placed in a "no win" situation where no amount of simple jiggling with interest rates or money supply can save the dollar. The apparent paradox is that short-term interest rates have soared while the U.S. money supply grows at double-digit annual rates, creating simultaneously an excess and shortage of liquidity!

The paradox is explained by John Maynard Keynes' so-called "liquidity preference" formula: in periods of extreme crisis of confidence, investors prefer to hold their funds in cash or shorter-term instruments rather than in illiquid assets. This has tended to accelerate money supply growth, causing the Federal Reserve to raise short-term interest rates in a futile effort to cool the inflationary expansion. At the same time, long-term rates have actually tended to decline or flatten as industrial corporations became increasingly reluctant to invest in new plant and equipment. This "flattening of the yield curve" — as short-term and long-term rates move closer together — tends to accelerate the flight of capital out of long-term bonds into short-term instruments.

Thus, Fed chief Arthur Burns' dilemma: if he continues to allow the money supply to expand, he will provoke an inflationary explosion; if he hikes up short-term rates even more, long-term rates will shoot up as well, destroying the U.S. industrial recovery. According to a spokesman for British brokerage house Arnhold S. Bleichroeder, the further jacking up of short-term rates in the U.S. would so destabilize the long-term U.S. securities market that OPEC investors would be forced to flee from the dollar into the pound sterling — even despite the fragility of the British gilt "bubble"!

The British and New York-based Lazard Frères could then emerge hegemonic in a global Keynesian paradise of government-sponsored "public employment" boondoggles financed through massive issues of short-term "Mefo bills"... while productive industry is cartelized and rationalized out of existence.

Incredibly enough, conservative commercial bankers in the U.S., relying on mechanistic economics of "Brazilian miracle worker" Milton Friedman, believe that the dollar can still be stabilized by simply raising short-term rates. One Mellon family-linked banker told West German businessmen in Frankfurt last week that the U.S. banks' prime rate will be hiked to 8.5 percent and this will "save the dollar." What better recipe for knocking the props out of U.S. industry! Similarly, St. Louis Federal Reserve Vice-President Denis Karnowsky, in a recent interview, clung to the hope that investors will not desert long-term instruments as short-term rates rise.

Canadian Dollar — Another Casualty

Meanwhile, the Canadian dollar, which is closely tied to the U.S. currency for obvious reasons, has been swept along in the U.S. dollar's collapse. The Canadian dollar fell to a new eight-year low of $.9195 on Oct. 6, after the Canadian Financer Minister "pulled a Blumenthal", in the words of a Citibank foreign exchange trader. The Canadian central bank, whose foreign currency reserves are at an all-time low, will not intervene in support of the currency, while Finance Minister Jean Chretien announced he did not mind the decline in the exchange rate since this would give a boost to exports!

Also on Oct. 6, the Bank of England decided to intervene only minimally in support of the dollar, in an attempt to cool — without breaking altogether — the inflationary inflow of foreign capital into the London gilts market. Previously, the Bank of England had been buying up huge amounts of dollars for its reserves, forcing it to print up pounds and creating an inflationary surge in British money supply. As a result, British foreign currency reserves hit a record $17.2 billion in September. By allowing the pound to float upwards against the dollar to the $1.76 level, the BOE hopes to avoid — at least temporarily — printing up more pounds.

A British-influenced West German journalist summed up the British currency strategy this way: "The pound can't move higher. It'll be stable but no stronger. With the oil money flowing, with the shocks the dollar is going to receive, the pound will be stable."

Some West German investors, however are threatening to call London's bluff by pointing out that there is no real substance beneath the gilt market fluff. Helmut Geiger, the head of the West German savings bank association, visited London last week and warned publicly that the British inflation rate is still too high. Although German banks have been placing their surplus liquidity into gilts up till now, Geiger said, they may decide to discontinue this practice in the future.

— Alice Roth

British, U.S. Banks Scramble For OPEC Funds

After plans to restructure the world banking system at the Washington International Monetary Fund meeting went under at the end of September, the first week of October witnessed international financial brawl for control over what all observers see as impending monetary holocaust.

The City of London has announced in every financial outlet at its disposal the most significant result of the IMF fiasco: the $1 trillion-plus structure of international dollar debt, starting with Peru, Turkey, and a host of other Third World countries, is headed for default. As the excerpts below from leading journals indicate, the British have decided that the U.S. commercial banks will be bankrupted, and that rather than mourning their failed IMF attempts at a dollar-sterling axis, London should make hay while the dollar slides.

"No safety net could save the dollar," said the top British bank Schröder's in London yesterday. "What's happening to it is what happened to sterling long ago. There's any number of ways to destroy the dollar. If the Arabs stop dollar purchases, here we are...You know what I'd really like to see? I'd like to see the big U.S. banks collapse. That would be great. They're far too powerful."

