THE DONKEY IN THE CHINA SHOP

Obama and Congressional Democrats Trying to Blackmail China

President Obama has just issued a blackmail to Prime Minister Wen Jiabao of China: "You immediately revalue the yuan or else…" According to an article of David E. Senger in *The New York Times* dated September 23, 2010, the two leaders met at the United Nations in New York and spent most of their two-hour session in a spare conference room, usually used by members of the Security Council, to discuss the currency issue. The session ended by Obama's issuing an ultimatum that is bound to be followed by trade war. Surely, this is a most unseemly use to which the sacred grounds of the Security Council, dedicated as it is to the maintenance of peace and prevention of war, have ever been put.

It is most undiplomatic, not to say arrogant, for a head of government to engage another in a in a tête-à-tête confrontation, to discuss technical currency problems that should first properly be sorted out at a lower level by experts. In a total lack of courtesy to be shown to a guest, Obama is threatening him with action on the part of Congressional Democrats, to railroad legislation through before the midterm elections that would put huge punitive tariffs on Chinese goods, thus plunging the world into trade war. Every one of those Congressional Democrats is a complete ignoramus where complex currency issues are concerned. The only thing they can do is parrot Keynesian and Friedmanite bunk.

The reason given for Obama's most unusual procedure is that he and his Congressional cohorts are "protecting U.S. interests: American jobs and American competitiveness". Of course, Obama would never pay the blackmail if China wanted to force upon the U.S. an unpalatable dollar-policy, e.g., demand that the dollar be immediately put back on a gold standard on the theory that the present dispute would not have arisen if the dollar were gold redeemable as it had been before Nixon's default. Obama has grossly overplayed a very weak hand. The U.S. has never been in a weaker bargaining position. All the trump cards are in the Chinese hand.

None of the arguments used by Obama in his impolite and immodest lecturing of the Chinese Prime Minister holds water. Exactly the same stratagem was applied against Japan in the 1980's. At that time the U.S. wanted Japan to let the yen float upwards "in order to help restore America's competitiveness". Japan meekly obliged, and the result was: bankrupting the Japanese financial system *while America became even more uncompetitive*.

That episode has been completely misrepresented by the American media and mainstream economists. To restore balance, here is the other side of the argument. Japan had a huge pile of U.S. Treasury paper as a result of several decades of trade surpluses — fruits of Japanese thrift and good husbandry. As the yen was floating upwards, Japan took enormous losses on its holdings of U.S. paper, since its gold value was no longer guaranteed after Nixon's default of 1971. For an American eye these losses were invisible, because Americans blithely assumed that everybody would carry his books in dollar units. But the Japanese carry them in yen units. As the yen was floating upwards from a little over 25 cents to over $1 per 100 yen, *the Japanese were forced to take a loss on their savings to the tune of over 75 cents on every dollar of American debt held.* The whole maneuver of floating the yen upwards was designed to avoid the shame attached to an exercise in default of sovereign debt, in order to save American face at Japan's expense. Such a drastic and open-ended loss of wealth would bankrupt even the strongest country financially. Japan today is in the throes of a depression, thanks to the U.S.' slapping its debt abatement on her economy. Thrift and industry were penalized, prodigality and financial irresponsibility rewarded.

But the worst was still to come. When the Japanese wanted to pay some of their overseas accounts by drawing on the remnants of their savings held in dollars, they were shocked. The money wasn't there. American money-doctors rushed in and talked Japan into embracing deficit-spending. Up to that point Japan had practically no government debt. Why should they? They could afford to pay cash. By contrast, today, Japan is one of the worst cases of government over-indebtedness, a result of "good" advice dispensed by the American money doctors.

The Chinese government is not in the habit of running its business on the basis of unbalanced budgets and deficit spending. Looking at the Japanese experience, no wonder that China does not want to be sucked into the black hole of bottomless government debts in which the U.S. and the Japanese governments are drowning.

