The Fall of the Almighty Dollar: An Essay in Polemics

——Carl Kreider——

The emotionally charged words of the title of this paper suggest its polemical character. Perhaps it is in order for an academic economist to justify an article of this sort. Most modern economists profess to be scientific. They feel most secure when they report on analyses of models they have created. Although not always relevant to the actual situation, theoretical models have the advantage of possessing characteristics which the analyst can control.

There is, however, a long and worthy tradition of economic writings that discuss issues that are highly relevant to the the crucial problems of their time and which take positions on these issues which are clearly of a polemical character. Thus Adam Smith published his WEALTH OF NATIONS largely as a vigorous attack on what he considered unwarranted and unwise government regulation of foreign trade and of domestic economic policy. He coined the term "Mercantilism" to characterize this system which had dominated European ecomonic and political practice for the previous two or three centuries. And he did not hesitate to say what he thought was wrong with the accepted doctrines of Mercantilism. Karl Marx is regarded by many economists as not a highly original economic theorist.[1] Rather he is noted as one who applied with relentless logic the accepted economic thought of his day. His purpose clearly was not just to engage in futile debate but rather to point the way to a reorganization of the whole capitalist system.

1) See, e.g., Barbara Ward, INDIA AND THE WEST, London, Hamish Hamilton, 1961, p. 53.

Anyone who is not convinced that the late Lord Keynes was a polemicist should read his ECNOMIC CONSEQUENCES OF THE PEACE,[2] or better still his ECONOMIC CONSEQUENCES OF MR. CHURCHILL.[3] But even his more scholarly GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY[4] is essentially a critique of the failures of the finance ministers of his day to understand the levels of governmental receipts and expenditures requiste for an adequate level of aggregate demand. And Lord Keynes was always willing and eager to advise the British Treasury concerning the concrete policies they should follow. If this present article can be only a whisper in the continuing tradition of these thundering voices of the past, I will consider my efforts amply rewarded.

In August 1972 I returned to Japan after 16 years of absence. A defeated nation then, Japan has now emerged as the third greatest of the world's economic giants. The Japanese economy is unparalleled for its ability to sustain a remarkably high level of economic growth for an unusually long period of time. But to me as an economist the most striking change I noted was not the ubiquitous color TVs, the air conditioners, and the automobiles I saw everywhere. Rather it was the phenomenal change in the position of the United States dollar. In 1956 the most stirring issues of international monetary relationships was the "world-wide dallar shortage." The Japanese (along with the countries of Western Europe) considered the American dollar to be the hardest and safest of all currencies. The dollar was as good as gold—even better because the dollar could earn an interest income whereas gold was only an expense to store. The only debatable issue about the dollar then was whether the dollar shortage could be ameliorated by suitable

2) London, Macmillan, 1919.

3) London, L. and V. Woolf, 1925. Also published in ESSAYS IN PERSUASION, New York, Harcourt, Brace, 1932.

4) London, Macmillan, 1936.

adjustments of exchange rates, or whether the dollar shortage was a "structural" one justifying the continuance of rigid exchange controls and other import restrictions on American exports. What a change 16 years had effected! By 1972 the almighty dollar had already been devalued once ("debased" was the word we used when we were more honest about it). According to the Smithsonian agreement of December 1971 the dollar was devalued by 16.88% vis-a-vis the yen.[5] In mid-February 1973 the dollar tumbled again. A formal American devaluation of 10% was accompanied by a float of the yen which forecast an aggregate devaluation of from 16 to 20 per cent below the rate of the Smithsonian agreement. Why has there been this drastic change in the international position of the dollar?

Probably the most important single factor has been the striking post-war recovery in the economies of Western Europe and of Japan. Although the costs of living in these countries have in general indicated a rate of inflation higher than that of the United States, the prices of their export products have not risen correspondingly.[6] As a result of these relative price changes, the enormous United States surplus in its merchandise trade balance fell sharply as the decade of the 1960s advanced so that it had practically disappeared by the end of the decade. It had actually changed to a merchandise trade deficit of nearly $3 billion in 1971 and to a much larger deficit of $6.3 billion in 1972. In fact, It was probably the announcement by the United States Department of Commerce of the size of the fourth quarter 1972 merchandise trade deficit which touched off the flurry of speculative pressure against the

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5) INTERNTIONAL FINANCIAL NEWS SURVEY, "Agreement on International Monetary Arrangements," December 22-30, 1971, p. 421.

