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Gold Option To Defend The Dollar ?

Authoritative Swiss government sources report that the Swiss National Bank's Pierre Longuetin, who conducted meetings with U.S. monetary officials in Washington this week, proposed that the United States employ its gold reserves to defend the dollar. According to the Swiss sources, "there is a configuration inside the Administration which is considering such things," although "nothing has materialized yet."

Although there are no indications at deadline that the "configuration" which wants to deploy American gold in the dollar's defense will have its own way in final policy-making, the fact of such discussions is a useful measure of the depth of the present monetary crisis. The Swiss evaluate the Longuetin mission to the United States as "a complete failure." In particular, the Europeans are incensed over the Treasury's blunt rejection of Swiss and West German proposals for additional central bank swap lines to finance currency intervention, as well as the Treasury's refusal of a Saudi offer to make foreign-currency swaps available to the U.S. "I have no confidence in anything in the United States at this point," commented the chairman of a leading Swiss bank.

Apart from Pierre Longuetin, another senior European official — West German Foreign Ministry Undersecretary Karl von Dohnanyi — visited Washington last week to sound Washington's stance towards the dollar. Apparently European governments and the financial sector had built up sufficient cynicism concerning the Carter Administration in the course of the week such that the market failed to react to press statements by the President Thursday March 2 indicating that the United States would take no special measures in support of the dollar.

In a grim assessment, the editors of Switzerland's leading newspaper *Neue Zuercher Zeitung* wrote yesterday: "Washington does not know what it is doing or why it is doing it. That is not in America's long-term self-interest. America's capacity for leadership has been gravely damaged. The fall of the dollar undermines the foundation of the world edifice. Strong finances and a strong currency are the basis of national sovereignty."

At deadline, the dollar continued to hold the line against the mark at above 2.01 and against the Swiss franc at above 1.85, or approximately the rates of last Friday, Feb. 24. The only surprising element of the situation is that the dollar has not fallen further. Vaguely, traders fear that governments might come in substantially with some tough measures, and are wary of taking positions. Shorts had their fingers burned badly after the Feb. 24 announcement of an agreement to settle the coal strike, coincident with the announcement of Swiss exchange controls.

Other Options Fading Fast

However, the options of governments have been narrowed down, over the past week, to the Swiss gold proposal, which would act as an impressive show of strength of the cooperating governments and central banks. Other options have faded. On Wednesday March 1, when the dollar fell below DM 2 for the first time ever, central banks intervened with almost $2 billion combined, including $500 million in Frankfurt, $1 billion in Zürich, and $300 million in Tokyo. The dollar's fall continued through what European traders characterized as "desperate and violent intervention" without affecting the price. Most of the slight recovery of the dollar from the lowest levels occurred as a result of profit-taking. As the most outspoken Congressional opponent of support for the dollar, Rep. Henry Reuss (D.-Wisc.) told a Chicago audience Feb. 28, $20 billion of central bank swap lines cannot stand up to a $600 billion private Eurodollar market. The central banks are outgunned. The only hope of overriding this lack of firepower is to use gold in central bank reserve operations, which would place a huge amount of best-quality liquidity in the hands of the central banks rather than the ragtag and bobtail of the private markets.

The second option, the subject of continuous rumors on the wire services throughout the week, is the imposition of exchange controls in West Germany and possibly other members of the joint float (see *Economics*). Although short-term foreign exchange movements have been attributed to expectations that the Bundesbank will impose controls, smart money believes that talk of controls is largely bluff. The Swiss have imposed controls which include extension of the 40 percent negative interest rate to all alien deposits, including those of central banks, and a blanket prohibition of purchases of Swiss securities by foreigners. Among the immediate side-effects was the worst-ever fall in the Swiss stock market last week. The West German stock and bond markets fell sharply early in the week on the mere threat of exchange controls, and the likelihood that the West German credit system could sustain controls for more than a few weeks is small. West German bankers believe that the leading internal European credit systems are likely to suffer more than the international credit markets under the present crisis.

The Gold Option

The gold option is therefore under serious discussion for the first time in years, although there are different proposals with varying and even opposing content in

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circulation. Most significant was the statement of Deutsche Bank's chairman emeritus Hermann Abs most respected man in West German banking. In an interview with *Die Welt-am-Sonntag* Feb. 18. Abs said, "No new monetary arrangement which might be created will work unless it contains a role for gold." Abs insisted that he was not talking about the classical gold standard, but about a major gold reserve role, "to rid ourselves of our fatal dependency on the dollar." West German bankers insist that Abs, who has never been a gold advocate in the past, reflects a growing opinion trend.

