The power struggle on the Euromarkets

by David Goldman

Following Volcker's squeeze on American interest rates, which have pushed the base level for Federal Funds above 16 percent and pushed the six-month Eurodollar rate to 15.75 percent, the Eurodollar markets will not exist in their present form much past the next several weeks. The Eurobond sector—the only long-term portion of the market—is already dead, with virtually no issue volume in all sectors. *EIR*, in a survey last December, warned that the freezing of Iranian assets by the United States, combined with the first installment of Volcker's credit crunch, would end the present functions of the Eurodollar market.

Now the knives are out.

The major monetary powers are now grappling for control over what will follow the Eurodollar market, which ballooned to trillion-dollar proportions in the wake of America's 1971 departure from the gold exchange standard and of the 1974 oil price increase. There are two major contestants:

London, according to a Feb. 19 *Financial Times* survey—echoed in conversations with British bankers—believes that the current inflationary mess in the United States will provoke a run out of currency deposits into hard-commodity, raw material positions, especially into those markets in which London maintains strength through Commonwealth ties. This will ultimately force a revision of the international order, the *Financial Times* says, along the lines proposed by the Brandt Commission (see International Credit). Britain's deployment in the raw materials markets is discussed below.

Secondly, the French—the most active promoters of the new European Monetary System as the core of a gold-backed world monetary system—have made a major offer to the Arab countries, which, if accepted, will make the EMS the ruling force in world monetary affairs. Speaking in Paris Feb. 19, French Prime Minister Raymond Barre proposed that OPEC agree to moderate price increases, in return for the promise of a real rate of return on OPEC assets. Momentarily, Barre will present these proposals to the Saudi leadership in person.

Barre's plan should be read in the light of two reports:

1) *International Currency Review*, a British semimonthly associated with the Sir Keith Joseph wing of the Tory party, claims that Saudi Arabia bought 3,000 tons of gold last year, now valued at $19.4 billion, largely in off-market transactions from the Soviet Union. Although *ICR* is normally a highly unreliable source, with a long history of publishing politically inspired "gray propaganda" concerning the Saudis, there is reason to believe that the report is not wholly false. European gold-market specialists believe the Saudis have accumulated large amounts of gold, citing the thinness of the gold markets (which indicate that some transactions are taking place off market), and the fact that some $20 billion of Saudi reserves are unaccounted for in official reporting.

2) France has made public a plan to institute central bank gold transfers as a step toward remonetization (see *Gold*).

France's decision to begin central bank exchanges of gold at a market-related price is the public feature of a much broader French initiative on monetary reform. There has been considerable trepidation in British and American banking circles over the long-awaited French initiative, promised last December, for thorough-going reform of the world monetary system. President Giscard d'Estaing's preferred plan is, according to *EIR*'s sources at the Elysee Palace, a link between the dollar and yen and the European Monetary System zone of stability, combined with gold-backed credit-issuing facilities through the projected European Monetary Fund.

However, as veteran French diplomat M. Raymond Offroy states in a recent interview, America's bitter resistance to the Giscard initiative prevents its completion at the institutional level at the moment. Two weeks ago, when Barre and West German Economics Minister Otto Von Lambsdorff met, it was decided to postpone "Phase II" of the European Monetary System until after next year's elections in France and West Germany, according to widely circulated public and private accounts of that meeting.

More than a "postponement," France has been compelled to act through other than institutional channels. M. Barre's Feb. 8 address to the Foreign Policy Association, one of three he delivered during a trip to New York City, was a tipoff to the character of French policy. By emphasizing France's continued commitment to detente with the Soviet Union, his opposition to "monetarist" austerity policies, and the usefulness of gold as a central bank reserve, Barre made a discreet offer to the United States. In effect, Barre offered the United States a means of bailing out of the Carter administration's untenable policy stance on foreign military and economic issues. The gold question comes up directly in that various American policymakers, including Rep. Reuss and Sen. Javits, are quietly pushing for the United States to open up some means of employing its 270 million ounces of gold to finance the Treasury's deficits on foreign and domestic account.

In both the New York and European banking communities, the consensus is that Barre met with a flat refusal. As long as the dollar appears stable on the foreign exchange markets, the administration will not make so great a concession to the West Europeans and the French in particular as endorsing this form of gold remonetization. The Treasury's position, in fact, puts the United States in a bind; as Barre told the Foreign Policy Association, it is a bad idea for central banks to sell gold "just for the fun of it," because that gold may be badly needed later. The suspension of Treasury gold sales, however, eliminates a much needed source of revenue and foreign exchange.

The critical factor, in any case, is that the French are proceeding to institutionalize central bank gold transfers. The United States, ironically, is the only nation with both enough gold and a pressing enough deficit to really benefit from this set-up, with a couple of minor exceptions. The most important feature of the French move is political: it sets the conditions for the more significant use of gold as a backing for low-interest credit, by opening the way for a stabilized gold price.

Typically, the City of London is trying to use Washington's weakness to its own advantage. The principal effect of this British orientation was the rise in the price of copper to above $1.40 last week, largely due to major institution buying on the London metals exchange. A circle of British financiers who look to Bank of England advisor Sir George Boulton as their principal source of guidance believe that the current troubles in the Rhodesian elections have created conditions where copper prices may break their old 1975 record—about the current price level—and rise above $2.00 a pound. In addition, the same circle expects the silver price to rise from the current level of $37 to $50 an ounce. The primary spokesman for this policy in the press are *London Times* editor William Rees-Mogg and *Financial Times* columnist Samuel Brittan, who believe that gold remonetization would be the prelude to a more generalized raw materials standard, a theme re-stated by Brittan in a Feb. 14 analysis for the *Financial Times.*

This approach to raw materials speculation implies a cynical view about the dollar's near-term health. Certainly, if the continuing deterioration of the American bond market and 19 percent wholesale price inflation rate cause trouble for the dollar, copper and silver prices will rise. However this is only a British flanking maneuver with respect to Western Europe's move towards gold remonetization. The British—as Sir George Boulton wrote in an Oct. 1978 memorandum for the Bank of England—hope that their control of important raw materials channels will somehow counterbalance a Western European system with 400 million ounces of combined gold reserves at its disposal.

London's ability to play raw materials markets is, in the very short run, impressive. Britain ran a $600 million balance of trade deficit during January almost entirely because London bought five times as much silver as usual, during the height of the run-up in silver prices! But London is in no position to do more than inconvenience continental Europe on basic world monetary questions. The real issue is the United States' response or lack of it, to reality.