Obama's argument, concocted for domestic consumption, is that upward-floating of the yuan would help restore American competitiveness and would put Americans back to work. However, the saga of the Japanese yen does not confirm this optimistic prediction. A side-effect of letting the yen float upwards under American duress was the devaluation of the dollar *vis-à-vis* the yen. As a consequence, Japanese producers have made further gains in competitiveness over that of their American competitors. With their stronger currency they could easily outbid American producers in world markets when shopping around for ingredients that go into production for exports. As a result, Japan's trade gap with America widened further. The imbecile theory of Milton Friedman, that a weaker currency is duty bound to make for gains in the country's exports, has never worked — except in the reverse. Whatever dubious advantage a weaker currency may have initially evaporates as soon as stockpiled imports are drawn down and used up. Ever after, the weaker currency has to face higher bills for imports. The terms of trade of the country resorting to devaluation deteriorates:

the same quantity of exports will buy a smaller quantity of imports. To devalue one's own currency is akin to self-mutilation of the champion before the race. The only thing it guarantees is failure. The champion must hand victory over to his adversary without running.

The charge that the Chinese artificially hold their currency weak is a red herring. The real strength of currencies is measured by the reserves held against them, and by the competitiveness of the export industry supporting them. By these measures the yuan is a strong currency, indeed, far stronger than the dollar. Torturing logic in calling the strong weak and the weak strong will not take Obama very far.

The real reason for the unprecedented blackmail of Obama has nothing to do with these false charges. It has all the more to do with the unpaid and unpayable debt of the U.S. The size of this debt beats all records in history, and cries out for debt-abatement or default. The blackmail was issued in desperation. The U.S. is like the biblical prodigal son who has blown his patrimony. He does not want to admit that he has acted foolishly. He does not want to repent. He just pushes the blame on others. But the moment of truth will arrive when the fact of prodigality must be admitted, and repentance must replace finger-pointing.

For a balanced view of the American-Chinese dispute one has to see clearly that if China caved in to American pressure, as did Japan before her, then China would agree to the embezzlement of her savings held by America, bankers to the world. China is a proud country and will never allow herself to be humiliated and short-changed in this way.

Obama, the Congressional Democrats, and their Keynesian/Friedmanite mentors should face up to the fact that they have overstayed their welcome as financial managers of the U.S. and the world. Pseudo-theorizing on the non-existent benefits of currency devaluation has grown threadbare. Blackmailing surplus countries and slapping the losses on them — while the orgy continues in the deficit country — is a counter-productive strategy. It is bound to fail, as it already has. It may force China to fix the value of the yuan, not in U.S. dollars but *in gold ounces*. That will be the last nail in the coffin of the once mighty U.S. dollar, to make it ready to join the Continental, the assignat, the Reichsmark, and the Zimbabwe dollar in the cemetery of worthless fiat currencies.

Maybe in November the American people will send representatives to Congress who will rally around Congressman Ron Paul of Texas, the only American leader with a viable plan to save the American government from the ultimate humiliation of publicly recognized bankruptcy.

America can lose nothing, and can gain everything by *playing the gold card first*. The prodigal son, repentant, could return to his father, symbolized by the American Constitution, who is ready to forgive and embrace him. Not only will the opening the U.S. Mint to gold, as demanded by the Constitution, restore the government to fiscal sanity and financial health; it will also bring confidence back to the international monetary system.

It will also help avoid trade wars, and prevent another wave of uncontrollable unemployment from engulfing the world.

Reference

position paper of professorfekete #3, July 4, 2010, *Floating Exchange Rates: Scheme to Embezzle the Dollar Balances of Surplus Countries*, www.professorfekete.com.

Calendar of Events

SOUND MONEY OR UNSOUND —THAT IS THE QUESTION

Symposium of the New Austrian School of Economics *in Auckland, New Zealand, November 15-19, 2010*

Lecturers: Professor Fekete (Hungary), Rudy Fritsch (Canada), Sandeep Jaitly (U.K.), Peter Van Coppenolle (Belgium)

Nov. 15.	a.m.	Sound Money: Unadulterated Gold Standard
	p.m.	Unsound Money: Our Diseased Monetary Bloodstream
Nov. 16.	a.m.	Fiat Currency: Destroyer of Capital
	p.m.	Fiat Currency: Destroyer of Labor
Nov. 17.	a.m.	When Atlas Shrugged: the Lure and Lore of Risk-Free Profits
	p.m.	Gold and the Babeldom of the Debt Tower
Nov. 18.	a.m.	The Fall and Rise of the Gold Standard
	p.m.	Sound, Less Sound, Least Sound: The Unhappy Birthday of the Euro
Nov. 19.	a.m.	And God Created Gold…
	p.m.	The Gold Standard Manifesto

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