6) INTERNATIONAL FINANCIAL STATISTICS published by the International Monetary Fund indicate that in the United States the consumer price index advanced by 32% in the decade between 1960 and 1970. The United States index of export prices advanced by 23%. On the other hand, Japan had a much greater advance in the consumer price index (plus 78%) but a much more modest increase in the index of prices of export goods (plus 8%).

dollar and thus led inevitably to the second American devaluation.

The second basic change which affected the international position of the dollar was the return of general currency convertibility. For nearly a decade after the close of World War II most currencies were not freely convertible. The American dollar, on the other hand, could readily be converted into any other currency or into gold. During the decade of the 1950s, however, although most currencies other than the dollar were not freely convertible into gold, they were readily convertible into each other. Indeed, one of the major goals of American economic foreign policy was the restoration of free convertibility of currencies. But, ironically, this worked to the disadvantage of the United States because it enabled persons to hold their liquid funds in the currencies of the countries having the highest short term interest rates. This led to inevitable "hot money" flows.

There is a third factor which should be considered, though at this point it is impossible to support it with as much empirical evidence as can be provided for the two previous points. The possibility remains, however, that the frequent devaluations of all currencies other than the dollar in the period between the close of World War II and the end of 1970 were too severe and as a result left the dollar relatively over valued. The initial exchange rates submitted by most countries to the International Monetary Fund when it began its operations in 1947 were essentially those which had obtained at the beginning of World War II. From 1947 until the end of 1970 there were over 200 devaluations of the various currencies of the world.[7] Thus at the same time that the economies of other countries were becoming competitive vis-a-vis the American economy the value of the American dollar relative to these other currencies was rising. This made it difficult for the

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7) Richard N. Cooper, CURRENCY DEVALUATION IN DEVELOPING COUNTRIES, Princeton, N. J., International Finance Section of Princeton University, 1971, p. 3.

United States to export, easier for the United States to import. There were world-wide devaluations in 1949, for example, that had the effect of reducing the value of most currencies of the world by over 30% in their relation to the dollar. Except for West Germany and Japan, most of the other major currencies of the world have been devalued once or more since then. Thus, Great Britain devalued by 14.4% in 1967. France devalued by 17.5% in 1958 and by 12.2% in 1969.

It is possible, of cource, that the extensive devaluations of 1949 had only reflected basic changes which should already have been taken into consideration in establishing the initial IMF parities in 1947. At that time most countries deliberately wanted to over value their currencies. Since they had been devastated by war they were in no position to export merchandise in any event, and an over valued currency could do no further damage to their export trade. They were desperately in need of imports for basic necessities and for reconstruction needs. Consequently they welcomed the stimulus which an over valued currency would give to their volume of imports. Furthermore, their bitter experiences with price inflation during and following World Wars I and II made them fear the possible inflationary effects of currency devaluation. This line of argument suggests that the extensive devaluations of 1949 only brought exchange rates to what might have been considered more realistic initial parities in 1947. Although the Japanese yen has not been devalued since 1949 the parity (¥360 to the dollar) which was established at that time gave a somewhat lower value to the yen than the rate of ¥330-350 which many observers had expected on the basis of the Bank of Japan's wholesale price index.[8]

The American dollar, however, got into trouble not only because of economic forces going on outside the United States, but also because of developments within the United States. The earnings of

8) T. M. F. Adams, A FINANCIAL HISTORY OF MODERN JAPAN, Tokyo, Research, 1964, p. 204.

the United States on its current account (merchandise trade) progressively became inadequate to finance American expenditures on capital and grant accounts. Three specific items may be noted: (1) American capital investments abroad; (2) American foreign aid; and (3) American military expenditures abroad. Each of these will now be considered in turn.