Federal Reserve officials note that gold is now a virtually constant subject of discussion at the Bank for International Settlements at Basle, and serious consideration of gold has reached the level of multinational corporate treasurers. However, the Oval Office is still dominated by the opinions of Blumenthal, Mondale, Schlesinger, and Schultze, the "gang of four," and there is no indication whatsoever that the White House will go along with any of the Western European suggestions. European estimates and the views of prodollar men in the Administration concur.

The form of Western European proposals, as stated in public in December by Swiss National Bank president Leutwiler (in his well-circulated "benign neglect" statement), involves a U.S. transfer of gold market prices to the European central banks, in return for foreign exchange for intervention purposes. However, the political content of the proposal goes beyond mere foreign currency intervention. Mobilization of gold reserves by political agreement among central banks, even for "Maginot Line" foreign exchange intervention purposes, rewrites the axioms of the foreign exchange market. Not only does it express a far higher level of political determination to defend the dollar among central banks, but it implies the use of a mass of presently frozen liquidity under strict central bank control.

In its current newsletter, the Washington Forum, a subsidiary of Drexel Burnham Lambert, argues that reported European suggestions that the United States raise funds on the international capital markets through foreign-currency denomination bonds are actually a means of pressuring the United States to employ gold, given that no one expects the U.S. to act on such proposals on face value. Virtually all sources concur that the Treasury has no intention of issuing foreign-currency bonds, which in any case would give investors who currently hold dollar-denomination U.S. Treasury securities an incentive to switch out, and yield no benefit whatsoever. Whether or not the Europeans have such a ploy in mind is not certain, but the European monetary authorities are keenly aware that currency juggling will not much help in the situation, whereas gold will.

The Europeans also have the option of unilaterally repegging the joint-float currencies to gold and issuing gold-backed central banks credits. That would have the double effect of insuring a zone of monetary stability in Europe (and probably Japan through a link-up), and removing much of the pressure from the dollar on the foreign exchange markets. Investors are now switching out of dollars, even though the currency is wildly undervalued by any standard and affords the best investment bargains in the world, because the entire commercial world is disinvesting to an increasing extent from dollar balances. Corporations and banks that hold dollars as working reserves cannot afford to maintain short-term dollar balances, despite the obvious long-term advantages of investment in an undervalued currency. Most of the current pressure against the dollar is due to this specific form of diversification. If central banks provide an alternative form of gold-backed liquidity, some of the pressure will be relieved.

Whether the Europeans attempt such a maneuver, bolder than anything they have done since World War II, is an open question, although it might be their only means of averting the economic depression that virtually all serious financial forecasters expect for 1978. There is one further consideration that operates in a special way in West Germany. Since the Europeans permitted their reserves to rise out of proportion to their needs to accommodate the American deficit, the standard Brookings Institution or Atlantic Council maxim has been that Europe will make any monetary concession to the United States demanded because of their military-strategic dependency. However, NSC Chairman Brzezinski's public sabotage of the SALT negotiations (through the "link" to the Horn of Africa charade), and the ferocious Warsaw Pact response to Brzezinski's attitude, have shaken the West Germans profoundly. If American cabinet members can get away with actions that jeopardize, rather than enhance, West German security, through London-inspired scenarios, the unwritten pact linking monetary and security questions works in reverse.

A final element in the situation is the Arab view of the dollar. The British financial press gave great play to the proposal of the Emir of Kuwait for an emergency OPEC meeting to consider whether OPEC should continue to price oil in dollars. Arab sources in the United States report that the new Emir is following British financial guidance, and that Kuwait is leading Arab moves to break with the dollar. The London *Financial Times* headlined its lead story on Thursday, "Warning from oil producers renews pressure on the dollar."

These reports are manifestly inaccurate. According to U.S. government sources, the meeting last week of Gulf country central bankers was the first that entirely avoided discussion of a break with the dollar, which generally takes the form of proposals for a "Gulf dinar." Saudi attendance at the meeting, also unusual, reportedly had a dampening effect on Kuwaiti and other plans to unload the U.S. currency. In the Paris daily *Les Echos* of March 2, the Saudi finance minister stated emphatically that Saudi Arabia will not abandon the dollar, no matter how low it falls.

However, the prospect of a small increase in the OPEC oil price at the emergency OPEC meeting the Kuwaitis have called is not to be excluded. Some Saudi sources believe that the Saudi government will, if necessary, yield to pressure for a price increase in order to head off the greater evil of a change in oil pricing from the dollar to a currency basket or SDR arrangement.

