

when major repayments come due for Mexico in the first quarter of 1977, and for Brazil in the second and third quarters of 1977.

In a report issued last week, the World Bank, the sister institution of the International Monetary Fund, argued that the Third World debt situation was not as bad as it might seem, because inflation reduces the relative value of dollar debts with respect to the commodities the Third

World exports. This is the proposed "solution" of World Bank president Robert McNamara, the old Kennedy and Johnson Defense Secretary, a close associate of the proposed Carter cabinet: world hyperinflation. The World Bank did not mention that inflation also raises the cost of Third World imports. But since they are committed to rapid reductions in the world population, they have no reason to consider how the Third World will manage to import food, let alone tractors.

Remarks on Illusions Concerning Feasibility of T-Ruble Convertibility

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Recent policy statements released by the Council for Mutual Economic Assistance's IBEC discredit prevailing presumptions among U.S. banking and related circles, presumptions to the effect that such a potent option did not exist in practice for the CMEA at this time. This upsetting of earlier estimations among U.S. circles might be regarded as consistent with a current tendency to govern the affairs of this nation by a policy of successive strategic miscalculations.

The principal features of the CMEA system which had been adduced to the consoling effect of proving that what has just happened could not occur are the evidences to the effect that the CMEA financial and related operations are permeated with irregularities. These ostensible (sometimes very real) irregularities are cited to show that such problems must be corrected before TR convertibility could become more than an administrative technicality.

This cited sort of critical appraisal of the CMEA has two principal defects, one laughable, the other appropriate for systematic treatment. The howling irony in the rather self-righteous criticisms of the CMEA I have encountered from relevant USA sources is demonstrated by considering how the internal affairs of the principal lower Manhattan financial institutions must appear to an analyst advantaged by the relative objectivity of a Moscow office. The point for systematic criticism is the pervasive fallacy of composition which permeates the U.S. sources to which I allude collectively here.

In general, the conduct of the affairs of CMEA institutions is overall governed primarily by the kind of economic warfare environment in which those institutions operate.

Overall, from its beginnings the Soviet Republic has been dominated in its external and internal relations by its status as a besieged-garrison state. From the outset, Soviet foreign trade and financial operations have been governed predominantly by the view of these operations as governed twofoldly by economic-warfare policies, the economic warfare which has been predominantly consis-

tent since Versailles on the external side and for which situation Soviet financial and trade activities are counter-measures on their side.

The relevant question evoked by the consequent irregularities in Soviet and CMEA practices is not whether these are irregularities arising from economic-warfare circumstances, bureaucratic ineptness, or otherwise, but the ability of the Soviet and CMEA system to maintain the elasticity-in-depth to sustain the disadvantages so incurred.

Second, in analyzing the Soviet and CMEA it is indispensable to emphasize that the very nature of the social-economic system assigns to short-term and intermediate-term developments and fluctuations a much, much lower order of relative importance that is appropriate for analysis of financial and trade operations in the OECD nations. Here, the elasticity-in-depth of the Soviet system becomes dominant. If the net effect after discounting short-term phenomena is to enhance the long-term elasticity or merely to "buy time" for internal development of greater such elasticity, the short-term problems are to be regarded as effectively smoothed-out.

Third, overlapping the two cited points, the essential economic data to be studied are a comparison of the real capital formation rates in the OECD and CMEA countries. Here, the magnitude of real capital formation is of relatively lesser importance than the net rate of new real capital formation (after replacement and maintenance). If the Soviet-CMEA rate is higher than the current rate of the OECD nations, the convertible ruble can operate at a decided advantage to the dollar at the TR-dollar interface.

Provided that the Soviets and CMEA restrict their indebtedness to the dollar and other OECD sources to short- and intermediate-term credits or to payment "in kind" from new production facilities created, provided that the net rate of real capital formation is relatively higher in the Soviet than in the OECD sector, the relative elasticity-in-depth of the TR ruble (under recently proposed terms) as a reserve currency for nested, multi-lateral trade-and-credit agreements is enormous with respect to the dollar.