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The British plan, plainly, is to become the bankers of the OPEC millions as the U.S. commercial banks fold, allowing the Arabs to pull out the overwhelming majority of their $100 billion-odd invested oil dollars now in U.S. commercial banks and short-term U.S. Treasury bills. While the British realize that any such shock to the dollar will easily drag down the geriatric pound sterling with it, they don't care, and say so. The question is not which currency the Arabs will go into; they will go into all currencies as vehicles. The question is *which institutions will control* the Arab funds when the U.S. commercial giants fold? The British are determined that they, with their "close personal ties to the Middle East," will gather up the petrocurrency and broker it to U.S. and other corporations and governments around the world in "private placements." The British will then have political control — and the commission fees.

Two other viewpoints emerge however. First is the attitude of the dogged if shortsighted U.S. commercial banks themselves: We're bigger than all the investment banks in the world, and *we* will broker the private placements. With their tunnel vision, however, the men at Chase and other commercial banks naturally cannot deal with the overiding fact that the very existence of their institutions is threatened without a proper support policy for the U.S. dollar and U.S. exports.

The giant U.S. investment banks are not out of the picture, either. With their capital resources dwarfing the British "merchant" bankers, and their more extensive inside contact with the U.S. corporations and municipalities which will be floating the notes the Arabs will want to buy, London's Wall Street cousins, Jewish and otherwise, will be in there kicking for the spoils.

The $40 Billion Noose

The following article by Ronald Nevans, excerpted below, appeared in the Sept. 15 issue of Financial World.

..."If the OPEC surplus continues for some time—as it will— then it's logical that the U.S., as the world's major oil importer, should bear the financial burden," claims Christopher Johnson, economic adviser to Lloyds Bank. "We in Europe have been asking the U.S. to grow rapidly. And in fact your economy has been increasing at the rate of 5 percent per annum—as fast as the Japanese and faster than the Germans. You just can't have growth of that magnitude without big oil imports. So I'm not concerned about the falling dollar."...

"The United States is now at the point that the United Kingdom was after World War I," continues the English economist over his Reform Club lunch. "The U.S. has begun its chronic balance of payments deficits—its long downhill slide." A farfetched comparison? Not entirely. "U.S. productivity is not increasing as fast as some others' — partly as a result of the switch in the U.S. economy from an industrial to a service base. The same switch we made earlier in Britain.

"But also: The pace of U.S. technological innovation has slowed, and the Americans are losing out to Germany and Japan. And besides that, energy costs have slowed productivity increases.

"The United States used to have 52 percent of the world's output in the postwar years. It now has 45 percent. That figure will drop to 33 percent within the next quarter century. The period of American dominance—say, 1958 to 1965—as good for the world. It's the best period we've ever had for economic growth—largely because of enlightened, liberal U.S. policies, which allowed imports increasingly in while exporting capital. But now that period is over. The United States will have slower economic growth in the future and perhaps a recession in 1978. The recovery at least has already peaked."...

"The long-term trend is not longer upward, as it has been since 1945," agrees the head of the international department at another Swiss bank. "We're faced with zero growth, sideways or slightly downward economic trends. Our recessions are no longer just a pause in the boom, but a permanent feature. So it would be normal to have a recession in 1978-79." The reasons? "We have reached a point of worldwide market saturation. The auto boom has to peter out because we have enough cars now. In construction, we have too much capacity. With a condition of population stability, we have solved the housing shortage. So the prospects for construction are for two-thirds of half of the former scale. And even consumer products, which have led the current recovery, are slowing down. Everyone has a television now. We don't need any more"...

"My colleagues at Oxford and Cambridge scoff at me," claims T.M. Rybczynski, economic advisor to the London-based Lazard Brothers and Co. Ltd. "But I believe the world has now entered the downward phase of the Kondratieff wave." The reference is to the theory propounded in the 1920's by the Russian economist, Nikolai Kondratieff, who held that the Western world had experienced two-and-a-half long waves, or upward and downward price fluctuations, since the end of the 18th century.

Among other changes, Rybczynski expects that, during the next quarter of a century, the economies of the West will grow at a slower pace than in the "Golden Era" following World War II; that inflation will continue at a relatively high rate, that unemployment will be at historically high levels; that rates of exchange will continue to fluctuate; and that the pattern of world payments will have been fundamentally altered by the fact that the OPEC countries will have emerged as the prime lenders to the world.

