against the spiralling downturn by constricting the overheated U.S. economy to a "stable base." Incompetently rejecting proposals by the U.S. Labor Party and others for immediate economic revival based on expansion sharply confined to basic industry and other productive areas, they hope instead that restraints and cutbacks will take the heat out of inflation while positioning the economy for long-term stable expansion at some future date. What they are proposing would in fact place a depressed United States economy up for grabs at bargain basement prices by London financiers.

This view was explicitly propounded by Federal Reserve Board member Henry C. Wallich in a Feb. 9 speech at Utah State University titled "Moving in for a Soft Landing." Wallich claimed that "the time has come to get ready for a soft landing out of rapid expansion to a stable base of long term growth...we must get ready to decelerate over the next two years or so."

Winter weather aside, most economists correctly identify the major stumbling block confronting the economy as the enormous debt overhang afflicting all major sectors, federal, state, and local governments, the corporate sector, and consumers. Most, also correctly, rule out the Milton Friedman economic butcher treatment of a tight monetary policy by the Federal Reserve. Says Dimitri Balatsos, Vice President of the Economics Department of Manufacturers Hanover Trust in New York: "If the Federal Reserve were to turn actively restrictive out of fear that continuing massive federal deficits and rapid monetary growth will rekindle strong inflationary pressures, a credit crunch and another recession become sure bets.

Debt Rollover Obsession

But what Mr. Balatsos and many of his fellow economists really fear — above all else — is that tighter monetary policy will prevent the huge amounts of debt from being refinanced, i.e., rolled over. The problem of rolling over the debt is compounded by the huge financing requirements of the Treasury Department this year to deal with a federal deficit, including federally sponsored agencies of from $102 billion to as much as $130 billion.

The solution to this problem, these economists have incompetently proposed, is for the Fed to keep short-term interest rates in the present 6.5 percent to 7 percent range, but to insure that the liquidity created goes into debt rollovers and not for production or consumption. In addition, this solution calls for some form of wage and price controls, either in the form of incentives for companies that keep wage and prices increases below a specified level (the Brookings Institution plan), or by imposing penalties for companies which don't (the Henry Wallich plan).

Some economists are so frantic over the debt problem that they openly advocate sale of the United States to foreign buyers, to obtain added funds. The following scenario was spelled out by a leading economist at a major New York bank. "Foreigners will continue to invest heavily in Treasury securities, as they did last year, as will states and municipalities, which will have a surplus of funds this year." This surplus will result from massive austerity cuts imposed by local governments under the unspoken threat of getting the Felix Rohatyn-New York City treatment. According to the scenario, everything would be fine as long as foreign funds and municipal surpluses found their way into Treasury securities. "The problems will occur if they decide to spend their money on goods and services, like bridges and hospitals. This will cause runaway inflation." These foolish economists believe that low interest rates and a depressed economy will allow the country to roll over its huge debt, one more time.

—Joe Stein

Exchange Control Rumors Weaken Internal Euro Capital Markets

Rumors that West Germany, and possibly Japan, will soon impose exchange controls to meet the continuing downward slide of the dollar widely circulated on foreign exchange markets this week, following the Feb. 24 imposition of controls in Switzerland.

FOREIGN EXCHANGE

Although the Swiss Central Bank put the controls into effect in the hope of catalyzing a commitment on the part of the Carter Administration to publicly support the dollar, by mid-week it became clear that maintaining the controls for any period of time, or extending the controls to other countries, will only serve to feed international monetary chaos. The Swiss controls failed to make a dent in the downward drop of the dollar to below the psychological "cut-off" point of two deutschemarks on March 1. On Feb. 28, rumors of controls being imposed in West Germany provoked a panicked withdrawal of foreign funds from the West German stock market by seven points on the Commerzbank index, despite the fact that the deutschemark rose that day against the depreciating dollar. The Swiss market fell also, by 5-10 percent with banking stocks most affected.

These "tremors" on European domestic capital markets merely serve

"technical" adjustments of capital flows, no matter how drastic, will have no impact on holding back the anti-dollar "bear raid" being run out of the City of London. Nothing short of introducing gold as a stabilizing factor behind the dollar — as proposed Feb. 27 by leading West German banker Hermann Abs — will succeed in driving a wedge between London's banks and the larger pool of panicked corporate and dollar-holding speculators, and

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restoring confidence in the dollar.

On Feb. 28, the West German Central Bank was also forced to support the domestic bond market with 150 million deutschemarks in funds. Until this week, deutschemark bonds — both domestic and foreign — benefited strongly from the weakness in the dollar sector, and were selling off at par or above, despite historically low interest rates.

