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# A high ebb will lead to a low flow

By Daniel Aronoff

**F**rom Mr Daniel J. Aronoff.

Sir, Martin Wolf makes a persuasive argument that the trade imbalance between the US and Asia may be more influenced by policies of Asian governments than by the low US savings rate: "The US is not profligate by choice. The world has thrust profligacy upon it" ("Asia's game with America is a long way from ending", August 11). He is doubtlessly correct that the artificial damping of Asian exchange rates caused by the massive build up of US assets in Asian portfolios is furthering multiple objectives of Asian governments as well as reflecting disparities in regional savings rates, but I'm not sure his pessimism, that in the end the US "will drown in liabilities", is fully warranted.

As Asian governments pursue massive purchases of US Treasuries they are, by definition, attempting to push their price above market equilibrium that is the mirror image of damping their exchange rates relative to the dollar. Thus they are buying "high". When they eventually sell their assets the process will reverse itself as sales of dollar assets will push up the relative value of Asian currencies, and they will be selling "low". This exchange involves a massive transfer of wealth from Asia to the US.

We cannot know how the short-term dynamics will work themselves out when the dollar asset build-up reverses itself, except that it will, other things equal, involve an appreciation of Asian currencies relative to the dollar.

One motivation that led Adam Smith to publish *The Wealth of Nations* was to demonstrate the fallacy of the mercantilist belief that a nation became wealthier as it accumulated reserves of gold. Smith's argument remains valid and it applies to nations that accumulate foreign assets; I think he would be more supportive of contemporary US policy than that of Asia.

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