Underlying Rybczynski's thesis is the estimate that in recent years the amount of capital needed to produce an additional unit of output has been rising, partly because of the increased energy costs and partly because of a rise in the cost of other raw materials. Yet the need for additional capital comes at a time when various contractionary influences are at work: a reduction in savings due to increased consumer consumption; an increased demand by labor for a bigger share of national income; and an increase in debt by developing countries.

So it all comes a complete circle: the higher cost of oil produces bigger deficits, both in the U.S. trade accounts and in those of developing countries; and these deficits in turn contribute to inflation, unemployment and lower rates of growth. One wonders if the U.S. Congress knew what it was doing when it turned down the President's request for a standby gasoline tax.

"Growing protectionism, expecially on the part of the U.S., is a very grave danger," continues the London banker over lunch at the Reform Club. "There's also the danger that many countries, including Spain, Italy and Greece, are having to borrow to meet interest payments. Over the next 25 years things will be more difficult, with greater tensions between the U.S., Europe and Japan. We'll face increasing crises as pieces of the fabric give way—as countries default on their debt, and so forth. The commercial lenders—especially the U.S. banks—have already lent to the limit and are beginning to pull back. But the IMF can't handle the problem—it lacks both the mechanism and the money."...

The Economist, Oct. 1: Talking America Into A Recession

The determination of both labour and business to change the administration's economic policy is making it hard for President Carter to keep his professed intentions. So is a spectacular trade deficit.

....business opinion remains determinedly unimpressed by Mr Carter; it has become almost sulky since Mr Lance resigned. Mr Blumenthal, although exchief executive of the Benedix Corporation, is not nearly so well regarded as the former Georgia banker. He is thought to be a maverick and some of the business leaders who met Mr Carter intend to make their telephone calls to Vice-president Mondale now that Mr Lance has gone....

For want of a more rational explanation, it seems that... the country is set on talking itself into a recession...

The United States is more dependent than most industrial countries on exports of agriculture and high technology for its foreign exchange earnings and both are in trouble. Big crops abroad have cut demand, and prices, for its agricultural exports. And the investment slump, especially in Canada and western Europe, has made it difficult to sell sophisticated machinery and equipment overseas....

The administration still seems to reject unequivocally the drastic alternatives of an induced recession and an across-the-board import surcharge to narrow the trade deficit, but there is much talk of more limited measures to "trim it around the edges."...

It is conceded that such curbs will not make much of a dent without a robust effort to reduce oil imports, but the political will to do this is still lacking.

'The Money Is Coming Our Way'

An official from Robert Fleming Ltd., one of the largest British merchant banks dealing in Arab Funds, had these comments:

Q: As the major British merchant bank placing Arab funds in international markets, do you think that the fall of the dollar means a shift in Arab funds away from commercial bank deposits to investment banks?
A: Yes, there has been a fantastic rise, from mothing to $1-2 billion this year, in Arab funds taking up private placements of U.S. and other corporate bonds, commercial paper, and general IOUs. Of course that is still small in relation to OPEC's total $40 billion annual investible surplus funds, but the rise is remarkable.

Q: If the commercial banks are hit by a confidence crisis, who will get the bulk of the Arab business?
A: Well, its clear that the investment banks are the ones with the connections, the ones the corporations already deal with for this, they can't trust the commerical banks to be impartial, because commercial banks always want to do their own financing...and the British naturally are the ones with the close personal ties and personality fit in the Middle East, so we expect a healthy chunk...

Q: What about the U.S. investment banks?
A: Well, they do have the U.S. corporate connections...Salomon Bros., Goldman Sachs do huge Arab deals for commercial paper of U.S. companies, it's true...but I think the British banks have a good historical record.

'The Arabs Have Been With Us For Years'

The following is excerpted from a conversation with a director of Chase Manhattan Bank's Mideast Advisory Service.

Q: Does the fall of the dollar mean a shift of Arab funds out of commercial bank deposits?
A: I don't foresee more than a gradual shift of new funds — this is nonsense about the commercial banks being in trouble. Of course there are private placements being done, but we do plenty of those... the Arabs have known us for years, they listen to us first.

Q: But isn't it clear that the investment banks like Lazard Frères, which sponsored the *Village Voice* attack on David Rockefeller recently, are attacking the commercial banks' new attempts at investment banking activities like private placements?
A: Let them, it's immaterial. Look, Chase Manhattan Ltd. is leading the syndication of Eurocurrency loans this year in London; the Arabs will never trust the really big money to any investment bank. N.M. Rothschilds? It doesn't exist any more. If you're the manager of an Arab central bank, shifting dozens of millions of dollars around the world each day, you're never going to trust all those funds to an investment bank with a measly $50 million capital. They'll stay with the commercial banks, we have the banking power, the placing power, the liquidity....