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FLOATING EXCHANGE RATES: SCHEME TO EMBEZZLE THE DOLLAR BALANCES OF SURPLUS COUNTRIES

Antal E. Fekete
E-mail: aefekete@hotmail.com

Summary

Milton Friedman's theory of floating exchange rates, on which the international monetary system has been based since 1971, has given rise to a coercive regime in the sense that IMF statutes forbid member countries to stabilize the value of their currencies. A country attempting to do that is branded "a currency manipulator" and is threatened with trade sanctions. The prohibition is understandable. It is designed to protect the scheme whereby the dollar balances of the surplus countries are stealthily embezzled. It works as follows. The United States lures the unsuspecting surplus country into the black hole of currency revaluation against the dollar. As their currencies are floating upwards, a part of the surplus countries' dollar balances are appropriated by the U.S. In effect, the U.S. is forcing its trading partners running a surplus to grant, unwittingly, a partial debt abatement. This exhausts the concept of embezzlement. The U.S., bankers to the world, conspires to short-change its depositors using the smoke-screen of floating foreign exchange. This regime, based on plunder, cannot endure. The only equitable monetary system is the one based on fixed exchange rates. And the only durable way to fix exchange rates is to make the currency redeemable in gold.

Friedman's theory is a blot on science and on the good faith of the United States in its dealings with its neighbors.

Floating *versus* fixed exchange rates

In putting pressure on China to follow Japan's example to revalue the yuan the American money doctors fail to point out that they are in effect asking China to take a loss, similar to those of Japan amounting to hundreds of billions of dollars, on her holdings of U.S. Treasury paper. China carries her books in yuans, not in U.S. dollars. Therefore every change in the yuan price of the dollar will have an immediate and predictable effect on the value of China's portfolio of U.S. Treasury paper. In particular, a decrease in the yuan price of the dollar results in a loss in the yuan value of China's dollar balances.

The question arises: by what right does the U.S., a country with chronic deficits and a history of reneging on her foreign debt — as on August 15, 1971 — demand that China write off a part of the American debt to China?

There is more. If China yielded to American pressure to let the yuan float upwards, it would mean not just a one-shot abatement of debt, but a standing commitment to grant further automatic abatements as new debts are being incurred by the U.S. This would make mockery out of the idea of independent nations trading with one another for mutual benefit. It would make China a vassal of the U.S., a role China in all dignity could not accept.

It is incumbent on the debtor, not on the creditor, to make the necessary adjustment in case of a persistent imbalance. The contrary position, advocated by Keynes, is a fallacy. It turns logic upside down. It penalizes hard work and thrift, while it rewards indolence and prodigality.

Water torturing Japan

Immediately after making the dollar an irredeemable currency the U.S. started running trade deficits on an ever increasing scale. Using Milton Friedman's spurious theory according to which floating exchange rates were supposed to make the currency of a surplus country stronger, the U.S. started twisting the arms of its trading partners running a surplus, first and foremost, Japan, to revalue their currencies upwards. Thus the unsuspecting trading partners of the U.S. were lured into the black hole of currency revaluation. In listening to the sweet siren song from Washington these surplus countries were oblivious to the fact that they were in effect taking a loss — as they were granting a debt-abatement to the U.S. proportional to the their dollar balances they held as a currency reserve.

For example, when the Japanese yen rose to the level where one dollar was worth three times less (say, 100 yens as compared to 300 earlier), this actually meant an abatement of the American debt to Japan in the ratio of 2/3 or 66 percent, without anybody recognizing what was going on. It was trumpeted as "free market on the go". It was not. It was embezzlement, pure and simple. The U.S., bankers to the world, embezzled Japanese funds held in dollar accounts to the tune of 66 percent.

Embezzlement on that scale has consequences. In fact, it bankrupted Japan, one of the strongest countries financially. As Japan fell upon hard times and wanted to draw on her foreign exchange reserves, it couldn't, for the simple reason that the funds were not there. At that point American money doctors rushed in and explained to the Japanese that, rather than paying their bills by drawing down their dollar balances, they should start running budget deficits and finance their needs through debt. Up to that point Japan was practically debt free. By now, Japan's debt is so huge that it is stifling the Japanese economy.

The U.S. has played the role of the bully-boy of international trade long enough, bluffing that the irredeemable dollar is „an ultimate extinguisher of debt". It is none too soon that someone call the bluff ― after so many countries have succumbed to pressure and suffered huge losses on their foreign exchange reserves as a consequence. Maybe China will stand up. If China is the first country opening her Mint to gold, thereby resolving the gridlock, then the U.S. will be forced to give up her monetary leadership in the world.

Calendar of Events

August 9-20, 2010, in Budapest, Hungary. The New Austrian School of Economics, the first 20-lecture course offered, entitled: *Disorder and Coordination in Economics — Has the world reached the ultimate economic and monetary disorder?* For more information, see the website www.professorfekete.com or contact szepesvari17@gmail.com

Preliminary announcement: a session in Hong Kong in late October is on the drawing board, followed by more events in New Zealand in November. Stay tuned.