(1) American capital investments abroad from 1950 through 1971 are estimated to be a net amount of $71 billion. These investments have not always been welcomed by the governments of the country in which they were made. Some (especially France and Canada) expressed the fear that American capital was becoming too dominant in their economies. Regardless of the attitudes taken toward long-term United States capital exports by the countries receiving the capital, it is hard to make a convincing case to show that United States capital exports have actually constituted a drain on the United States balance of payments. An export of capital is, of course, a debit on the balance of payments. Much of this investment, however, was in the form of direct investments. These direct investments usually resulted in substantial merchandise exports (a credit item) in the year in which they were made. In subsequent years there would be continued credits to the American balance of payments arising from the profits stemming from these investments. In fact, we must raise the question of whether there can be any long term solution to the American balance of payments problem until it is recognized by both Americans and non-Americans that the result of the large volume of American capital invested overseas should be a merchandise balance for the United States which is normally in a deficit. In this way it would resemble the position of Great Britain in the late 19th and early 20th centuries. The shift in the United States merchandise balance of trade in 1971 and 1972, though dramatic for its suddenness and too large in quantity, may actually be regarded as a more "normal" state of affairs than the persistent merchandise trade surpluses of the several decades that

preceded it. By exporting merchandise to the United States other countries can service their long term debt to the United States.

(2) American economic aid abroad, though substantial, has also not necessarily been a net drain on the United States balance of payments. In recent years most of this aid has been "tied." That is, recipients of the aid have been obligated to spend the funds in the United States. Thus the aid, a debit to the American balance of payments, is exactly counterbalanced by merchandise exports, a credit item. It is conceivable, of course, that in the absence of the aid the countries receiving the aid would have purchased the product in the United States. In other words, they would have used their own supplies of foreign exchange rather than the credits the United States supplied under the aid program. To the extent that this happens the aid may have served to reduce the volume of "normal" exports. On the other hand, it also seems reasonable to argue that if the aid has served a useful economic purpose in the recipient country it will probably have assisted in the economic development of that country. In the long run mutually profitable trade should develop between the aid granting and aid receiving countries as a result of this economic development. Furthermore, much of the aid that the United States has given in recent years has been in the form of loans rather than grants. Although such aid constitutes a debit to the American balance of payments when the aid is granted there will be a corresponding credit when the aid is repaid.

(3) American military expenditures abroad are quantitatively large. They are also qualititatively different than the other two categories which have been just considered. Capital investments and foreign economic aid probably do not constitute a serious burden on the American balance of payments in the short run. They certainly constitute a net credit in the long run. Military expenditures, however, represent an almost total loss to the balance of payments both in the short and the long run. The Pentagon has followed "Buy

American" regulations that have become increasingly stringent. To conserve American foreign exchange military supplies purchased by the Pentagon must be secured from American suppliers, unless they can be bought abroad at more than 50% lesser price. This gives rise to the anomalous situation that the American soldiers in Germany have to eat "ham sandwiches flown in from Washington!" Furthermore, many American military expenditures are for personnel costs. In this way the productive powers of American labor have been used for destructive purposes rather than to create useful goods. This has undoubtedly contributed to inflationary pressures in the United States which have made American goods less competitive in world markets. Similarly the American manufacture of munitions has used scarce productive resources for destructive purposes and thus also has contributed to American price inflation. At the same time there has been no corresponding increase in the productive capacities of the countries where these munitions have been used. Indeed, the economies of countries such as Vietnam have all but been destroyed by American military activity there.[9]

President Nixon, in announcing the February 1973 devaluation of 10% is reported to have said that he is not sure that the devaluation of the dollar will be adequate to bring the American foreign accounts into balance. He suggested that the United States might also have to impose higher tariff barriers on American imports. The

9) A credit which American military operations have provided to the United States balance of payments arises from the large scale exports of United States military hardware--much of it to countries which desperately needed to use their foreign exchange for more productive purposes. These exports increased from approximately $250 million a year in the 1950s to $1.0 billion in 1961 and to $3.4 billion in 1971. (NEW YORK TIMES, February 25, 1973.) In part they stemmed from the comparative advantage enjoyed by the American manufacture of arms which arose from heavy United States government subsidization of military research. In part they may have arisen from what Prime Minister Wilson once called "American high pressure salesmanship in selling arms." But I fear that they contributed to international tensions rather than to peaceful economic development.

fact that he levied a 10% surcharge on imports from August to December 1971 would indicate that this is no empty threat.

But the danger is that the hard work that the United States has done in the past 40 years to build up freer international trade may all come to naught if the United States starts raising the barriers now. The game of trade barriers is a game that all can play. Each nation can raise barriers against each other nation. The 1930s, when this game was played in dead earnest, demonstrated clearly that it is a game which all players can lose. Indeed, the rising trade barriers of the 1930s were an important cause of World War II.

