

# FRIEDBERG'S

## COMMODITY & CURRENCY COMMENTS

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### The Why of the Coming Recession

Jan. 1st-Jan. 2nd, 1980

Inflation "could only succeed in winning people on to these unwonted exertions by a prolongation of what would in fact be a delusion; contriving matters so, that by a progressive rise of money prices, every producer shall always seem to be in the very act of obtaining an increased remuneration which he never, in reality, does obtain" (1)

A general rise in nominal demand "produced a rise of prices, which, not being supposed to be connected with a depreciation of the currency (i.e. not perceived as being connected with general inflation), each merchant or manufacturer considered to arise from an increase of the effectual demand for his article, and fancied there was a ready and permanent market for almost any quantity of the article which he could produce." (2)

An unexpected inflation, "may create a false opinion of an increase of demand; which false opinion leads, as the reality would do, to an increase of production" (2)

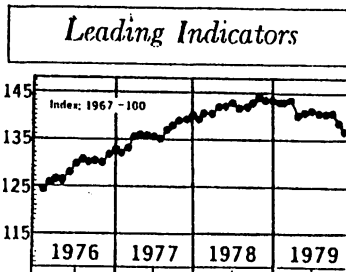
John Stuart Mill (1833)

At last, THE RECESSION. The signs are unmistakably clear : leading indicators in November tumbled 1.3% continuing the steady downdrift prevailing since late 1978, inventories have risen in physical volume by 2.5% since March 1979, a month that saw the peak in real volume of manufacturing, trade sales and factory shipments, the savings ratio has dipped to a record low 3.5% of income, and so on.

In the past many months, readers of our Comments have repeatedly been told that most forecasts were based solely on the inevitability of the business cycle but that the recession, in our view, was nowhere to be seen. ( Commodity & Currency Comments : Dec. 4th/78; Feb. 28th/79; Apr. 3rd/79; May 2nd/79; Nov. 5th/79 ) Our optimistic view challenged the very foundation of those monetarists who believed that a series of Federal Reserve tightening moves would induce contraction in nominal ( and even current ) GNP. We maintained that the demand for money was falling faster than generally anticipated, i.e. velocity was increasing. Furthermore, we stated, monetarists were focusing on Money Supply yardsticks that were too narrow. In fact, bank credit had literally been exploding upwards, aided by the issuance of Money Market Certificates, other non-deposit sources of money such as Repurchase Agreements and the multiplier effect of shifting deposits with high fractional reserve requirements to low fractional reserve requirements. Very recently, we argued that the expanding portfolio of Bank Investments provided an excellent cushion for further loan expansion, despite the historically high loan/deposit ratio. Signs of a credit crunch were hard to find. In the first place, interest rates were barely positive in real terms, as compared to real premiums of as much as 100% above the going rate of inflation, as in the credit crunch period of 1969. Secondly, the enormous Eurodollar banking sector was still granting credits at ever-decreasing margins, regardless of credit risks, a sure sign that liquidity was plentiful. Finally, the Fed had pledged that there would be no crunch, backing its words by persisting to maintain a Fed Funds upper target of 15 1/4% (meetings held October 6th and 22nd ).

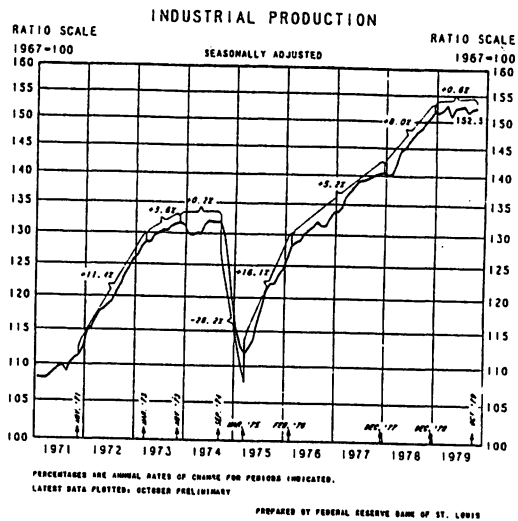
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- (1) Principles of Political Economy (1848). New edition, edited by W.J. Ashley. London: Longmans, Green and Co. 1909.
- (2) Mill, John Stuart. " The Currency Juggle " Tait's Edinburgh Magazine (1833). As reprinted in Vol. 1 of Dissertations and Discussions. Boston :1965. pp.68-81.
- (3) Two Views of Monetary Policy : The Atwood-Mill Debate Revisited. Thomas M. Humphrey, Federal Reserve Bank of Richmond, Economic Review, September/October 1977.



