ways, this looks like the very opposite of the “runaway” inflation scenario feared by many governments. Instead of cycles of debt producing inflation, causing depreciation and greater debt/inflation, the current dollar dynamics of the world economy have created a situation of runaway dependency, where non-US dollar holders are forced to continue to throw good money after bad in order to protect shrinking national balance sheets, balance sheets which then become worse as a result. The reason for this is clear: the dollar has become, in the eyes of many states, simply too big to (be allowed to) fail. The result is a delicate sort of brinkmanship, where the United States continues to spend like a drunken pirate, while the rest of the world wonders if they will be left holding the check—and today debt, as much as gunships, has become the main means of taking hostages the world over.

Those on the business-right in the United States have long advocated a weak dollar—supposedly because a weak dollar means a better ability to compete overseas in exported goods and services. Recently, they have been joined by many on the center-left who see the growth of the export sector as a way of increasing employment or stemming the flow of manufacturing production away from the United States. The problem with this sort of thinking is that there is little reason to believe that either of these supposed results is actually true. There is little relationship between US GDP growth and the value of the dollar, negatively or positively. Ditto for employment. What’s more, to compete in the export field with, say, China or India, would require such a large devaluation that the United States would start looking like, well, India or China. No one in the United States, left or right, is ready for that.

Just as likely as the prospect of export/job growth is the dynamic described by Commissioner Yiu: that low interest rates in the US (currently hovering around 0%) will encourage US investors to borrow large amounts of money and invest it in assets overseas. As the dollar slides, the cost of those loans goes down (the interest cost of those loans already being little or nothing, and according to the US Federal Reserve, likely to remain so, they can easily be sent into a state of negative interest by small declines in the value of the originating currency, i.e. the US dollar). This means that even moderately performing assets outside the United States can look very profitable to US investors. Just how such a dynamic is expected to create jobs or promote exports at home seems, at best, a little nebulous. Similar dynamics in Great Britain in the 1950s effectively sentenced the British economy to three decades of decline.

All of this has China, on behalf of the world’s exporting economies, rightly worried. Yet China has steadfastly held to a fixed exchange between *yuan* and dollar, meaning that the value of its currency has dropped just as quickly as the United States’. Ironically, this is likely to make the Chinese far more competitive than they already are in the US market vis-à-vis those economies whose currencies float against the dollar (all are going up relative to the dollar). In this way, the cost of Chinese manufactured goods to US consumers stays steady while everyone else’s goes up. This is likely the reason why the Chinese government will never increase the value of the *yuan* relative to the dollar, since this would be a keelhaul to Chinese capitalists whose overall average profit rates have been quite low over the last two

decades. This has the rest of the world wondering just what the hell China is so upset about.⁴

The perhaps more pressing issue is oil, which is more likely to impinge on the ability of national governments to maintain the dollar-at-the-brink economy than their own long-term economic self interest. China is heavily dependent on imported oil. Its overall positive “current account” balance notwithstanding, the value of China’s trade *deficit* with oil exporting countries is roughly half the size of its trade *surplus* with the United States. A weak dollar thus impinges on China’s ability to buy oil with its cash reserves, which looms large as a political consideration in China’s future (and is prompting a huge investment in hydro-power). This may be one reason why the Chinese government has been investing billions in Africa, that is, to secure potential future oil sources. China already gets a good bit of oil from Angola, and recent threats about building a military base in the Horn of Africa to combat piracy are more likely about securing the oil potential of the Sudan (and nearby countries) than some sudden moral pang about the sanctity of freedom on the high seas.

