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Flight capital lifts dollar; real economies sink deeper

by Marcia Merry

If you're wearing reality-lenses, and not rose-colored glasses, it's easy to see how the "invisible hand" lifted the dollar up to new heights at the end of May. According to estimates of London moneymen, an estimated $3 billion a day of flight capital ran out of Argentina and from Chinese sources in Hong Kong, Taiwan, and other points in Asia, over a several-day period beginning May 19. Senior City of London banking sources see the massive influx into the dollar as primarily illegal Communist Chinese flight capital. Over a period of four days, the dollar was pushed up from 1.95 deutschemarks to above 2.00 deutschemarks, the highest dollar level in more than two and a half years. However, unable to see reality, President Bush on May 22 could only express "concern," and offer some platitudes about the soundness of the economy and the dollar. Various financial columns expressed similar perplexities about what the London *Financial Times* called "the current extreme dollar strength."

Meantime, the impact of the flight into the dollar, and other factors, played out through the world monetary system, as the pound fell to a 22-month low. Reports came out that the central bank interventions to suppress the dollar rise were having little effect. Hong Kong's stock market index plunged a total of 498 points—15%—from Friday, May 19 to Monday, May 21. Despite Bank of England regulatory measures in effect in Hong Kong and related Asian markets, the potential remains for Asian financial markets to blow out.

In London on May 24, interest rates were jacked up to 14%—the highest level since January 1985, in the name of helping the pound. Chancellor of the Exchequer Nigel Lawson said in a radio address, "I shall do whatever is necessary at the time."

While Bush is still blinking, the dollar's rise may be reversed by a round of interest rate hikes in other countries following the Bank of England's example. Interest rate increases are expected to be announced soon by other Group of Seven member nations. The Bank of Japan is expected to make its first interst rate increase this year. The German Bundesbank will likely raise rates no later than early June.

In Washington, it was agreed on May 23 not to ease up on interest rates because of reports showing how "strong" the U.S. economy is, and therefore what a danger there is from an economic surge-inflation. A May 23 report from the Commerce Department showed that durable goods orders were "surprisingly" up by 2.9% in April. Never mind that on May 24, the Commerce Department released a second report from their economists stating that the economy was "weak." The report said that first quarter performance of the U.S. economy showed an annual rate of growth of only 4.3%.

Whatever the government said, by May 24, export groups, from auto manufacturers to farm commodity exporters, said that they were prepared to live with the new "strong" dollar. The Agriculture Department's Economic Analysis staff director, Keith Collins, said, "It's not going to have a sustainable effect on our exports."

However, behind the up and down swings of the day, the reality is that the entire world economy is weakening, and the political factors that are impelling daily monetary behavior will only become more extreme. In Argentina, as long as the International Monetary Fund is working to prevent newly elected President Carlos Menem from effecting any recovery of the looted Argentine economy, there will be more instability. The revolutionary momentum in China is growing, after the decades of enforced economic primitivism.

In the United States itself, the real measures of the economy show it in severe decline. For example, the iron and steel industry has declined in output capacity to the point of

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national industrial crisis. The shipyard industry has no orders at all on the books for merchant vessels—none! The farm sector is now in the throes of a second year of killer drought, on top of the agriculture credit crisis and years of low prices from the food cartel. The United States at present is no "safe haven" for capital, and the pressure is mounting for a monster financial blow-out.

Enter: trade war

Another factor guaranteed to make things worse, is the trade war policy now being hotly pursued by the United States. On May 25, the United States cited Brazil, Japan, and India for unfair trade practices. The selection was made from a list drawn up by Trade Representative Carla Hills. It cited a group of nations considered by the United States as guilty of unfair trade practices and candidates for retaliatory action under the "Super 301" provision of the 1988 Omnibus Trade Bill. Earlier in the month, a special 241-page report, "1989 National Trade Estimate Report on Foreign Trade Barriers," was released by the administration. It listed 36 countries and regions and cited their trade "violations." In addition, analyses were given of trade violations in the auto and banking sectors.