COMPOSITE of key indicators of future economic activity fell in November to 136.6% of the 1967 average from a revised 138.4% in October, the Commerce Department reports.

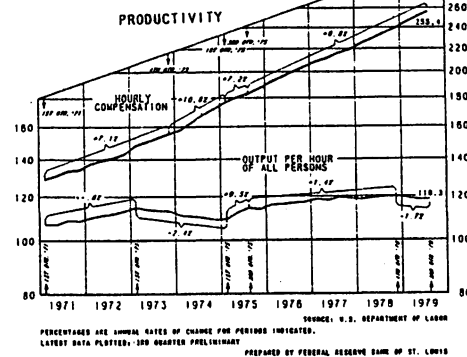
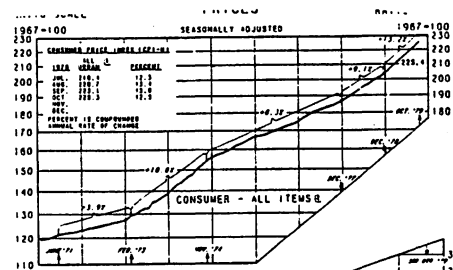
The Wall Street Journal



If credit availability has indeed been overly generous, why then is the economy entering a recession? First, a little theory: Inflation is primarily a monetary phenomenon while the real economy is primarily a function of real factors such as the level of technology, incentives or lack of them, monopolistic power or the lack of it, and freedom of prices and the highly important message conveyed by a movement of relative prices among factors of production and consumption. Despite assertions to the contrary, rapid inflation is not inimical to an expanding economy if the INFLATION rate is fully anticipated and the costs of that inflation rate are compensated. Countries with high rates of inflation, such as Brazil, Colombia, South Korea and Chile have been able to show very respectable rates of growth because, at one time or another, costs have been neutralized via indexation arrangements. Without delving unnecessarily into the matter, one can confidently state that the U.S. economy, in the 1973-1979 period, has been ill prepared to operate in a double-digit inflation environment. Little or no consideration has been given to alleviate the tax burden on nominal (but not real) gains, be it wages, salaries, interest or capital appreciation; the economy has been decapitalized in real terms while personal incentives have been disappearing. Furthermore, the competitive free economy and the important signals it relays via the workings of movements in relative prices has been continuously tampered with, beginning with the 1971-73 general price-control period and through the latest and quite glaring disaster of energy controls. Growing bureaucratic involvement in all sectors of the economy, such as environmental laws and regulation affecting the transportation sector, have withheld productive factors from the economy, further slowing output and, consequently, decreasing aggregate demand. Little wonder that gains in productivity have levelled off in recent years while aggregate demand until very recently has been thought to be deficient. In sum, the U.S. economy is stagnation-recession prone.

Our opening question should be restated: why did the U.S. economy not falter earlier, say the beginning of 1978? The answer is unanticipated inflation. We should recall that government and private economists during 1978 had forecast inflation rates of 6-7% per annum for the foreseeable future. As time went on, forecasts were revised upwards but top figures of 9% per annum were still being bandied about as recently as the first quarter of 1979. As it turned out, by late 1978, inflation was already running at an annual 8.5% while first, second and third quarters of 1979 figures exceeded 13%. This unanticipated rate of price increases had a salutary, albeit temporary, effect on the real economy. John Stuart Mill, a classical economist of the early 19 Century, understood this phenomenon rather well. Thomas M. Humphrey restates Mill's dictum:

"suppose there occurs an unanticipated



increase in nominal aggregate demand that drives up general prices. To each producer, the inflation appears as an unexpected rise in the demand for his product. In an environment in which changes are always occurring in the relative demand for different goods, he will not know whether this change is special to him or pervasive. But if inflation has not occurred for some time, he will likely interpret the demand shift as special to himself and so expand output. Surprised by inflation, he will misinterpret the general price increase as a rise in the relative price of his own product. In this way each producer will be led to think that the demand for his product has increased relative to the demand for other products. Consequently, each will tend to expand production and aggregate output will rise." (3)

Voilà. A simple explanation for a phenomenon that has been a feature of the U.S. economic system for, now, well over a decade. It is not enough for the government to simply reflate the economy via expansionary budgets and monetary policy; it must do so at an ever accelerating pace so as to 'surprise' its entrepreneurs and wage earners and allure them to, optimistically, expand output.