Like all major commodities, oil is traded in dollars everywhere (except at a small exchange in Iran, which trades in Euros and yen, and another in Russia, which trades in rubles). This means that most OPEC countries hold large US dollar reserves as well, even while they hold significant current account deficits with Euro-based countries. As above, many oil producing countries thus feel they are trading increasing-value-assets for falling-value-assets, which, for obvious reasons, they do not like. In addition, because oil is traded in dollars, oil becomes a natural hedge against dollar deflation. If you think the dollar is going to go down, buy a barrel of oil: even if the global value of that barrel of oil stays the same, you make money as the dollar falls and the price in dollars goes up in the currency of the world’s largest consumer. Given that oil is likely to continue to rise in market value anyway, investments like this make even more sense. All of which means that issues beyond market supply and demand are influencing oil prices, something else that oil producers do not like. It is unclear just what a bubble market in something so central to global production—as oil is—would do to the world economy. While speculation in oil is nothing new, obviously, seeing oil go into the mach 2 style hyper-speculation that dominates the world of currency trading is not something anyone in either oil production or energy intensive forms of manufacturing is prepared for, though it has likely been heading that way for the last 5 years or more. Some might argue that such a cocktail could spell the end of the ability of national governments and/or the IMF to exert any control over their own currency markets. This is more

⁴ Asset bubbles aside, the fact that the Chinese currency, the *renminbi*, is pegged to the dollar means that as goes the dollar, so goes the *yuan*. The November 12th announcement was meant to point out that this need not necessarily be the case for long—that de-linking is a possibility—but this is likely an idle threat, as China, more than anyone these days, is deeply invested in the dollar. The real threat is that Chinese displeasure in the decline of their investment will manifest itself in foot dragging on issues like global climate control, Tibetan human rights and nuclear-armed Iran and North Korea, none of which is particularly important to the United States or China at the moment. Whether such factors are likely to lead the Chinese to lessen their investment/dependence on the dollar in the future, which would only add further downward pressure, is an open question, but all indications from the US administration are that no one is worried.

than neo-liberalism and the usual market-fawning laissez-fantasy of the last 20 years, but an unsurprising potential outcome. Nobody really knows what a post-brink global economy of this sort actually will look like.

All of this can be summed up by noting that no one is currently driving the bus. And while just about everyone has a reason to jump off, the carriage is now at full speed, so no one dares. As noted in previous editorials, we here at DA are skeptical of visions of capitalist conspiracy—the sort of view that sees G-20 (or whatever the current count is) meetings as gatherings to plot the next step in the chess game of global hegemony. If only that were the case! Right now, planning seems to be the last thing anyone wants to do.

But a bigger question than what the governing “great powers” and their capitalist paymasters want is what they are actually capable of. To wit, it may well be that things are already too far gone—that the type of centrally planned, rational international system of cartelized capitalism that James Baker III, Helmut Kohl and Yasuhiro Nakasone had in mind when they agreed to the Plaza Accord is no longer possible, if it was then. Instead, it may be that a century plus of liberal/conservative/social democratic/nationalist/left/right/and center dreams of creating a regime of balanced and peaceful parallel accumulation has been revealed as a short-term presentist fantasy—a bigger version of ever recurring faith at year three in the business-cycle that the coming decline in year 7 will somehow be better and different than previous downturns, or perhaps simply not come.

The editors of DA do not want to base a once-and-for-all structural assertion on something as unscientific as four decades of post-Bretton Woods history, but from the perspective of the all-important dollar valuations upon which much of the international system of nations is currently based, Lenin’s vision of capitalism as hard wired to chaos, competition, war and (hopefully) revolution looks far more plausible than the “ultra-imperialist” cartel version of capitalism that Karl Kautsky cribbed from Joseph Schumpeter, and contemporary backseat drivers from Hardt and Negri to Chomsky and Krugman currently propound.

It may well be that this bus simply is not steerable and never was—that the ability to steer a system built around rapacious, caustic competition and the market anarchy of capitalist property norms (famously described by ruling class apologists Werner Sombart and Rudolf Hilferding as “creative destruction”) is just one of those many popular lies we live by. And if Rubin et al ever have the courage to peep through the cracks of their fingers, as they hold them over their own eyes, they now seem to close them just as quickly....and move to a seat in the rear. As for the rest of the world, we have only one bit of advice: buckle up.