However, since that report, which was received with fury by U.S. trading partners, and since the trip of Vice President Dan Quayle to Asia, which was received with much ill will over the issue of U.S. trade violations against Asian and Australian interests, the administration has only been willing to indicate "concern" over alienating allies.

Therefore, once again, the issue of the condition of the real physical economy is raised. The Iron and Steel Institute, for example, which just finished its annual meeting, has told the administration they must have a continuation of the restriction on foreign steel imports, or their industry won't survive.

And once again, President Bush can't figure out what to do. On May 22, when Bush met with his advisers over the issue of the list of those nations violating U.S. trade interests by imposing restrictions on entry of U.S. goods, he was reportedly impressed with the argument that the United States will be charged with hypocrisy if it blasts other nations for trade violations—especially if the U.S. targets Japan. The United States maintains restrictions against imports of not only steel, but autos, superconductors, and other goods. Bush reportedly joked, "Maybe we ought to take action against a whole bunch of countries—including ourselves."

The final communiqué cites Brazil for violating licensing and services, India for investment, and Japan for wood products, satellites, and superconductors.

While monetary chaos and trade dissension rip the West, the advocates of the "New Way" with Russia are promoting trade and financial deals to the East as the way out. In San Francisco on May 24, both U.S. and U.S.S.R. representatives spoke of wondrous opportunities, in addresses to an audience representing 250 companies. Sen. Alan Cranston (D-Calif.) and A.W. Clausen of Bank of America called for expansion of ties with Russia, but few specifics were given. N.I. Maslennikov, deputy chairman of the Russian Federation Council of Ministers, said, "We see the potential as nothing short of enormous," and singled out the great opportunities in Siberia.

The first Western-controlled joint banking venture with Moscow has just been set up by Crédit Lyonnais, the second-largest French private bank, and the entity that has just bought out Chase Manhattan of Belgium. The deal creates the new International Moscow Bank, which will involve a five-bank consortium including Austria's Kreditanstalt, West Germany's Bayerische Vereinsbank, Italy's BCI, and Finland's Kansallis-Osake-Pankki. The new Moscow-based bank is to finance trade, and to "train" Soviets in Western banking methods. If they teach by the present book, this will mean flimflam, and the kind of grinding austerity now bringing down governments and setting desperate peoples into political motion.

In contrast, some sane indications came out of Cairo and Dakar. Egyptian President Hosni Mubarak sent an address which was read at the May 22 opening in Cairo of the four-day conference of the World Food Council on the world hunger emergency, which called for creditor nations to write off some Third World debt so the money could be used to eradicate hunger. (See *Business Briefs*)

In Dakar, Senegal, French President François Mitterrand said May 23 that France planned to write off debt totaling $2.6 billion owed by 35 of the world's poorest nations. He made the announcement at a three-day summit of leaders of the French-speaking world, attended by many nations that would benefit from the write-off. In Africa, the Mitterrand proposal would affect the debt—received as "development aid"—of 35 black African nations, representing about 43% of their total foreign debt. In 1987, Canada made a similar announcement when it hosted the second world Francophone summit.

The poverty in Africa caused by years of forced debt austerity under the World Bank/International Monetary Fund programs, is now epitomized by the plight of Sudan. There, 250,000 citizens died of starvation last year. This year, 2 million Sudanese are desperate for food, and 100,000 face starvation unless adequate relief is supplied.

In July, the Group of Seven wealthiest nations meets in Paris over world monetary and debt policy. Mitterrand said in Dakar that he would announce an overall debt relief plan for Third World nations. He described it as entailing the creation of a multilateral fund to allow for a debt-for-stock swap and guaranteed interest rates. As events proceed in China, Argentina, and other nations pressed to the wall by the economic constraints of postwar banking and other economic arrangements, the bankers who have previously run the Group of Seven may have some surprises on their agenda.