based on high-technology exports to the Middle East.

3) The recent sterling balance agreement has precipitated further Arab capital flows into Britain, the same oil analyst noted, since Arab sterling holders who got into sterling at $2.40 are not about to get out at $1.70. Instead, they are investing in British industrial recovery, accounting for much of the recent British stock market climb and the heavy demand for this week's record£1.25 billion Treasury offering.

This European-Arab rapprochement helps to stabilize the dollar *only as long as* the dollar is still accepted as the international reserve currency — only up to that point when OPEC and the Europeans decide to accept the Soviet Union's offer to replace the remains of the Bretton Woods monetary system with a gold-backed system incorporating the transfer ruble. As the Journal of Commerce reported this week, British banks, as well as the Italian state industry, are enthralled with the prospects for trade-financing in the "Euro-Ruble."

Nor will Europe tolerate the inflationary growth of dollar reserves indefinitely. Noted the Journal of Commerce in its Dec. 17 editorial: "One central banker present at Basel said last week, not completely in jest, that the U.S. might have made too much of a point about the importance of funding sterling. If the talk turns to funding dollars held as international reserves, the amounts involved will be infinitely greater than the $3 billion and the complexities far more trying."

Respite for European Austerity

OPEC reserve redeployment has been a major prop for the European debtor nations, relieving them of the necessity to implement more severe austerity programs. This is a slap in the face to U.S. international banks, who had hoped that the deutschemark's decline against the dollar would be complemented by even greater devaluations of other Western European currencies against the deutschemark. Instead, the deutschemark, due to its de facto secondary reserve currency role, has been forced to take the brunt of the dollar's two-week gain. Every major Western European currency, except the Belgian franc, Swedish kroner, and Norwegian kroner, have shown positive *gains* against the deutschemark. Not surprisingly, those sectors which have seen the greatest Arab capital inflow — Britain, France, and Italy — have shown the greatest currency strength.

New York foreign exchange traders have expressed their exasperation over the relative buoyancy of the French franc in particular: "It should be trading below 20 cents...This is only the quiet before the harsh storm in February." Commented one chief trader at a major New York commercial bank, "The Scandinavian currencies have been riding high in the snake. There has been no necessity for central bank intervention...Of course, distortions could occur later in the year."

The Japanese yen has also been the beneficiary of OPEC oil-for-technology deals. A heavy inflow of foreign funds into Japanese bonds, much of it Arab, has lifted the yen to its highest level against the dollar since mid-October. Japan has just extended $1 billion in credits to Iraq for industrial projects in exchange for a stable supply of oil.

Forlani Trip to USSR Seals Multi-Level Economic Agreements

WORLD TRADE

Last week's meeting between Italian Foreign Minister Arnaldo Forlani and Soviet Premier Leonid Brezhnev in Moscow took place on the financial level as well as the political. Forlani was accompanied by the foreign ministry's economics advisor, Mario Mondello, who began working out the concrete details of large-scale Soviet-Italian economic collaboration.

The economic agreements themselves have multiple levels as well: strict barter arrangements which will provide nearly 50 per cent of Italy's natural gas import needs; technological exchange which the USSR financed through conventional channels by the Banca d'Italia, the country's central bank; and $7 billion worth of industrial deals whose financing is still the subject of discussion.

The deals could be financed by short-term Soviet promissory notes, discounted in the West on a longer-term basis at the virutally prohibitive rate of 10 per cent, as Trade Minister Rinaldo Ossola has mooted. Two other possibilites would be more acceptable to both sides, and indeed would be ground-breaking contributions to a new international monetary system. One is the use of OPEC "hard currency" holdings presently put to no productive use, and the other would be the East-West trade bank proposed by the foreign affairs spokesman of the Montedison chemical conglomerate, Giuseppe Ratti, using transferable Soviet rubles. Soviet rubles would probably be utilized in tandem with the pooled Western European gold reserves that will facilitate clearing transactions between the European Economic Community and Comecon.

Meanwhile, specific projects have been delineated which if consummated will require the full $7 billion. The Jan. 13 issue of *La Repubblica* published a list of Italian corporations involved, though not the price tag on each deal.

* ENI (the state petroleum enterprise, Ente Nazionale Idrocarburi) — increased gas and oil imports, plus investment in USSR petrochemical facilities.
* Finsider — construction of a Soviet coal duct for $303 million and subsequent purchase of the coal involved by the Italian government.
* Finmeccanica-Breda thermonuclear division — USSR nuclear technology and supplies.
* Montedison — petrochemical plant construction at Tomsk in the USSR.
* FIAT — expansion of the present Togliatti plant for bulldozer production as well as sale of gas turbines.
* Pirelli rubber and petrochemicals — unspecified.
* Fincantieri — sale of ships and floating basins.