The game is up. The derivative rate of inflation has, at least temporarily, levelled off, having absorbed most of the excess monetary creation of recent years. Economic participants are no longer being 'fooled', the inflation rate having been fully anticipated. If the reverse were to occur, unanticipated deflation, (or prices rising at a rate substantially lower than 10%), a serious economic slump may be unavoidable. More than likely, however, sufficient economic stimulus will be provided to avert a return to 6-8% per annum inflation. The economy will move down to an equilibrium level compatible with its real pattern of sub-optimal utilization of resources and the stage will be set for the illusory 1981-1983 boomlet.

#### The Year of the Metals - Revisited

In our January 1979 issue entitled "1979: The Year of the Metals" we predicted that 1979 "should witness an extraordinary rise in metal prices." Our boldness was greater than our prophetic vision for, with the exception of Copper, we were wide off the mark in the cases of Gold, Platinum and Silver. Starting at \$200, we predicted that Gold would reach the unthinkable \$310/oz. With regard to Platinum, then trading at \$350/oz, we projected a fearless \$470-490/oz when, in fact, by year-end prices had exactly doubled. As to silver, what can one say ...? Our minimum projection of \$9/oz (a sensational 50% appreciation) has been put to shame by year-end quotes of \$35/oz. Only in the case of Copper were we able to hit a bull's eye: prices would average well in excess of 90¢/lb, we said then, and prices have averaged exactly 91¢/lb for all of 1979.

In our defence, one can adduce the incredible political trastornations that shook the world over this past year. As at January 1st, 1979, Time's Man of the Year, Ayatollah Khomeini, was a rather obscure religious fanatic involved in a very parochial type of an affair against a very powerful monarch. But we cannot and must not find pretexts for, after all, did we not base our projections on technical analysis and "basic to technical analysis is its total indifference to fundamental factors"? Did we not say that "charts care little about such mundane matters as OPEC, the U.S. dollar and recessions"?

But we find solace in the fundamental accuracy of our Jan. 1st/79 economic forecast. Listen, "... in an almost defiant tone, they are signalling that a worldwide recession is not imminent, that accelerating inflation will drown out OPEC's 14/5% oil mark up, that the U.S. dollar could go either way ...".

And now, the moment of truth: what of 1980? We will tell you our story but it will not be as bold nor as brief nor even as precise as last January. Perhaps for that reason, you must lend it less credence. Perhaps the gift of simple prophecy has left us to be replaced by earthly sophistry. If so, be sure to keep some precious bars under your mattress.

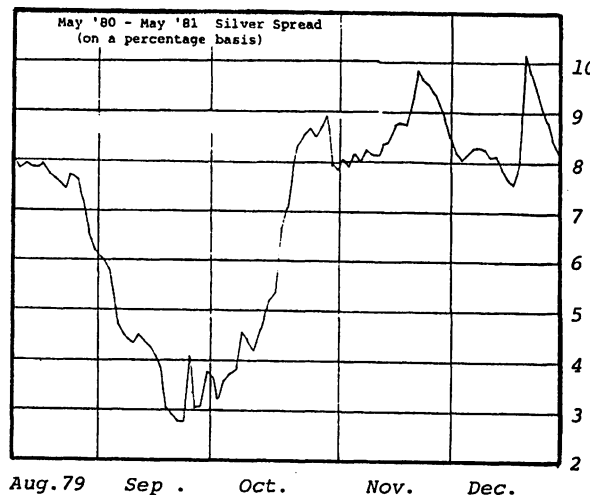
#### SILVER

#### Tulip Bulb Mania Revisited

In our comments of last month, we projected a rise in Silver prices from the then prevailing \$17/oz to a first target of \$21/oz and an eventual move to \$27/oz. These projections were based on chart considerations alone and had absolutely no fundamental justification other than a very short run 'squeeze' play on the part of oil-rich investors. In recent days, buying has become totally frantic with spot bullion rising an incredible \$5/oz in just a single day; it should be recalled that up to early 1978, silver traded regularly at under \$5/oz!

Have OPEC and the Ayatollah suppressed the time-honored tenets of classical economics, namely, that a rise in price rations demand and increases supply to bring forth a reasonable equilibrium? In our October 3rd issue, we pointed out that the 1-year Silver spread had narrowed to an unsustainable 4.7% annual premium, making the convenience yield of holding bullion an extremely expensive proposition. To wit, a holder of the metal could have sold the bullion and re-invested its proceeds at something like 12 3/8% while, simultaneously, he could have purchased the deferred contracts, thus pocketing a 7 1/2% return. On this assumption, we posited that warehouse stocks would be rebuilt and a more normal carrying charge structure would have had to re-appear, thus taking the edge off a true corner. With staggered momentum, visible stocks began to grow, spreads to widen and, consequently, the convenience yield (or lost opportunity) narrowed (see table). Curiously, while the deferred 1 year spreads (such as the May 80 - May 81 spread we recommended) indicated a lingering tightness, nearby positions reflected no lack of spot metal. In fact, Sept-Dec.'79, Dec.79-Mar.80 and, now, Jan.80-Mar.80, traded at full carrying charges, a remarkable phenomenon in view of the constant threat of a squeeze. The persistent undervaluation of the May '80-May '81 spread ( and all the other forward spreads ) puzzled us so much that we advised abandoning half of the (very profitable) spread at 160 points. A dramatic gain can be realized on the other half as the spread has continued to widen and now stands at 265 points.

