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Federal Swap Program, Creating Jobs, and Trade Equilibrium¹

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Key Words

Federal Swap Program, Trade Equilibrium, Trade Deficit, Jobs, Dollar Surplus Countries, Imports from Countries looking for American Exports, and Outsourcing within the U.S.

On August 10, 2010, the U.S. Fed reopened the “dollar swap” program to help alleviate financial pressure growing out of Europe’s fiscal crisis. Let me explain how it works; as I reemphasize the critical value of “Trade Equilibrium” in creating jobs.

Federal Swap Program

The Federal swap program involves two transactions. At initiation, a foreign central bank buys dollars from the U.S. Fed and sells its own currency to the latter at the prevailing market exchange rate. The foreign central bank, in turn, lends these dollars to institutions in its jurisdiction. The short term transaction between the two central banks is reversed on a predetermined future date. The foreign central bank buys back its currency from the U.S. Fed and sells dollars to the latter at the same exchange rate that was used in the first transaction. The former also pays interest to the latter for its use of dollars.

The foreign central bank bears the risks involved in sub-lending dollars in its jurisdiction. The U.S. Fed does not face exchange risk because of the pre-determined exchange rate. (Source: The Federal Reserve Bank of New York)

While the swap program may help some foreign countries get some respite from dollar-shortage, it has no direct effect on creating jobs in the U.S. If the recipient uses it to payoff a U.S. exporter, it would be good for the U.S. economy and the jobs. However, if it is used to payoff another country, such as Japan, which in turn may use it to buy U.S. treasuries, it would not help the U. S. job market.

Trade Equilibrium, a Pre-requisite to Creating Jobs

As I continue to stress the fact that the U.S. trade deficit of billions of dollars is the primary culprit behind it losing millions of job—which in turn decreases income, demand, investment, and tax revenues. Budget deficits balloon as the public programs get axed.

¹ While in many ways this article on “Trade Equilibrium” is similar to my other articles on the same topic already published on the university website, it is also different in some other important ways (contents, presentation, reasoning, etc.).

The state of “Trade Equilibrium” is the principal cure for our economic ills. The billions of dollars of new capital—pouring in from foreign countries, not from printing presses—would generate incremental investments, jobs, income, demand, and profits. It would increase tax revenues, reduce national debt, and, yes, decrease personal and business taxes. The ensuing “dollar appreciation” will reduce our cost of imports.

There is a fundamental difference between the President Obama’s goal to double our exports in five years and the theory of Trade Equilibrium I am suggesting. Emphasis on “increasing exports” only encourages businesses to set individual goals to do so. Emphasis on “Trade Equilibrium” (which includes export promotion) makes it a national challenge.

In the mean time, the U.S. should begin switching its business with China (and other dollar surplus nations) to other countries. The new trading partners should be those who are able to supply products the U.S. wants to buy—as they also need the products which America can export to them. Clearly, it will take years to make such shifts. But the U.S. must adopt this strategy right away. The sooner it implements it, the quicker China (and other dollar surplus countries) will begin buying more American products. The U.S. should also encourage its business firms to outsource the help they need to the lower cost areas in the U.S. itself such as Alabama, Mississippi, Tennessee, etc.