Foreign Exchange by David Goldman

There *is* a danger of exchange controls

The U.S. decision to go with 'benign neglect' has magnified the danger of currency blocs and exchange controls.

Financial analysts continue to deny furiously that the United States would ever impose exchange controls.

However, when the U.S. Treasury, under orders from Undersecretary Beryl Sprinkel, halted U.S. intervention on foreign exchange markets earlier this year, it set into motion a dangerous financial crisis that may, indeed, force putting exchange controls into effect.

On June 21, the president of the European Community's Council, Gaston Thorn, told U.S. State Department officials Lawrence Eagleburger and William Clark in Europe that the EC is now moving to tighten up the European Monetary System in order "to keep pace with the dollar zone." In recent months, partly owing to fears of political instability after the Socialist electoral victory in France, many tens of billions of dollars in European currencies have been dumped on international markets. Since Sprinkel's announcement that the U.S. Federal Reserve would not intervene in behalf of exchange rate stability, European governments have been forced to heavily draw down their dollar reserves.

Germany's 1981 current account deficit, it is now estimated, will hit 70 billion marks, about $5 billion higher than projected.

Leading German financial officials report that even if U.S. interest rates drop, which would partly stem capital flight from Europe, German rates will remain high for many months in hopes of attracting foreign investment.

Recently, when senior German finance ministry officials went to Saudi Arabia in hopes of raising $10 billion in loans, the Saudis told them they are limiting purchases of German securities this year to $3 billion.

"It is no secret," the commercial daily *Handelsblatt* noted, "that German bankers have been returning from Riyadh with empty pockets." This month, for the first time since the war, the government withdrew a national railway issue from the bond market.

It was during Thorn's meeting with Eagleburger and Clark that the most serious threat to date was issued by Europe that it may have no choice but to cement a European currency bloc against the dollar.

Thorn informed the U.S. representatives that at the Ottawa summit meeting this July, "The European Community would speak with one voice for lower interest rates." He then appealed to Great Britain that it use the occasion of this crisis to join the European Monetary System, which Britain has boycotted since the EMS founding in 1979. "How is it that we, in the name of the European Community, can expect to keep pace with the dollar zone, when we have not completed" the EMS, he asked.

At its founding, the EMS was never intended to act as a vehicle of counterwarfare against the dollar. Since the French election, however, a completely different political chain of command has taken over. The EMS is now being run by the stringent monetarists at European Community headquarters in Brussels and the Swiss-based Bank for International Settlements (BIS).

In a series of international conferences recently, the EC-BIS command reported it aims to use the EMS to coordinate heavy-handed budget-cutting European-wide. As Thorn told his U.S. visitors this week, "Europe should get its own house in order" in return for a U.S. promise to lower interest rates.

Why does this add up to a looming danger of exchange controls? Because, as the recent behavior of the U.S. Federal Reserve underlines, there is a large faction of U.S. monetarists with no intention of lowering U.S. interest rates if they have their way.

Despite last week's dip in the commercial bank prime rate to 19.5 percent, Fed chief Paul Volcker lifted the cost of federal funds—the rate on funds banks trade between themselves—to 22 percent.

Volcker has done this despite several indications that the money supply is getting under control and that the economy is sagging. A huge dollar slush fund in high interest paper is currently moving between the offshore Euromarket and New York, and the billions in "smart" European money behind the currency dumping are making huge gains from Volcker's commitment to stick with high rates.

In comments at a recent Paris OECD meeting, Italian Finance Minister Andreatta asserted the United States has declared "currency warfare" against Europe.