The type of financier mentality most appropriate to

lower Manhattan is more or less inherently incapable of understanding the implications of those combined points, because he can not accept an economic analysis of the current OECD situation in terms of the methods uniquely appropriate to study of the Soviet-CMEA sector. The Soviet economy as an economy is more or less comparable to the kind of U.S. economy implicit in the proposal for the Third National Bank. That is, the Soviet economy operates on principles directly analogous to a pure industrial capitalism. Monetary processes are of course superimposed as an essential complement to industrial processes, but those monetary institutions and their functions are subordinate to the primary industrial interest — whereas, in the USA, industrial development is subordinate to the primary interests represented by financial institutions.

This difference between the U.S. and Soviet economies, treating them as if both were capitalist economies, is that accumulated monetary instabilities in the Soviet economy can be settled politically by a stroke of the pen. Hence, the strength of TR-linked monetary systems depends not upon the current financial practices but

upon the possibility for establishing a workable, durable monetary system on the basis of the net rate of real capital formation of the Soviet and CMEA economies.

In general the Soviets and CMEA can absorb relatively indefinite amounts of credit, to the extent that the growth in the resulting net rate of real capital formation is greater than the rate of payments so incurred.

In practice, such growth is bounded by the advances in Soviet productive technology and the ability to expand the Soviet industrial labor force. Increased capital formation itself will accelerate Soviet productive technology. The principal internal source for increasing the industrial labor force is agriculture. In general, modern technology applied to Soviet agriculture determines the rate at which the industrial labor force can be expanded.

This could be augmented if the Soviets could realize the objectives of the emergent TR policy: stable agreements which would permit the CMEA sector to plan long-term division-of-labor rationalization of Soviet development with respect to European OECD and key developing nations.

U.S. Dollar Hits 18-Month Low, New Monetary System on Horizon

FOREIGN EXCHANGE

The U.S. dollar fell to an 18-month low against several European currencies this week. Although there are "market" factors operating against the dollar — most notably, the rapid decline in U.S. interest rates caused by depressed business loan demand and Federal Reserve efforts to shore up the liquidity of certain leading New York institutions — the overriding reason for the dollar's weakness is the political convergence of the Soviets and allied OPEC and European business interests around the building of an alternative gold-based monetary system.

On the morning of Dec. 21, a major Soviet international bank dumped some 500 million U.S. dollars on the Zurich foreign exchange market, slashing the dollar's value in Swiss francs by 1 per cent in 15 minutes. The same day, the top East German policy magazine IPW announced that the Soviets were undertaking "the responsibility to reconstruct the world economy." Startled Swiss bankers described the Soviet intervention as a "very well-performed coup." "We would not rule out a conspiracy," stated an executive of the New York Federal Reserve in response to widely circulating rumors that this was a deliberate Soviet signal to hasten the dollar system's demise.

Saudi Arabia, Algeria, Iraq, and Qatar will make mass withdrawal of their short-term deposits on the Eurodollar market during 1977, the Italian newspaper *Il Fiorino* reported on Dec. 23. London banking sources also predicted an "accelerating" Arab pull-out from short-term dollar assets into gold and European equities, according to the Associated Press.

The West German government has so far refused to buckle under to the demands of Jimmy Carter's "transition team" to bolster the dollar via West German reflation. The Bundesbank has moved to tighten domestic credit during December at the same time that the U.S. "Fed Funds" (overnight bank deposit) and bank prime rates have been dropping precipitously, driving interest rate-sensitive capital out of the dollar sector. Although the Bundesbank maintained minimal support operations for the dollar during the past week — amounting to some \$13 million — and New York commercial banks have been "putting out the word" that the Bundesbank will ease credit in January, it is by no means a foregone conclusion that the West Germans will toe the Carter line. Rather than risk further inflation, West Germany could simply "let the dollar go," thereby sacrificing some exports to the U.S., but preparing the way for an independent European monetary policy and expanded trade opportunities with the Comecon and OPEC countries.

Group of Ten — Debacle for Dollar

The most telling sign of an impending European "break away" from the dollar was the pathetic failure of the U.S. government at the Group of 10 meeting in Paris a week and a half ago to raise more than half the \$6 billion required for the "General Agreement to Borrow" bail-out fund. West Germany and the other industrial nations which comprise the G-10 have balked at printing up any more currency for purposes of bailing out U.S. banks' international investments.