OECD's Proposed Solution

Last week's meeting
Cooperation and Development in Paris witnessed the

most exotic attempt to lure the world into accepting London policy aims thus far. Since the public confrontation last month between West Germany and the United States over American reflation demands, British Chancellor of the Exchequer Denis Healey two weeks ago — and just now the British-dominated OECD staff — abandoned the old Brookings Institution "three-engine" theory of U.S., BRD, and Japanese reflation. Instead they propose reflation by all the countries that can, as soon as possible. The official acronym for the proposal summarizes its content.

The OECD unveiled a plan for money-printing under the formal title, *Coordinated Reflation Action Program*, or CRAP. According to the London Financial Times, CRAP is designed to "ease the blockage" in the industrial economies and "spread the load" of reflation. In a coprophagic fit, British Chancellor of the Exchequer Denis Healey told the meeting that the advanced sector should use CRAP for "collective stimulation," according to wire-service accounts. Otherwise, Healey threatened, "political and economic strains" would spread "from the Mediterranean fringe of Europe" to "the European heartland."

There is no mistake — the above was said in public and reprinted in the public press — the British have told the world precisely what their odorous plans are. CRAP would mean world hyperinflation, and a monetary situation dominated by uncontrollable runs from one currency to another, with London acting as arbiter.

—David Goldman

Brzezinski Pushes Linkage To Wreck SALT

Aided and abetted by such City of London spokesman as Winston Churchill III and Henry Kissinger, a faction within the Carter Administration led by National Security Advisor Zbigniew Brzezinski has been acting over the past week to manufacture anticommunist hysteria over the Horn of Africa crisis with the intent of making negotiation of a new Strategic Arms Limitation Treaty impossible.

At an "emergency press conference" in Washington Feb. 24, Brzezinski alleged, contrary to State Department reports, that 11,000 Cuban troops led by a three-star Soviet Red Army general are now fighting in the Horn. Since then, he has been locked in a highly-visible battle with saner Administration forces grouped around Secretary of State Cyrus Vance and has publicly acted to force the U.S. to make a SALT II accord contingent upon Soviet withdrawal of support from Ethiopia—contrary to current Administration policy. Such a "linkage" policy, borrowed directly from Brzezinski's predecessor, Henry Kissinger, will not only not succeed in its immediate goal, but will threaten to bring the U.S. to the brink of thermonuclear war.

Stymied thus far in his campaign to force the Administration into adopting a Horn-SALT linkage as official policy, Brzezinski has been nevertheless successful in bamboozling President Carter into going along with a slightly-modified version of this tactic, even though no real support for Brzezinski's linkage line exists in the Congress.

A highly ambiguous statement of linkage first emerged in a response issued by the Carter Administration Feb. 25 to a speech given by Soviet leader Leonid Brezhnev the day before warning that "some in the United States would like to retard" the SALT negotiations. The Administration statement, while making no direct connection between the success of the SALT talks and the Horn, pointedly cautioned that the future of U.S.-Soviet relations "depends upon constructive efforts to help resolve local conflicts, such as the Horn of Africa," adding that Soviet "intervention in this area... inevitably widens and intensifies hostilities and raises the general level of tension in the world."

Although ostensibly published by the State Department, this news service has since learned that the document was in fact written by Brzezinski's National Security Council (NSC) staff, which then pressured the White House into laundering it through State. While spokesmen for the NSC and a whole range of British-

Two Policies On SALT

The main media are reflecting the faction fight in the Administration. Compare how the New York Times *and the* Washington Post *covered Brzezinski's March 1 statements on the relationship between the Horn of Africa and SALT:*

New York Times, *"Brzezinski Sees Ethiopia Issue Slowing Arms Talks," March 2:*

Zbigniew Brzezinski, the President's national security advisor, said today that Soviet military involvement on the Ethiopian side in the war against Somalia could complicate efforts to achieve a new strategic-arms accord. But he said the United States was not formally linking progress in the talks to Soviet actions in the African conflict.

Washington Post, *"U.S. Links Salt to Horn of Africa," March 2:*

The White House for the first time yesterday directly tied the fate of the strategic nuclear arms negotiations with the Soviet Union to the concerted administration concern with Soviet and Cuban military presence in the Horn of Africa....It was the first time the administration explicitly has pointed to a potential rebound against Salt, the core issue in U.S.-Soviet détente. It was also the first time the Carter Administration has so explicitly invoked American political linkage between disparate issues on the U.S.-Soviet scene.