	Silver Fixing		1 Year over Spot %	1 Year Eurodollar Bid Rates %	Convenience Yield %	U.S. Warehouse Stocks (thou. oz.)
	Spot ( in Cents )	1 Year				
1979:						
Sept. 4.	1094.8	1176.8	7.49	11.75	-4.26	112,828
10	1220.	1277.4	4.7049	12.375	-7.6701	112,865
17	1340	1409.1	5.1567	12.4175	-7.2808	114,498
24	1600	1721.7	7.6061	12.25	-4.64	115,916
Oct. 1	1709	1827.1	6.9105	12.4175	-5.53	115,923
8	1530	1651.8	8.0915	13.375	-5.28	115,957
15	1774	1892.9	6.702	13.9375	-7.23	121,262
22	1745	1886.2	8.092	14.25	-6.16	123,460
29	1579.2	1712.8	8.46	14.50	-6.04	123,313
Nov. 5	1620	1717.3	6.01	14.25	-8.24	126,607
12	1645	1762.5	7.14	13.75	-6.61	126,867
19	1638	1789.4	9.24	13 15/16	-4.6975	126,658
26	1628	1769.3	8.68	13 1/16	-4.3825	125,368
Dec. 3	1988	2144	7.85	13 1/8	-5.275	128,338
10	1900.9	2062.1	8.48	12 1/2	-4.02	128,046
17	2160	2350.5	8.82	13 3/16	-4.3675	128,454
24	H			13 1/8		131,809
31	3220	3452.7	7.23	12 7/8	-5.645	133,139



A look at the above table reveals a fairly substantial build up of visible supplies. Informal industry reports indicate that an astonishing amount of old silver is being scrapped, smelted and refined. Retail establishments are rapidly depleting their old-priced silver-based merchandise thus maintaining apparent consumption figures on an even keel. In the coming months, newly-priced sterling ware, jewelry and photographic film will begin facing steep consumer resistance, causing a huge back-up in the traditional pipelines. Pure silver mining and increased Indian smuggling should add very considerably to the supply side, while, given present prices, by-product extraction of silver may turn out to be a primary consideration for many copper-zinc-lead projects.

More importantly, in the U.S. alone, a very important amount of silver has been withdrawn from the consumption flow over the past 2 years, ending up in private warehouses. This private investment hoard has increased, by our reckoning, by at least 60 million ounces, which, at today's prices, represents a cool \$2.1 billion! The following table, taken from widely available data, supports our estimate:

## SILVER IN THE UNITED STATES

	1978				1979		
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Qtr	2nd Qtr	3rd Qtr
Stocks, beginning of period							
Industry Stocks	35,935	33,010	28,966	24,577	28,790	33,482	27,747
Defense Dept.	6,710	6,080	6,840	6,970	6,450	5,940	5,810
Treasury Bullion	39,360	39,266	39,217	39,208	39,157	39,149	39,129
Commodity Exchange	68,368	74,149	72,752	67,755	58,227	49,592	54,114
Chicago Board of Trade	61,040	62,510	63,955	62,240	59,885	55,325	56,845
Total	211,413	215,015	211,730	200,750	192,509	183,488	183,645
Plus :							
Production :							
Mine	10,172	9,610	9,094	10,509	9,415	9,604	9,349
Refinery	24,482	23,847	22,120	20,993	21,952	22,822	20,641
Imports	23,275	21,827	20,643	9,896	24,756	18,071	18,570
Total	57,929	55,284	51,857	41,398	56,123	50,497	48,560
Minus :							
Consumption :							
Net Industrial	38,192	43,155	37,284	41,534	51,779	43,040	37,324
Coinage	8	11	11	15	5	13	76
Exports	5,655	5,000	7,235	4,510	5,197	4,208	5,239
Total	43,855	48,166	44,530	46,059	56,981	47,261	42,633
Stocks, end of period							
Industry	33,010	28,966	24,577	28,790	33,482	27,747	23,706
Defense Dept.	6,080	6,840	6,970	6,450	5,940	5,810	5,240
Treasury Bullion	39,266	39,217	39,208	39,157	39,149	39,129	39,064
Commodity Exchange	74,149	72,752	67,755	58,227	49,592	54,114	51,465
Chicago Board of Trade	62,510	63,955	62,240	59,885	55,325	56,845	65,290
Total	215,015	211,730	200,750	192,509	183,488	183,645	184,765
Apparent Increased in Private Vaults	10,472	10,403	18,307	3,580	8,163	3,079	4,801

Source: U.S. Dept. of the Interior Bureau of Mines.