New York securities traders confirmed that the decline in domestic European capital markets was due to the rumors that further exchange controls are down the road. Bleichroeder's investment house insisted that the West Germans will be able to hold out without controls for a maximum of another two weeks. After that point, if controls are imposed for any period of time, the spokesman added, the West German government would soon face problems in financing its capital needs, projected at 60 billion deutschemarks this year.

Severest Measures in Peacetime

Swiss Central Bank chairman Leutwiller issued a public statement on Feb. 27 characterizing the measures as "the most severe undertaken in peacetime." Only firm action by the U.S. Administration could solve the dollar crisis, and if such action is not forthcoming, Switzerland may be forced to introduce a "two-tier foreign exchange system."

In an effort to avoid this step, Leutwiller sent Mr. Longuitine, a chief spokesman of the Central Bank, on a special mission to Washington to plead for U.S. action with numerous officials.

The present Swiss controls blanketly prohibit any purchasing of Swiss franc securities by foreigners, and impose a negative 40 percent interest rate on foreign bank deposits. Local banking business in Switzerland will be hit by this with a reduction in interest-bearing and generating funds.

A well-informed regional banking official in West Germany went so far as to insist that extension of further controls in Europe would "destroy Frankfurt and Luxembourg as banking centers." Although Luxembourg would presumably be exempt from controls directed against domestic West German bond purchases, Luxembourg's banks are strongly dependent on free exchanges of deposits with their home banks.

London banks are fully aware that stop-gap and technical measures will have no effect on their drive to pull down the U.S. economy and force a worldwide reduction in general levels of output. Confirming numerous private comments by London investment bankers, *Investors Chronicle* insists on Feb. 17 that it isn't really clear why the deutschemark is strong. "It could be argued...that Germany's good luck owes a great deal to the absence of the hawk-eyed scrutiny by foreigners that has claimed the dollar as its victim in the last six months." In London's view, dollar instability will undermine the West German economy sufficiently to justify a run on the mark.

* * *

Investors Chronicle, *"Time for a run on the Deutschemark," Feb. 17:*

Though nearing its thirtieth birthday, West Germany has not lost its *Wirtschaftswunderkind* qualities. The economic whizz-kid of Europe has lived through the recent stormy years more peacefully than anyone else (except the next-door Alpine gnomes). At any rate this is the verdict the exchange markets have delivered. It could be argued, however, that Germany's good luck owes a great deal to the absence of the hawk-eyed scrutiny by foreigners that has claimed the dollar as its victim in the last six months.

While all sorts of money and capital markets have been acutely conscious of each and every twitch in the U.S. monetary aggregates, a kind of "practical monetarism" (i.e., selective and arbitrary) has characterised the general attitude towards Germany and its money supply.

The main reason for this is the sheer size and weight of the U.S. economy and the publicity that surrounds it. Another point in Germany's favour is that it was one of the first western countries to gird itself with money supply targets. Reputations die hard (viz Dr. Burns's halo despite the fact that the Fed under him was not really as restrictive as seemed to be the case) and Germany has had the extra boon of falling inflation (last year's 3.5 percent was the lowest annual rate since 1970). No matter that Germany has consistently exceeded its monetary targets and that productivity increases have not matched the excesses....

The German unwillingness to reflate the economy substantially is all the more understandable given that the Germans are naturally more familiar with their own economic statistics than foreigners are. So while foreign confidence in Germany is still boundless, the Germans know only too well that their broadly defined money supply (M_3) rose at an annual rate of 15.4 percent in the second half of 1977 while the roughly comparable measure for the U.S. (M_2) showed an annual rate of increase of only 9 percent in the same period. The higher rate of growth of the German money supply is partly the result of the dollar's weakness and the Bundesbank's efforts to halt the rise of the deutschemark. But liquidity is very high in Germany anyway; the banks free liquid reserves (assets readily convertible into central bank money) stood at nearly DM14 billion at the end of December....

The present calm on the foreign exchanges, according to London dealers (and ignoring local trouble spots like France and Italy), will only last as long as the markets do not realise that there has been little fundamental change in the dollar's position. But a run on the dollar makes life complicated for Germany and it is only a question of time before the markets shift their attention to the deutschemark. If the disparity between U.S. and German money supply growth rates persists, a time must come when confidence in Germany's ability to handle inflation will wane. A *limited* run on the deutschemark, for a change, would help everyone. Intervention by the Bundesbank would bring the domestic money supply to heel and dollars would be for once going back to the U.S. reducing "European" money supply. Only, alas, currency runs usually get out of control.