

## Eurodollars May Inundate Us

For several decades the U.S. dollar has been the primary international currency in which the great majority of international dealings are transacted. The reason for this pleasant development is found in the ignominious decline of the British pound, which used to be the world's most trusted currency. Before World War I, gold had been the universal money of man around the globe. It was natural money which governments could not manage, create, and depreciate. Because of its "rigidity" and unmanageability, many governments withdrew it from individual cashholdings, hoarded it in central banks and other safe places, e.g. Fort Knox, and issued in its stead easily manageable paper money. Unfortunately, the national paper currencies were generally mismanaged and inflated, which precluded their use in international transactions. For a while the British pound continued to enjoy its old prestige of dependability and redeemability in gold until it, too, fell under suspicion. Before and after World War II the British government inflated and depreciated it, devalued it several times in relation to other currencies, and limited its use through exchange controls until it lost its international appeal. The U.S. dollar thus emerged as the primary international currency serving trade and commerce the world over.

How do foreigners acquire U.S. dollars? They can sell goods and services to Americans making payments in U.S. dollars. Or, they can secure loans from financial institutions in the U.S., or better yet, seek foreign aid from the federal government. Some of the loan and grant funds undoubtedly find their way back to the U.S. in payment of American commodities; but there cannot be any doubt that some tend to stay in the cashholdings of foreign

governments and financial institutions. Some are hoarded by individuals all over the world.

Foreigners may sell economic goods to Americans in order to earn U.S. dollars. For over twenty years they have been selling more goods than they were buying from Americans, thus accumulating large dollar balances in the form of bank notes or demand deposits in American commercial banks. In the holistic terminology of central planners and managers, this excess of foreign selling over buying is called a U.S. balance of payments deficit. That is, the U.S. suffered chronic balance of payments deficits which flooded the world with U.S. dollars. It permitted the U.S. to acquire real resources without giving anything in return except U.S. paper money. For Americans this was marvelous as they enjoyed a vast selection of foreign goods, from Japanese cars to German instruments, raising American levels of living. Goods prices in the U.S. remained lower than they otherwise would have been. In the exporting countries, however, the loss of economic goods raised prices and kept people poorer than they otherwise would have been. But all along they were accumulating U.S. dollars.

The dollars now held by foreigners are called "Eurodollars" because most of them are owned by Europeans. Many of those dollars are deposited in European banks. If U.S. currency is deposited the European bank may keep it. If checks and other instruments of transfer are deposited the bank collects the funds in its account with an American commercial bank or a Federal Reserve Bank where they are kept on deposit. When, during the 1950's,



foreign banks accumulated ever larger dollar balances, they began to lend them out. In fact, they began to pay interest on dollar deposits in order to attract more lendable funds. The loan market, commonly called the "Eurodollar market," is not limited to Europe, it extends all over the financial world.

Eurodollar operations are international in character. Banks receive deposits from abroad and make loans abroad. For many European banks such operations nowadays represent a major share of banking activity. They are enjoying the advantage, which is very rare in the banking world today, that no national government has the power to control this market. The U.S. Government has no jurisdiction over Swiss banks, for instance, and the Swiss Government has no control over U.S. dollars, which leaves the market relatively free and unhampered. For political authorities this lack of control has created great anxiety as they are convinced that things must go wrong if they are not supervised by them. This is why the Eurodollar market is often taunted and denounced by governments and their spokesmen who would like to control it.

The importance of the Eurodollar market becomes clearly visible in the magnitude of its operations. According to a Morgan Guarantee Trust estimate, the total volume of foreign bank credit operations denominated in U.S. dollars amounted to some \$350 billion in 1977. Other estimates set the total volume even higher. These figures do not include the issues placed on the Eurobond market, which attracts savings from individual cash holdings. In 1977, 195 bond issues were denominated in dollars with a value of \$9.54 billion.

The great danger to Americans lies in a potential run on the U.S., if and when world confidence should be shaken. As long as people everywhere keep their faith in the dependability of the U.S. dollar and their confidence remains unshattered, they will hold on to their dollars. They will not spend them on purchases in the U.S. But if they should lose this confidence a panic run on the U.S. would develop that would send goods prices through the roof.

The present situation is as delicate as it can get on the day before the panic. Many circumstances are creating doubt about the stability of the dollar. Its value in the international exchange markets is very unstable. Nearly every day it is falling to <sup>a</sup> new low in Zurich or Tokio, London or Paris. Foreign holders of U.S. dollars are suffering staggering losses. How long will they continue to suffer in silence? When will they turn and spend their dollars in the U.S.? That is the crucial dollar question.

In this somber financial situation the gestures and policies of the U.S. Government are not very encouraging. Its budgetary deficits remain at record levels, which necessitate the creation of ever more dollars. The U.S. balance of payments deficits are bigger than ever before, now exceeding \$30 billion a year. Nearly all federal policies encourage consumption and discourage production. Domestic oil and gas prices are kept low forcibly, which fosters consumption, discourages production, but promotes the importation of massive quantities of foreign oil. In fact, every time a federal official opens his mouth on domestic or foreign affairs the U.S. dollar seems to fall to a new low in international money markets.



As U.S. goods prices are rising at double-digit rates and the U.S. dollar is hovering at all-time lows, the conditions for an international run on the dollar, that is, for foreign panic purchases of American goods and services in exchange for the shrinking dollar, are given. No one knows what may trigger the run. But we can think of one cause in particular that undoubtedly would touch it off: federal price controls. In fact, the mere talk of such controls, or President Carter's denial of his intention to impose controls, may spark the disaster.

It is an elementary principle of economics that price controls increase the demand for economic goods while they discourage production, thus engendering goods shortages. In anticipation of goods shortages the foreign dollar holders would rush to buy American goods. If their favorite export commodities are no longer available they would buy land and buildings, hotels and motels, stores and factories, banks and corporations, and anything they may desire. All along they would return massive quantities of U.S. dollars which had accumulated abroad during many years of American deficit spending. But this sudden return of U.S. dollars would inundate American markets, raise goods prices significantly or, if price controls prevent such rises, cause dismal shortages in everything under police control.

In short, the weakness of the U.S. dollar in international money markets concerns us all. It may spark a galloping inflation in the U.S. If the federal government makes matters worse through ever more controls and regulations, the fall of the dollar from international pre-eminence may engulf the whole world in deep depression. We hate to think about the economic and political consequences of such a disaster.

Hans F. Sennholz