Prepared by FMG.

Given the mind-boggling increase of Silver in real terms over the past 12 years (1250%) and, particularly, over the past 12 months (500%), it would not be surprising to see a gradual dis-hoarding of this private holdings. Furthermore, it would not be unreasonable to suppose that, worldwide, hoarding has proceeded at approximately the same pace, thus multiplying potential supplies.

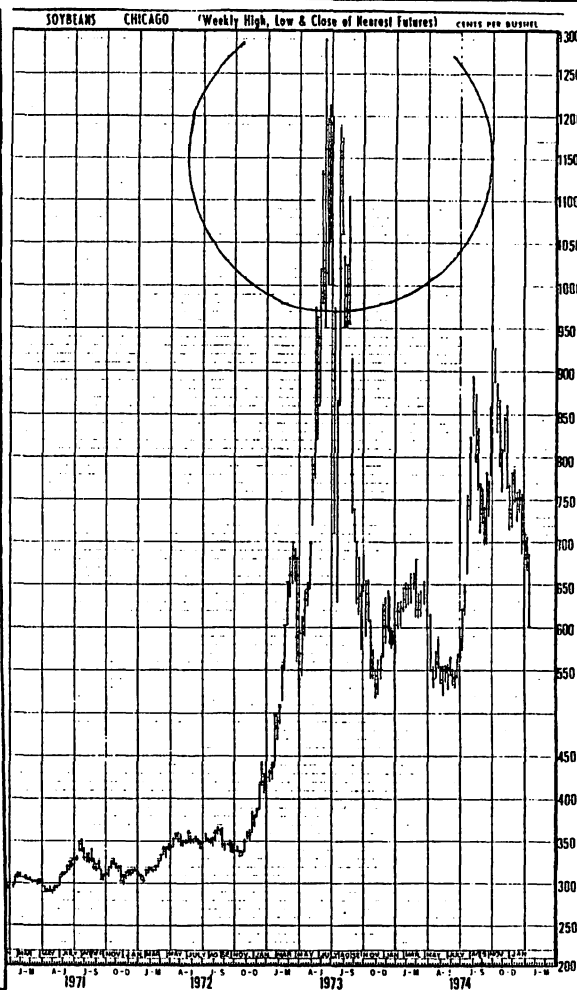
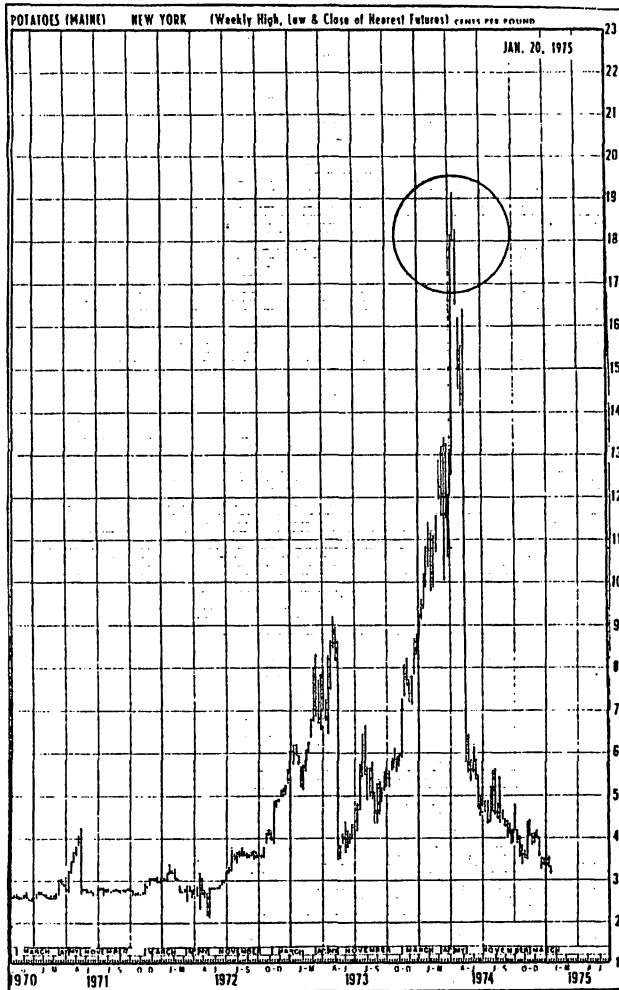
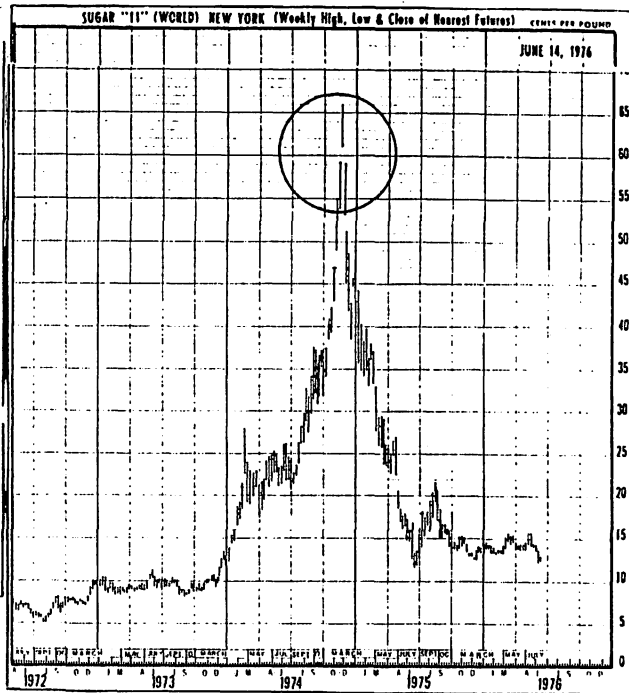
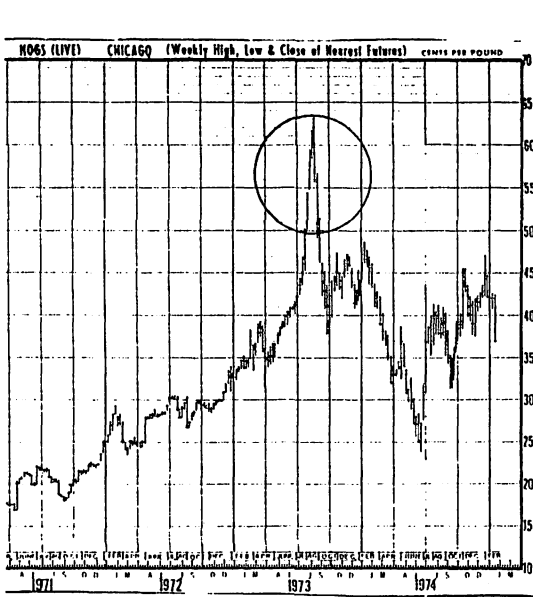
Irrespective of the buying power propelling silver prices into the stratosphere, there is simply not enough money in the world to sustain prices at anywhere near present levels for many more months. The numbers are staggering: a decrease in demand and/or increase in supplies of 200 million ounces yearly requires no less than \$7 billion of investment demand, atop \$7 billion in minimum, irreplaceable consumption.

