



The Cross of Gold

One hundred eight years ago a dynamic orator from Nebraska, William Jennings Bryan, electrified his party and the nation with a single speech, delivered and polished by endless repetition, and with a single line from that speech. This nation, he declared, is being crucified on a **Cross of Gold**.

He was right then and he would be right today. The times have changed in many ways, and the gold that wracks us is no longer yellow metal. It is now accounting and electronic transaction records and money moving around the world as fast as light. The technology of money and monetary policy has been transformed, but the causes and effects have not changed. The face of modern finance is all new but shortsightedness and greed never change. They are the poison, so to speak, and the details of metals and accounting are only the ice in the glass.

The dollar today is so overvalued that we can not afford our own standard of living.

The American people are ambitious, hard working, ingenious, and blessed with an abundance of all the tools of economic success. They are probably the most productive population in the world. Yet we can't afford our own standard of living. Others pay for it and we borrow it. We are able to pull this off because our money is so overvalued. We want automobiles and Japanese industrialists want dollars. It is a match made in heaven. We want to drive around in our cars, and Arabian royalty want dollars. It's pure Fred Astaire and Ginger Rogers. Why stop dancing now?

The cost of the overvalued dollar is not hard to discern if we look. Every year thousands of farm families give up, and thousands of farm acres are taken out of production. Every year we import more of the goods that we use, and produce less of them. Every year our leading companies in the computer and software fields scale back technical work in America and expand technical and engineering facilities in Asia. The actual anti-missile missiles on which so many hopes rest are not made in America. We buy them from Japan. The most essential and advanced part of the space station, a masterpiece of modern technology, was made in Russia. In any case, we are no longer able to travel to it unless the Russian space authority condescends to send us, so it would perhaps become wiser to just forget the whole thing.

In the measure that our dollar is overvalued, our work and our achievements are depreciated. No one wants us to produce anything. Whatever we produce for ourselves is just that much less that we would buy from them. Gads! Perish the thought.

The Smoke and Mirrors of Productivity

Productivity, creativity, energy, dedication: all of these are real and the American people have never been lacking in them. Despite the glossy federal statistics of recent years, we are not becoming more productive. The text becomes necessarily a little dry and technical at this point, because it is important to understand how the statistics are misleading us. I will take two salient examples.

- A. The first example is computers. I am indebted to other analysts for this example. There are various alternative ways of estimating how powerful a computer or a computer chip is, but the most common measure is how many calculations it can do in a second or a minute. Large gains in raw speed have continued, but the limitations of this measure have become increasingly evident to everyone, including the chip makers. Thanks to today's more complex software, it takes a lot more calculations to produce a given end result, and in fact there has not been a breakthrough in how fast computers produce usable results. Even Intel Corporation, recognizing this fact, has changed its design philosophy, away from counting calculations.

The Federal statisticians have not caught up. They still count the calculations as results, and they count faster calculations as more computing power. By their standards, since the dollar price of chips has stayed roughly constant even while they do far more calculations each second, the cost of computing has fallen by orders of magnitude. The cost of getting results by computer, by contrast, has fallen, but rather modestly in the last six or eight years. Higher speed is being interpreted as greater productivity, but it is not. Amazingly, because of the size of the computer business and also because of the enormous gains in pure speed in recent years, this error alone accounts for nearly all of the recorded gains in American productivity.

- B. The second example is imports of goods. Most readers will recall the conventional wisdom from when they studied macroeconomics that imports – other things being equal – reduce gross national product. That is not always true, even though it is true in America today. Our dependence on imports is undermining our capacity to produce and to compete. However, the narrow point here is not about how imports actually affect GNP. It is about how imports affect and distort the way we measure GNP.

Suppose Wal-Mart buys a shirt in China for \$5 and resells it in Chicago for \$35. I will use Wal-Mart in this example, but not because they are doing anything wrong. When

we measure GNP, we don't question the equality of price and value. Thus, Wal-Mart has delivered \$35 of value to some lucky Chicagoan. Now, GNP is a record of value created, so we need to ask how much value has Wal-Mart created. They did not create the shirt itself. They purchased it for \$5. That value was created in China. On the other hand, Wal-Mart must be credited with creating the other \$30 of value. Economic value does not grow on trees. Some economic agent has to create it. Since there is no one else to take the credit, it falls into the account of Wal-Mart.