President Nixon has shown great courage (although in my mind mistaken judgement) in cutting down domestic governmental spending programs which he regards as inflationary. He would make far greater progress in the war against inflation if he would agree to cut down military expenditures which are far more inflationary.

In August 1971 when the United States first took steps to meet the dollar crisis President Nixon acted unilaterally. He apparently did not consult with the other members of the Group of Ten before he announced the end of dollar convertibility into gold. This unilateral action created grave political problems in Japan where it followed so closely another unilateral American decision—the "ping pong" diplomacy leading to the Nixon-Chou talks in Peking last year. Understandably, the Japanese refer to these acts as the "Nixon shock." In 1973, on the other hand, there apparently was prior consultation. United States Treasury Undersecretary Paul Volcker came to Japan in secret to confer with Japanese officials prior to the time of the recent United States action. This is a much better way to conduct international monetary cooperation.

But the American devaluation is still bitter medicine for the Japanese to take. Because it is designed to increase American exports and reduce imports it will, if effective, do the precise opposite for Japan. The Japanese are afraid that their booming economy will be hurt because there will be unemployment in their export industries. A flood of American imports will also take the jobs of people of Japan who are now engaged in the production of these "import substitution" products. Americans would well be advised to remain sensitive to the fact that foreign trade is more important to the Japanese economy than to the American economy. Perhaps, however, Japan should take immediate steps to increase its gross national product in the future, not so much by increasing its exports as by devoting more of its resources to improving the quality of life in Japan. To an outsider at least, greater Japanese governmental expenditures for pollution control and for social services would seem to be highly important.

But the United States must find a better way to solve the American balance of payments problem than to export the problem to Japan. I am convinced that the most effective way that America can do this is to reduce drastically its inflated uneconomic expenditures for military purposes. The world's strongest currencies today are the Japanese yen and the German mark. It is no accident that this is so. Both of these countries were defeated in war and were prevented by the terms of peace from engaging in extensive military operations. How long will it take America to learn from this clear object lesson?

Americans have though that they can have both guns and butter—an almighty military machine and an almighty dallar as well. The events of February 1973 should clearly tell the United States that it can not have both. It must choose.

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全能なるドルの没落：論争的小論

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カール・クライダー

現代経済学は科学性を主張する余り，ややもすると現実問題との関わりが薄くなりがちである。しかし経済学の伝統は，その時代の現実問題を議論するという論争的性格を有するものであった。スミス，マルクス，ケインズは全て上記伝統の流れを汲んでいる。この小論もそのような経済学の伝統の上に立つものである。

私が日本を離れていた16年の間にドルの地位は大きく変った。私が日本を去った1956年当時の国際通貨の最大の問題は「ドル不足」であった。しかしそのドルは，1971〜73年の二度に亘り切下げられた。ドルのこのような国際的地位の変化は何故生じたのか。この問いに答えるのが本論文の目的である。

それには三つの原因が考えられよう。その最も重要と思われるものは，西ヨーロッパと日本経済の戦後における目覚ましい復興である。次に一般通貨の交換性回復を第二の原因として挙げることが出来る。第三の原因と考えられるのは，第二次大戦後1970年末に至る期間の合計200回を超す世界の通貨切下げにより，ドルが相対的に過大評価されるようになったという事である。尤もこれに対しては現時点では先の二つの要因程の実証的裏付けを与えられない。

しかしドルの苦難はアメリカ外部の経済力に原因するのみならず，アメリカ内部での動きにも起因している。つまりアメリカの経常収支の収入が，資本並びに贈与収支での支出を次第に賄い切れなくなったという事である。それについては，(1)海外投資，(2)海外経済援助，(3)海外軍事支出の三項目が注目されよう。このうち(1)，(2)は必ずしも国際収支上の流出を形成するものではなかった。しかし(3)は量的に大であり，しかも先の二項目

とは質的に異なっている。更に軍事支出はアメリカの労働力が破壊目的に使用されている点，及び兵器製造が希少な資源を破壊目的に使っている点でアメリカ国内のインフレ圧力となっている。従ってアメリカの国際収支改善の最も効果的方法は，海外軍事支出を大幅に削減する事である。アメリカは今まで銃とバター，即ち全能の軍事兵器と全能のドルの両方を持ち得ると思ってきた。しかし1973年２月の出来事は，アメリカが今やそのどちらか一方を選択せねばならない事を教えている。