Free markets have once more demonstrated (if there ever was a need to) that they can be perfectly capable of satisfying demand, even in so-called semi-renewable resources with highly inelastic supply functions. In the early 70's, strong concern was being voiced by Silver users that, some day, given present trends of deficit production, the world would run out of silver. The Club of Rome, in its (infamous) Limits to Growth preached an end to many resources on the same basis: extrapolating trends. But trends can never be extrapolated. At some point, and in its slow and patient way, a free market will anticipate an uncomfortable situation and pave the way for the re-establishment of some sort of equilibrium. Unlike the Biblical Joseph who enjoyed the gift of prophecy and was thus able to prepare Egypt for the inevitable years of shortages, present day governments do not possess such foresight and would be better advised to allow the free market to ration out supplies.

We can confidently predict that the world will not run out of silver. Furthermore, Silver prices, in real terms, will begin to drop very soon and, as such, will provide a painfully negative return to those who persist in 'buying at any price'.

STRATEGY:

- 1) Liquidate all long positions at present levels; let the uninformed squeeze the last dollar out of this remarkable bull-market.
- 2) Be prepared to establish short positions. Use the following procedure for picking a top: (a) a new record weekly high, closing that week below the prior week's close (see samples, Soybeans, Hogs, Potatoes) or (b) a weekly close on the bottom of the week's range after having recorded a new high, preceded by a gap above the high of the prior week (see sample, Sugar).
- 3) Retain (or re-establish) long May '81 - short May '80 spread, now running at 265 points. Full carrying charges at present levels indicate an approximate target of 460-470 points. Downside risk should be contained in the 230-250 area if one assumes a quick fall-back in silver prices to the \$20 area and a drop in short term rates to 12% (basis one-year Euro-deposits).