So if the ambitious Chinese tailors, ever eager to expand their market and make more profits, increase production and slash their price to \$3 per shirt, Wal-Mart's product rises from \$30 to \$32 (= \$35 - \$3). Actually, they might be more inclined to pass the reduction along - lowering their price from \$35 to \$33 - because then they would sell more units. With each added shirt they sell, they create another \$30 of economic value. To sum up, the more Wal-Mart imports, the more productive they are. The problem with this statement is of course that Productivity is supposed to have something to do with Capacity to accomplish valuable tasks. Wal-Mart has not expanded its capabilities simply by becoming more dependent on Chinese textiles.

The strong dollar creates the illusion of productivity even while it undermines the reality of it. We can no longer afford a space program, but we have the most productive retailers in the world. Perhaps we are not really more productive than other people. Perhaps we're just overpaid.

What is the Better Course of Action?

We have to start to compete. We have to devalue our dollar and revalue the work and the achievements of our people and our businesses.

It was reported a few days ago that American business has amassed more the \$550 billion in cash. Not for capital investment. Investment has never rebounded in this so-called recovery. There is simply not much that corporate management wants to do more of. Management is betting its capital on money market funds rather than on the productive capacity of the business, because those businesses are on balance not very productive. Few if any enterprises can be productive in competition with an endless supply of cheap imports. Few enterprises are compelling investments in competition with expanding overseas ventures. Capital spending in America as a whole has fared well, because that counts investment in new homes, but investment in new factories and new products has lagged to the tune of \$500 billion.

We have no rational choice except to lower the dollar. The alternative is to build such a mountain of debt to others that our standard of living will collapse of its own weight. We have seen post-industrial society, and it is Argentina.

Tactics

It is not as easy to depreciate the dollar as it might seem, because it goes against the desires and financial interests of the rest of the world. They like to accumulate overvalued dollars. Most of the major currencies of the world are convertible, which means that they are bought and sold by the public. It is not technically hard for the dollar to depreciate relative to these currencies. All that is needed is for traders and commercial parties to sell dollars to buy the other currencies. China and her currency – the yuan – constitute a more difficult problem because the yuan is not convertible. There is no market in which yuan are bought and sold. On a small scale, foreign tourists in China can purchase yuan from any local bank, but the total dollar value is small, and very little of it ever leaves China. Any business which needs to acquire yuan for its operations in China has to buy them directly from the Chinese government, at a rate of exchange that China dictates. On the surface it seems impossible for us to have any impact on the conversion rate between dollars and yuan.

At the same time we can not simply ignore the yuan, because of the size of China and her importance in world trade and investment flows. Many nations might be willing to accept a lower dollar, even though it would hurt their exports to us, but none of them can tolerate a lower yuan. They are having a hard enough time competing with China already, and they can not allow their currencies to rise in relation to the yuan. Thus in practice we can not lower the dollar unless we depreciate it relative to the yuan. We have to raise the yuan.

There is only one way to attack this problem, and it is the most direct way: our Federal Reserve Board simply needs to buy yuan at a price above the conversion rate posted by the Bank of China. The Chinese government buys and sells yuan for about eight cents per yuan. If the Fed posts a bid of, say, eleven cents per yuan, everyone in the world who has yuan will want to sell them to the Fed. Initially there will be only a trickle coming in because the Bank of China maintains very strict exchange controls. They really don't want Any yuan to leave the country. We have to make our bid generous enough to break through this resistance. Toward that end it would probably be wise to start with a much more lucrative bid: say one dollar per yuan. If we make it profitable enough, the yuan will beat a path to our door. How does this happen? Wal-Mart stores approach the Bank of China to buy \$10 million worth of yuan – about 120 million yuan – in order to purchase goods for export to America. Immediately thereafter however their chief buyer suffers some unspecified but debilitating injury and the goods are not bought. But a few days later, as if by coincidence, about 120 million yuan are presented to the Federal Reserve open market window in New York and purchased for \$120 million, no questions asked. Wal-Mart management confidently expects their Asia buyer to make a swift and complete recovery, for which he mostly needs complete rest in some bewitching tropical location.