Barter And Beyond

Because the Italian government could not meet the Soviet request for a $1 billion direct addition to the $750 million Italian state credit, the USSR agreed to barter natural gas in exchange for Italian goods and services, reported the Jan. 17 *Journal of Commerce.* The Soviets will increase their gas exports to Italy from the present 7 billion cubic meters a year to 10 billion. In exchange, the USSR is to receive plant and equipment from Montedison, ENI, FIAT, and Finsider. Italy has a 20-year gas-supply contract with the USSR which began in 1975, when the Soviets provided 22 per cent of total imports of the fuel.

As for the $7 billion financing question mark, Ossola will follow up the Forlani-Mondello visit and negotiate the final contracts for credit arrangements next month, though this plainly does not mean that his personal preferences on the subject will prevail. Nor, on the other hand, is it at all certain that the use of of the transferable ruble for East-West trade will be introduced to finance the deals. However, the context is precisely the one outlined in the USSR's *International Affairs* article (see International Report) — the use of the ruble as a credit instrument that could in turn provide multilateral financing, e.g., by being further relayed by the Italian government to one of its key Third-World-OPEC trading partners, such as Libya.

If such transactions were formalized by way of Ratti's proposed financial institution, this would be equivalent to a seed-form of the International Development Bank proposed by the U.S. Labor Party in April 1975, and widely discussed among Western European and Third World policymakers since that time. The use of petrodollars to fund such a bank, while clearly less than a consummate break with the bloated world debt structure tied to the dollar, would represent a significant redeployment of OPEC financial resources out of dollar-debt refinancing — a task that Saudi Arabia and others has explicitly repudiated — toward the promotion of international industrial and technological growth.

Farm Policy Fight Shapes Up; Wheatgrowers Demand 'Market Development'

AGRICULTURE

The opening salvo was issued this week in what will be a crucial political fight over the renewal or replacement of the comprehensive 1973 farm legislation which expires this year. On Tuesday, Sen. Talmadge (D-Ga.), chairman of the Senate Agriculture Committee, introduced a bill to extend current basic farm support programs for five years beginning in 1978 and, for the first time, to base grain and cotton supports on actual production cost estimates.

The bill, co-sponsored by a group of conservative senators including senators Dole (R-Kan.), Allen (D-Ala.), Eastland (D-Miss.), Helms (R-NC), and Huddleston, contains no provision for a grain reserve system. Considered anathema by most farm producers, a government grain reserve scheme has been a prominent theme of Democratic think-tank and other Trilateral Commission backers of the Carter regime who view it as an urgent new foreign policy weapon, and is likely to become an explosive issue in the unfolding farm policy debate.

At the same time, this week, National Association of Wheat Growers' president Don Woodward speaking at the organization's annual meeting in Honolulu called for a revitalization of export markets, intensified market development activities, improved export financing, "and an overall policy of expanded U.S. wheat trade." In the same breath, Woodward cautioned wheat producers about grain reserve systems.

While spokesmen for several of the Talmadge bill's sponsors deny that its rapid introduction is part of an attempt to preempt Carter Administration initiatives around government-held or government-accessed grain reserves, they make haste to cite Carter Agriculture Secretary Bergland's stated opposition to government reserves elicited during his recent confirmation hearings — with the obvious intention of holding Mr. Bergland to his word on that matter. The same spokesmen readily acknowledge that the composition of the Carter transition team, especially its foreign policy orientation, together with the consumer lobby that is "much bigger this year" otherwise portend a push for a government reserve and associated schemes on the part of the new Administration.

Presently, supporters of the Talmadge bill — all committed to expand exports and domestic farm production and the expansion of agriculture research and development efforts as the avenue of solution for the dangers facing the American farm sector — have the initiative. A sampling of pro-Carter Administration and Bergland to make a move, insisting that Senators Clark (D-Iowa) and McGovern (D-ND) will offer counter-proposals to the Talmadge bill.

As Woodward emphasized, the problem for wheat producers — among the hardest hit with falling farm prices and incomes as export markets stagnate and contract — is the current existence of large "surplus" de facto reserves, stockpiled on farms and in commercial warehouses across the grain belt. While cost-of-production-based support prices, and related crop loan levels to enable farmers to finance the construction of increased storage capacity, will provide an equitable base-line defense of the farm sector, the Talmadge bill's sponsors correctly emphasize expanded trade as the fundamental issue in line with the "full production" policy orientation established by former Agriculture Secretary Butz.