pean Monetary System, after years of public acrimony between his government and British Prime Minister Thatcher, is an extraordinary development. Once Europe is pushed to the verge of general insolvency by the actions of the Federal Reserve, the "currency bloc" idea might take a very different form than the Italian and French social democrats have in mind. Rather than a weakling European currency bloc, captive in a world market dominated by dollar-denominated flight capital, the EMS might play some monetary hardball with the Federal Reserve. Suppose the Europeans were to impose exchange controls with real teeth and remonetize gold fully? The EMS could, without much difficulty, provoke a crash of the ultra-overvalued U.S. dollar and a rash of flight capital in the other direction. For the past six months the balance between the European central banks and the Eurodollar flight-capital market has tilted in one direction. Under conditions of duress, the Europeans could pull it right back again.

Leave aside, for a moment. the implications of such a development for the Eurodollar market's ability to refinance half a trillion dollars outstanding of Third World debt. What would the consequences be for the $3.5 trillion United States real-estate bubble, ultimately more vulnerable than the international bubble?

Peculiarities of the American tax system encourage real-estate speculators to leverage as far as possible. Because mortagage or other interest costs are deducted from taxable income, speculators prefer to pay out virtually all current rental income from commercial properties in interest costs, hoping to make up the difference by selling the property at a higher cost later. Capital gains thus received are then taxed at roughly half the 48 percent corporate income-tax rate.

The whole current operation of the real-estate market depends on capital appreciation of properties, i.e. the availability of a "greater fool" down the road. Should such a fool not present himself, the market will crash, as it has before. This occurred most recently in 1975, when the major banks' Real Estate Investment Trusts went under. Another crash would threaten the integrity of the entire banking system.

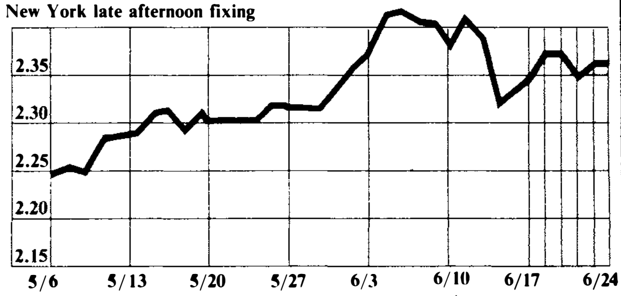
For the past year, Canadian, Swiss, and other well-laundered flight capital, much of it originating in the international narcotics traffic, has played the role of "greater fool." Now the real-estate industry is counting on pension funds to keep the bidding going.

On paper, it is possible to project—as most of the life insurance companies have—that the looting of the world's available savings can keep the speculative bubble going. But the policies which make such financial transfers also threaten the existence of institutions which show surprising resilience when their survival is at stake, and bring to bear political realities which make this type of crisis inherently unmanageable.

Currency Rates

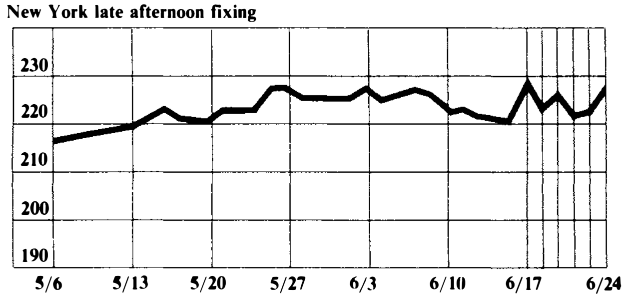
The dollar in deutschemarks

New York late afternoon fixing



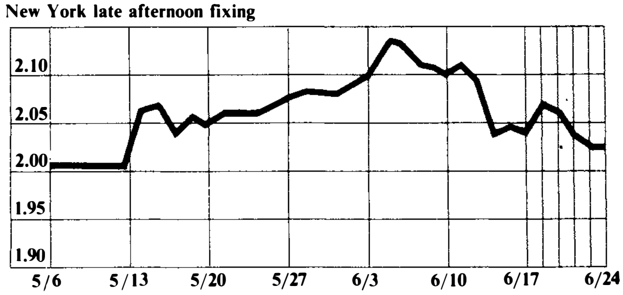
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing