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Mismanaging the World Economy

Upon this planet there are some 150 separate nations, each with its own people, history, political and economic systems, laws, and so forth. The peoples of these individual nations, because of their varied origins and experiences, have different ideals and goals. Yet, none of these nations is completely isolated from all the others. To the contrary, nations increasingly interact as the means of transportation and communication effectively shrink the planet. But how can these different nations interact with each other such that the humans of the world will have the greatest practicable opportunity to reach their individual potential and goals, restricted only insofar as necessary to ensure that the actions of any one or group do not deny this opportunity to others? What economic arrangement is best suited for promoting this end in the international arena?

Two alternative model systems that could be used as the basis for international economic arrangements are the limited-government, free-market system, and the externally planned and managed system. As long-time readers of our publications know, we believe that there is convincing evidence that a limited-government, market-oriented system as contemplated in the U.S. Constitution is best suited to this goal. However, others disagree. Some believe that an economic system (national or international) must be managed and controlled from the top down in order to ensure "economic order."

One group holding the latter view that appears to have immense influence throughout the world is the Trilateral Commission. This commission was founded in 1973, reportedly by David Rockefeller. The Trilateralists claim that their purpose is to "foster closer cooperation" among Western Europe, Japan, and North America. David Rockefeller is chairman of Chase Manhattan Bank, and the membership list of the Trilateral Commission reads like a "Who's Who" of the financial and political elite. The objectives and designs of this commission, especially regarding a "renovated world monetary system," are the focus of this report. Because of the influence of its members, the Trilateralists' stated objectives should not be taken lightly.

Trilateralist Objectives

According to the report, "Towards a Renovated International System," published by the Trilateral Commission, "The management of interdependence has become indispensable for world order in coming years. Its origins lie in the extraordinary expansion of interaction between modern states and societies." The key words are "management" and "states." But why does the international system need to be "managed," and what is the role of "states" to be?

According to the Commission, "Intensive interaction between societies at various levels is essential for economic efficiency and improving the standard of living for individuals. On the other hand, it produces mutual interference across national frontiers which jeopardizes some of its advantages. Thus it requires steering mechanisms." Or, as is asserted elsewhere by the Commission, "These tasks all require extensive cooperation among some or most nations for effective handling. The separate states cannot cope with them." Thus, we see that at the foundation of the Trilateralists' position is their view that increasing interaction among states is necessary for improved economic well-being but carries the seeds of much trouble, trouble that cannot be handled by the leaders of the separate states acting in each state's own self-interest. The Trilateralists have no confidence in the leaders of separate states to cooperate voluntarily as they seek their own goals. No, as we see below, the Trilateralists see their task as orchestrating world relationships.

Who will do the necessary "managing" or "steering"? The Commission concludes that, "Some group of nations will have to take the responsibility for insuring that the international system functions effectively.... Accordingly, it can only be done collectively for some time by members of the trilateral region [Japan, the European Community, and North America] and notably some of its key states." But "key states" do not manage, people do. Which persons? Why of course the elite of the key states – the Trilateralists. They presume to know what is best for the hundreds of separate states and billions of individual persons.

According to the Trilateralists, "the major tasks of a global strategy involve keeping the peace, managing the world economy, satisfying basic human needs, and protecting human rights." Herein our interest is on "managing the world economy," and more specifically on the role that the Trilateralists foresee the IMF (International Monetary Fund) having in that task. However, the four major tasks mentioned above are related. For example, if managing the world economy entails the denial of private property rights or the imposition of confiscatory taxes, it would impact severely on the other tasks.

"Towards a Renovated World Monetary System," another Trilateral Commission report states, "*We believe a serious attempt should be made to lodge responsibility for overseeing and in some cases managing the improvements stated above in an international institution, most logically a revamped International Monetary Fund.*" [Emphasis theirs.]

Various sections of that report reveal that the Commission foresees these "improvements":

"*We believe that a renovated monetary system should impose substantial pressure for timely exchange rate*

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FINANCE

HAVE INTEREST RATES REACHED A PEAK?

Thus far during 1978, interest rates have risen markedly, with a substantial portion of this increase occurring during recent weeks. Some analysts assert that interest rates have reached or shortly will reach a peak and that they will change little or even decrease during coming months. Others claim that the recent rapid increase in interest rates indicates that another "credit crunch" (such as occurred in 1966, 1969, and 1974) is imminent.

We believe that most interest rate forecasts, particularly those involving specific levels, are useless. Forecasts of interest rates usually involve estimates of the demand for and supply of loanable funds among various sectors. However, supply and demand in the money and capital markets cannot be measured except after the fact, and little is understood about the magnitudes by which changes in interest rates affect credit demands or savings. In addition, various institutional factors, about which very little can be stated with assurance, may be involved. For example, the recent linking of the interest rates that are paid on some time (savings) deposits to the yields on 6-month Treasury bills *may* forestall the outflow of time deposits that has occurred in the past when T-bill yields have risen substantially above rates paid on time deposits. Thus, mortgage borrowers *may* find that funds will remain more readily available even as interest rates rise to relatively high levels, but will the mortgage borrowers be willing and able to pay the higher rates?

Some level of higher interest rates eventually must curtail credit demands by some types of borrowers. But how high will the rates have to rise now that there are fewer legal barriers to their remaining in the market? Which sectors will be most affected? By how much at any given level of interest rates? The answers to such questions can only be guesses at this time.

However, those who invest in interest bearing securities presumably act on the basis of their expectations. The consensus of such expectations is revealed by the shape of the yield curve for Treasury securities. A yield curve is a plot of the yields of the securities of a single obligor (in this instance, the U.S. Government) according to the remaining time to maturity. Although there is no reason to believe that these investors are unusually prescient as a group, at least their expectations are recorded only when they "put their money on the line." This effective aid to clear thinking seldom is used by economists.

When credit conditions are relatively "easy," the yield curve has an upward slope. This reflects the higher yields necessary to compensate investors for the greater risk of tying up their funds for longer periods. Furthermore, investors in debt securities will tend to buy shorter maturities and accept the lower rate if they believe that rates are going to rise and, therefore, that they will be able to reinvest their maturing securities at higher yields. As long as the curve is upward sloping, it is not clear if the higher yields at longer maturities are attributable to a risk premium or to the expectation of higher future rates. However, it is clear that a downward sloping yield curve reflects a consensus among investors that interest rates will decline; otherwise, why would anyone accept a smaller yield on, say, a 2-year note than is available on a 182-day bill?

The accompanying chart shows the yield curves at the trough, at the subsequent peak, and at various intervening dates during the three most recent cyclical increases in interest rates and during the current period. Some commentators seem to believe that the recent "flattening" of the yield curve (see the curve for July 1978) is an indication that a peak in interest rates is imminent. This belief is not consistent with the experience of the three preceding credit episodes. Not only did interest rates continue to increase for many months after the yield curve became "flat," but also the eventual peak in short-term rates was substantially higher than when the curve was flat. Although the most recent yield curve is relatively high, it has not as yet become downward sloping. The latter fact suggests that the peak in interest rates during this cycle probably will not occur for some months, and the former fact suggests that new record high rates are distinctly possible during this cycle. Note that during 1961-66, the yield curve flattened at about 4 percent, during 1967-69 at about 5 percent, during 1971-74 at about 6 percent, and during this cycle at about 8 percent. In each of the instances, successive highs were reached at the cyclical peaks. Moreover, even after the curves became downward sloping, yields along the entire range of maturities increased further, which indicates that the first appearance of a downward sloping curve does not mean that a decline in interest rates is imminent.

Another indication that further increases in interest rates are probable is provided by business-cycle data. Cyclical trends of interest rates *lag* those of general business activity. Thus, a prediction that the increasing trend of interest rates soon will end is an implicit assertion that a recession has begun or will begin shortly. With 70 percent of the primary leading indicators appraised as expanding cyclically and all of the primary roughly coincident series expanding, the business conditions historically associated with a downward trend in interest rates simply are not evident at this time. Of course temporary decreases are always possible and quite unpredictable. Our focus here is on cyclical trends.

Whether or not another "credit crunch" will occur during this cycle depends partly on how that term is defined. Presumably such an event would involve overt "tight money" actions by the monetary authorities, that is, they would attempt to reduce the supply of available credit, not simply fail to accommodate completely a surging demand. But such actions cannot be accurately forecast. How the Federal Reserve Board will react to "double digit inflation," changes in the employment situation, threats to their "independence" from politicians, bankruptcies, foreign-exchange developments, or any other circumstance that may arise is not known, even by the Board members themselves. If they do accommodate a surging credit demand, almost surely inflating, too, will surge.

Predictions at this time that interest rates may be at their peaks seem unwarranted. Interest rates probably will increase further during the current cycle, and their eventual peaks may well set new record highs.

MISMANAGING THE WORLD ECONOMY

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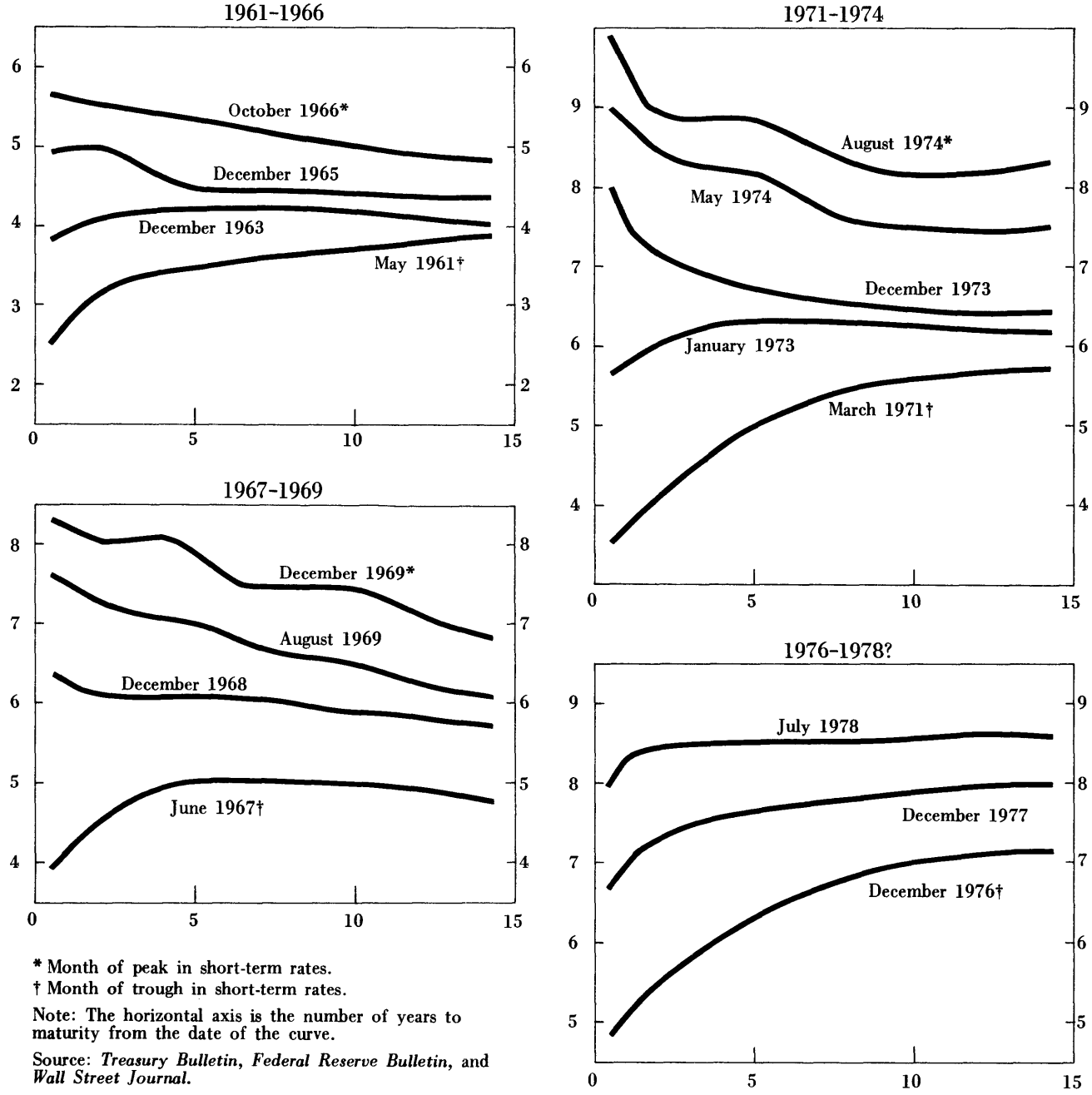
changes, by countries in surplus as well as by countries in deficit."

"We favor a system whereby countries that hold dollar balances can convert them into bancor* in a new International Monetary Fund account, called a substitution account."

* Bancor is the name the Commission would give to a "revamped" SDR (Special Drawing Rights). SDRs are credits to IMF members accounts created by agreement among the members that they would accept such IMF credits in payment of obligations by other members under certain conditions.

APPROXIMATE YIELD CURVES FOR U.S. GOVERNMENT SECURITIES
As of Selected Dates During Four Periods of Cyclical Increases in Interest Rates



* Month of peak in short-term rates.
† Month of trough in short-term rates.

Note: The horizontal axis is the number of years to maturity from the date of the curve.

Source: *Treasury Bulletin, Federal Reserve Bulletin,* and *Wall Street Journal.*

"We believe that the appropriate course of action is for all industrial countries to shift the emphasis in domestic stabilization policy from monetary to fiscal measures." [Emphasis theirs.]

"A renovated system needs to place the new Special Drawing Rights (SDRs) in a position of primacy among reserve assets.

"We also envisage that bancor would become a unit of account in many private international transactions, and that financial instruments might be denominated in bancor."

Having the "responsibility for overseeing and . . . managing" these "improvements," the IMF effectively would manage the international monetary system under this arrangement. But why would individual nations agree to any demands placed on them by the IMF? How could the IMF enforce its monetary decisions? One device would be the revamped SDR, or bancor. According to Fred Hirsch and Michael Doyle, members of the Council on Foreign Relations but not Trilateralists, "The SDR may indeed turn out to play its most important role *not* as a major portion of global reserves, which has been its declared objective . . . but rather as a *distributional* instrument and an associated negative *sanction* (being withheld from transgressors) for international trade and payment obligations." [Emphasis theirs.] Thus, the IMF could impose its policies on others by threatening to withhold reserves from some while giving them to others.

Members of the Trilateral Commission recognize that "it will take several years, at best, to negotiate, formulate

in legal terms, and ratify many of the proposed elements of the renovated system." Therefore, they have outlined five interim measures that should be undertaken: "1. coordination of intervention in exchange markets; 2. consolidation of some outstanding dollar balances; 3. enlargement of short-term lending facilities; 4. commitment to and control of the euro-currency market; 5. definition of a gold policy." Inasmuch as these prescriptions for "improvements" of the world monetary system were made in 1973, we already have 5 years of experience by which to see to what extent the interim measures might have been implemented.

Interim Measures

Charles A. Coombs, a former senior official of the Federal Reserve System, has stated that in 1975, "through informal cooperation, the major central banks had quietly reactivated much of the machinery developed during the sixties to control speculation and otherwise assist an orderly functioning of the exchange markets. . . . In effect, managed rather than free floating of the key exchange rates has now become the order of the day."† Mr. Coombs' remarks confirm what had been apparent: that central banks have been coordinating intervention in foreign exchange markets. Support of the U.S. dollar during the past year also makes that clear. Before the United States intervened in support of the dollar, West Germany, Switzerland, and Japan, the "strong" currency nations, intervened massively. Thus, the first interim measure appears to be in place.

The second measure, consolidation of outstanding dollar balances, has been recommended by officials even if not yet in place. In April, H. Johannes Witteveen, the then managing director of the IMF, proposed that central banks with accumulated surplus dollars be permitted to exchange them at the IMF for newly issued SDRs. This would enable the dollar-surplus central banks to reduce their dollar exposure while maintaining their reserves. In addition, the Witteveen proposal would entitle those central banks to the interest obtained by the IMF from investing the dollars in U.S. Treasury securities so long as those central banks held the SDR balances.

The third interim measure, enlargement of short-term lending facilities, also has been implemented. As we reported in our *Economic Education Bulletin,* "A Monetary Chronology," in 1973 the "extended Fund facility" provided an additional credit of 65 percent of quota; the "oil facility" of 1974 and 1975 added SDR 6.9 billion to the total of credit available through the IMF; the compensatory financing facility was expanded to 75 percent of quota in 1975, and at the same time its joint limit with the buffer stock facility was removed; and a temporary 45 percent widening of credit tranches was implemented in 1976. In 1977 a new supplementary financing facility with about $10 billion available was established. Obviously IMF lending facilities have been expanded.

In 1975, when fear of a collapse of a Eurobank was high, the financial press reported that central banks privately had assured the international banks that the central banks stood ready to help in such an event. Indications were that each central bank would take responsibility for the banks domiciled in its country. The Trilateral Commission had emphasized in its fourth interim measure that "growing uneasiness would be considerably allayed if *the leading central banks jointly declared their readiness to stand squarely behind the euro-currency market in the event of major withdrawals by depositors.*" [Emphasis theirs.] That was done, but the central banks rejected the Trilateralists' idea of "controlling," or managing, the euro-currency market.

The fifth interim measure spells out the Trilateralists' gold policy. It can be summed up in two sentences: "We look eventually to the gradual abandonment of gold as an official monetary medium. . . . *We believe an action consonant with our long-run objectives and at the same time advancing the interim aim of calming markets would be the coordinated and joint sale of official gold into private markets.*" [Emphasis theirs.] Since that declaration, the U.S. Treasury sold about 1,250,000 ounces of gold at two auctions in 1975, and the IMF has sold over 13 million ounces of gold (out of 25 million ounces that it plans to sell) at regular auctions that began in June 1976. Also, on May 23, 1978, the U.S. Treasury began selling 300,000 ounces of gold per month for at least 6 months. Clearly the fifth Trilateralist measure also has been implemented.

By the foregoing we are not implying that the Trilateral Commission as an organization was able to force the adoption of these measures. However, as we pointed out earlier, the influence of its members is so great that the Trilateral Commission's ideas have an "inside track" to the top of the large corporations and of government. Former Trilateralists in high U.S. office include President Carter, Vice-President Mondale, Cyrus Vance, Zbigniew Brzezinski, Harold Brown, Paul Warnke, and Andrew Young, among others. Thus, the controlling members of the Commission need not force the changes desired, they can accomplish their end simply by molding the thinking of top officials by providing the intellectual underpinning for it. The CFR has influenced U.S. foreign policy in this way for many years.

What To Expect?

That the Trilateral Commission has published its designs for a new world order is helpful in that it allows analysts to compare events with these designs and thereby to assess "progress" toward the ultimate tasks. We already have seen the implementation of some interim measures largely as the Trilateralists had indicated. We cannot too forcefully stress our belief based on 40 years of research that these plans for managing world economic arrangements are bound to be counterproductive in terms of the other three major tasks set forth by the Commission – world peace, improved economic well-being, and the protection of human rights. Consider the economic state of the free-world nations now. These are characterized by chronic inflating, repeated currency crises, political turmoil, great uncertainty, rising taxes, diminishing property rights, increasing pressure for trade protectionism, and so forth. All of this was accomplished by a few decades of management of the domestic economies. Think of what can be accomplished by worldwide management!

PRICE OF GOLD

	1977	*1978*	
	Jul. 14	*Jul. 6*	*Jul. 13*
Final fixing in London	$143.85	$182.75	$186.70

† Charles A. Coombs, *The Arena of International Finance,* John Wiley & Sons, New York, 1976, pp. 237-8.

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