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Times, Schroder's Geoffrey Bell reports a huge increase in the volume of funds under London merchant bank management. After 1974, Bell reported, the merchant banks introduced Reserve Asset Management Plans to handle surplus funds of OPEC central institutions, U.S. and European multinational corporations, and, later, the commercial banks themselves. The London merchant banks and some of the U.S. investment groups like Brown Bros. Harriman and Merril Lynch were best-placed to manage the flood of free liquidity, Bell explained. (Privately, Hambros Ltd. estimate the volume of funds under such management at about $5 billion a year.)

How can Britain, whose industrial output remains at 1970 levels despite the paper-recovery of its foreign exchange reserves and financial markets, expect to compete with the huge U.S. capital market, backed by the strongest economy in the world? London's argument is that since there are now as many dollars abroad as in the U.S. money supply, the dollar is out of control of the U.S. monetary authorities. For this reason, says *International Currency Review*, a London bi-monthly, "a really catastrophic run on the dollar" is entirely possible. A commentator in last week's *Money Manager* adds, "The control of the American money market now lies in the free forces of the City of London, and not the U.S. monetary authorities."

Truth About the Consequences

Even a very small diversion of petrodollar flows into the United States on capital account would have devastating consequences for the dollar. Since 1974, at least half of the OPEC surplus has flown back to the United States, and half of this has gone into nongovernmental long-term private investment. This is the conclusion of one internationally-oriented New York investment bank. Overall, according to this estimate, the net rise of foreign assets in the U.S. reported in the capital account of balance of payments has risen, on average, by 35 billion per annum, or by about the same amount as the OPEC surplus. Foreign private investment has been roughly half of this:

Non-government investment in U.S. private sector

Year	Amount
1974	$27 billion
1975	$ 5 billion
1976	$16 billion
1977	$ 8 billion*

*projection of first half

Source: U.S. Dept. of Commerce

The fluctuations in private-sector investment tend to correspond to compensating changes in foreign official investments, bringing the annual total to an average $35 billion.

This includes both direct OPEC investments and petrodollars recycled through mainly continental European banks and central banks, according to the cited Wall Street analysis. Only this year, with the $12 billion net inflow into London, has the City gotten a piece of the action. Any disruption of these flows would devastate the dollar.

The British are currently making their play in the Mideast. Granted, the Arab stake in U.S. stability in the U.S. is commensurately great. But if the Administration continues to tolerate dollar-dumper Michael Blumenthal, and publicly advertise its intention to unseat dollar-defender Arthur Burns, the dollar will go out of control in the very short run.

—*David Goldman*

A New Stage In The Dollar Fight

FOREIGN EXCHANGE

The unusual public message from the White House to the Federal Reserve on Oct. 20, warning further substantial increases in short-term interest rates could damage the progress of the U.S. "recovery," marked a new state in the fight over U.S. monetary policy and the fate of the dollar. While industry-oriented regional Federal Reserve presidents, certain U.S. business leaders, and European and Japanese central bankers have been lobbying for a strong dollar policy against inflation, the "toilet paper dollar" faction has regrouped for a new assault against the U.S. currency.

Echoing the views of the Democratic Party majority of the Joint Economic Committee of Congress, the White House statement took the Federal Reserve to task for unwarranted concern over the rapid growth of the U.S. money supply. In its efforts to curb money supply growth, the statement argued, the Fed has pushed up short-term interest rates about 2 percent since last spring, endangering the mortgage markets and the whole economy.

The White House statement coincided with renewed discussion over whether current Federal Reserve chairman Arthur Burns will be retained by President Carter when his present term expires next Jan. 31. One well-placed source indicated Oct. 21 that the man British-oriented, U.S. Fabian circles have in mind for the post is Bruce McLaury, the former president of the Federal Reserve Bank of Minneapolis. McLaury is also a member of David Rockefeller's Trilateral Commission and president of the Brookings Institution. In addition to McLaury's ideological qualifications, there are technical reasons in his favor. With the Atlantic seaboard already fully represented on the Board of Governors, any new appointee must come from one of the other Fed districts.

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From Across the Atlantic

Viewing these developments from the other side of the Atlantic, the conservative French financial daily *Les Echos* reported disconsolately Oct. 20 that Federal Reserve Chairman Burns is being undermined in his efforts to maintain a strong dollar by the congressional Joint Economic Committee's Democratic majority. "The man who is known abroad as the best defender of the U.S. dollar thus finds himself accused in his own country of being a recession maker."

The counter moves launched by some business leaders and the regional Fed presidents, combined with pressure from the European and Japanese central banks, showed up in the sudden shift by Treasury Secretary Michael Blumenthal Oct. 19 in favor of a strong dollar. Blumenthal, who has been the chief mover behind the toilet paper dollar, told a meeting of the American Bankers Association in Houston that "a strong and stable dollar is essential both to the U.S. and the world at large."

However, Blumenthal added that the Fed would only intervene in the markets to support the dollar if "disorderly conditions" develop, a remark which was interpreted by the *Wall Street Journal* and other financial commentators as further confirmation that Blumenthal's Treasury is not distressed about the dollar's current slide. Blumenthal's statement temporarily halted the collapse of the dollar, nevertheless.

The pressure to contain the U.S. money supply growth and defend the dollar was discussed at the Oct. 18 meeting of the Federal Reserve's top policy making body, the Federal Reserve Open Market Committee. Although the minutes of the committee's monthly meeting won't be released for 30 days, insiders in the U.S. banking system were expecting the regional Fed presidents and their allies on the Fed Board of Governors to come to the meeting with their knives out against the advocates of inflation.

The committee is the arm of the Fed that conducts its day-to-day money market transactions and is supposed to control money supply growth and interest rates. In the past weeks, it has come under increasing attack from conservative industrial interests in regions like Pittsburgh, Texas, and the Midwest for allowing the U.S. money supply to expand at the fastest rate of the postwar period except for 1972 — the inflationary prelude to the 1974-75 recession — fueling fears of inflation and the collapse of the dollar on the foreign exchanges.

According to one banking source, the regional Fed presidents until now have been cowed by the staffers at the Washington Fed who are close to the Fabian Brookings Institution. These Brookings protégés have told the Fed presidents month after month that the giant bulges in the nation's basic money supply — like the near-record $4.9 billion jump several weeks ago — were just "one-time anomalies."

Now the Fed presidents have had enough, the source said; they want the Fed to put a stop to the accelerating money supply growth by exerting direct control over the growth of banking reserves and the monetary base, the way the West German and Swiss central banks manage their affairs.

By itself this cure is almost as bad as the inflation disease. The effect of simply putting the brakes on money supply growth and clamping down indiscriminately on the availability of credit to all borrowers would plunge U.S. industry into a new recession.

But some of the same industry-oriented bankers in the regions who want to control inflation because it is aborting capital formation are considering the two-tier credit approach proposed by the U.S. Labor Party. The two-tier plan would keep credit to productive industry and agriculture cheap while drying up credit for speculative activities — including the British-inspired wave of speculation against the U.S. dollar — via punitively high interest rates.

In an interview Oct. 18, a former Fed official conceded that "the two-tier potential of the Fed is an option under consideration — but only in a situation when an emergency is at hand, where you can see the whites of its eyes."

Blumenthal to Be Bounced?

Although Blumenthal appeared to be on the side of the dollar today, even telling the Houston meeting that although the U.S. has been running a large trade deficit a further depreciation of the dollar is not in order, the pressure from regional industrial interests is still on full blast.

Last week the *London Economist's* weekly financial report leaked that President Carter is under pressure to bounce Blumenthal from the Treasury post in favor of someone like Bank of America's Tom Clausen, who is more palatable to the business forces here that want to see the dollar strengthened.

The most solid opposition to Blumenthal's strategy of "talking the dollar down" and forcing the West Germans and Japanese to upvalue their currencies and reflate their economies is coming from the European central banks and the Bank of Japan. Concerted European central bank intervention to stem further appreciation of their currencies was evident all last wesk. Speaking before the Machinery Producers Association in Stuttgart on Oct. 21, West German central bank governor Otto Emminger spoke out against the continuing appreciation of the mark against the dollar, specifying "unadjusted imbalances" in the cost of financing trade between the U.S. and West Germany. Emminger said that the Bundesbank is working to smooth out fluctuations in the foreign exchange markets.

At the beginning of last week, as the yen continued to appreciate — at one point on Oct. 18 to an historic rate of 251.55 yen to the dollar, the Bank of Japan intervened heavily to stop the appreciation of the yen.

The Japanese central bank would like to work in coordination with the European central banks to relieve the upward pressure on their currencies, pressure that is destroying the competitiveness of their exports. According to reports in the *Journal of Commerce* last week, Japanese commercial bankers are hoping that the U.S. Treasury will shift away from its policy of benign neglect toward the dollar in response to the mounting criticism in Washington — a recognition of the domestic factional debate over the dollar.