Platinum & Palladium - a picture of U.S. Vulnerability

According to data recently released by the Bureau of Mines, Platinum sales to consuming industries in the third quarter of 1979 increased, owing mainly to a 90 percent rise in sales to the petroleum sector. Year over year comparisons continue to show dramatic gains with full year figures likely to be up as much as 20% over 1978 levels.

Much more significant is the steady and very pronounced trend towards dependency evidenced by U.S. consuming industries over the past 20 years. Stocks as a percent of imports (both figures include all platinum-group metals but consist primarily of platinum and palladium) have declined at an alarming pace and stand today at barely 22% ( see table).

Platinum and Allied Metals

	<u>Private industry</u> <u>Stocks as of Dec.31*</u> (in Troy Ounces)	<u>Imports for</u> <u>Consumption</u> (in Troy oz.)	<u>Stocks as % of</u> <u>Imports</u>
1960	515,750	680,646	0.7577
1965	926,373	1,172,643	0.7900
1970	710,024	1,410,786	0.5033
1975	849,210	1,820,284	0.4665
1979 (p)	783,571	3,442,000 e	0.2276

\* for 1979, stocks as of Sept.30th.

e Estimated

Recognizing this ominous development, Congress has recently approved an appropriation bill for the purchase of strategic materials, platinum being among them. The funds authorized, however, are woefully deficient in view of today's prices and will do little towards reversing the trend (specifically, the bill authorizes \$237 million for the acquisition of strategic & critical materials for the NATIONAL DEFENSE STOCKPILE).

Gov't Stockpiles and Objectives (end of 1977)

	<u>GOAL</u>	<u>INVENTORY</u>	<u>DEFICIENCY</u>	<u>DEFICIENCY IN \$(at today's price)</u>
Platinum	1,314,000ozs.	453,000ozs.	861,000ozs.	\$600,000,000
Palladium	2,450,000ozs.	1,255,000ozs.	1,195,000ozs.	\$210,000,000

Platinum enjoys a growing and relatively inelastic industrial demand although usage is clearly cyclical in nature. Platinum is an ideal investment vehicle in that it possesses a relatively higher value to weight ratio than either Gold or Silver and it has a more standardized & widely recognized price than diamonds or other objects of art. Furthermore, anticipated purchases by the U.S. government for strategic purposes as well as the relatively low inventories in the private sector, provide a comfortable support in the \$450/oz area, despite any cyclical drop-offs in demand.

Platinum and palladium should become the glamour metals of the early 1980's. We advise additions to presently held long positions on sharp speculative shake-outs, holding out for a long term, manifold, increase in price.