There is no need for us to go alone. We have many partners and allies in the world, which would be willing to allow the dollar to depreciate as long as the yuan does

not follow it down. Every one of them therefore has an incentive to extend the same generous bid for yuan.

One mistake that we want at all costs to avoid is to try to supplement our actions by applying direct currency controls. Greed, left alone, will achieve what we want. Any sort of regulatory interference will only create competing objectives which can be manipulated to block the program from accomplishing its simple purpose, and an overpaid and intrusive bureaucracy to do just that. As important as it is for us to lower the dollar, it is not worth destroying the entire world banking system to do it. It is very hard for the Chinese government to stop the greedy from exploiting their position. If they refuse to sell yuan to Wal-Mart, Wal-Mart must of necessity stop buying from them, but that is the worst thing that can happen. As long as Wal-Mart does not completely burn its bridges in China, as long as they buy enough goods to keep the door open, the Bank of China is stuck. The reality is that the yuan is too cheap, and it is always good to have reality playing for your team.

Will such a program work? Yes. Will it work fast? Probably not. Nothing that will eventually work will work fast. It is too bad that the overvaluation of the dollar has been allowed, by our Federal Reserve, to become a crisis, because there is no crisis response that will work. We can not get the result we need quickly. But we can start working toward it immediately.

The Politics of the Dollar

The overvalued dollar finds a lot of supporters in Washington. Preserving it amounts to selling the country. As long as the American people do not protest the loss of their economic future, the political benefits are immense. The competitors that we are selling the nation to are willing to pay very well for it, and we are spending the proceeds on all sorts of ventures. The invasion and attempted conquest of Iraq is absorbing a large portion of the proceeds. Currying favor with the Chinese government is also expensive. Appeasing Third World nations by taking in and educating their ambitious youth is also expensive. Some of these actions are moreover good in themselves. There is nothing wrong with maintaining cordial relations with the Chinese nation. There is certainly nothing wrong with attracting eager young men and women from Africa to study here. But we are paying too much – much too much – to please the world and we are offsetting the cost by selling our future to them on the cheap.

Everyone knows, at least in general terms, how our trade deficit is. The deficit reported for this past June was in the neighborhood of \$55 billion. That is for only one month. It amounts to an annualized rate of \$660 billion per year, which is about 6% of our entire national product. Washington – this is a truly bipartisan problem – never sniffed an import order that they didn't like, because imports tie exporters to us. To take one salient example, it is obvious that the Japanese auto makers are completely dependent on our purchases of cars. If we would stop buying, they would be wiped out very quickly. They, on the other hand, control the political agenda in Japan completely. Growing

imports of Japanese cars therefore are the lever by which our government controls the Japanese government.

This story is repeated all over the globe, from Japan to China, and on to the Persian Gulf, Europe, and Africa. When our president travels to their capitals, he brings with him valuable favors: trade concessions, new research and engineering facilities to be established by our leading technology companies, and places at our universities. All that he asks in return is that they vote with us at the United Nations or buy more of our mounting federal debt, or some equivalent benefit. These however are not necessarily benefits for the American people, and in any case they are definitely not benefits worth the cost. They are things that advance the political goals of the administration, at the expense of the American people.

Summing Up

The dollar is strong because we are selling our future in order to borrow and spend today. Everyone wants to sell things to us; everyone wants to lend to us. The strong dollar preserves the illusion that we can afford it. If we could indeed afford our standard of living, we would be running surpluses in our trade account rather than massive deficits. If we could afford it, we would be lending to and investing judiciously in the rest of the world, but in reality we borrow on a scale never before imagined – much less achieved – in the history of the world.

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