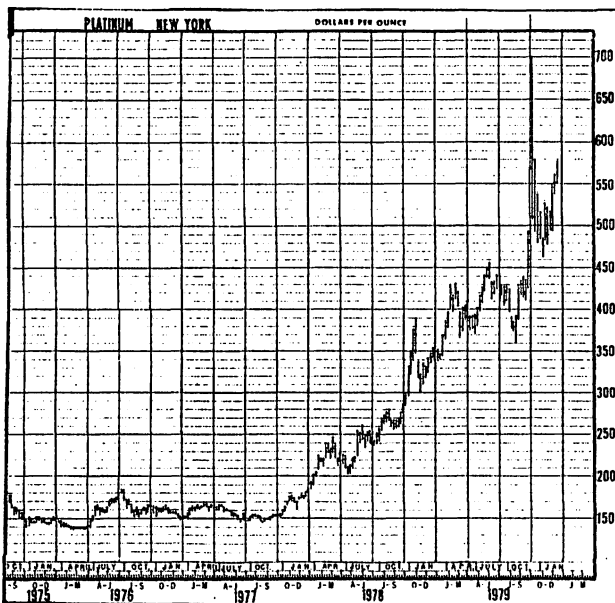
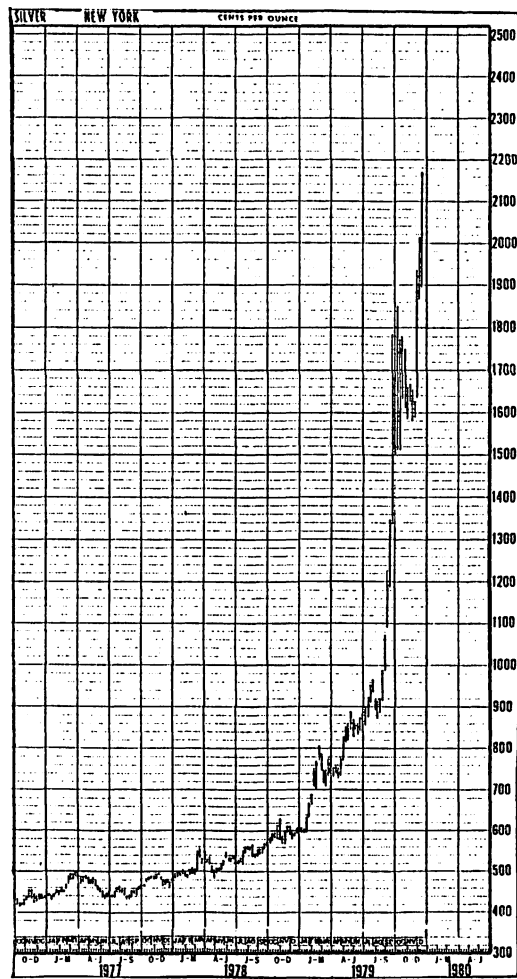
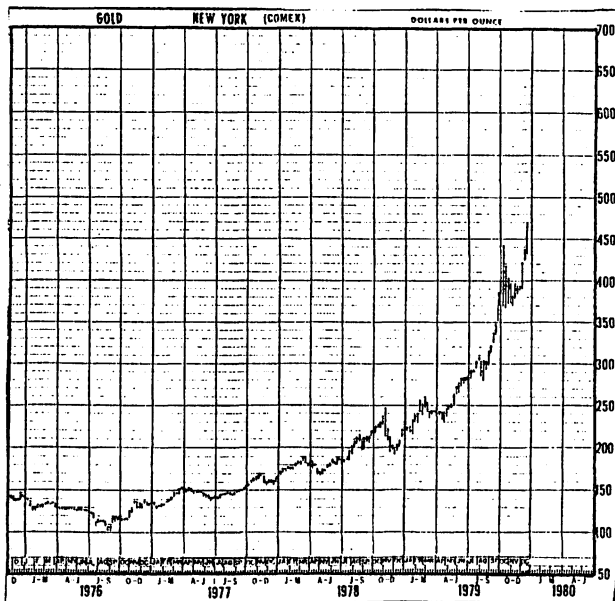
GOLD - The inexorable March to a new GOLD STANDARD

Some months ago we discussed the enticing prospects of a return to a modified Gold Standard. Given its vast gold holdings (248 million ounces, at this writing), the U.S. was on its way to re-emerging from a Chapter 11 reorganization. We stated the case in the following manner: "The U.S., recognizing an accomplished fact, resumes international convertibility of U.S. dollars into gold at a price not substantially higher than the recent highs, i.e. somewhere between \$450 and \$550/oz. At such a price, the U.S. would be able to "redeem" its net external liabilities which can variously be calculated at between \$55 billion and \$120 billion (depending on whether one uses short term or long term claims and liabilities as well as Central Banks only or Central Banks and other Banks and Foreigners, as classified by the IMF). At the upper figure, full convertibility can be handled with a \$450/oz price (\$120 billion ÷ 267 million ounces). We would recommend a \$50-100/oz premium so as to instill enough confidence on the part of official U.S. dollar holders & preclude a wholesale rush to the Gold Window."

Here we are, just three months later, and gold is already trading at \$535/oz, an appropriate convertibility level by any yardstick. Can or will the U.S. come out of its deure bankruptcy? We submit that two things are necessary: one, a political willingness to reverse the established anti-gold feelings so prevalent at the Treasury Department and, two, a well established mechanism to buttress the RETURN. Despite the intellectual appeal forre-establishing a Gold Standard, political action, being purely pragmatic and the result of expediency will have to be forced into such a course of action. Nevertheless, the time horizon for this acceptance will vary inversely with the rise in prices. The second pre-condition has already some ingredients present: the establishment of the EMS (heavily backed by GOLD), more thoughtful consideration of monetary courses of action as espoused By Mr.Volker and other Central Banks such as the Bank of England,the IMF's successful recipe involving Domestic Credit Expansion targets, etc.

In our last two issues, we suggested that gold was completing a substantial high level consolidation and that, imminently, prices would take off from the \$400/oz and to reach \$500 in short order. The recent move has already exceeded this target; the relative orderliness of the advance, however, indicates still higher levels.

No one in his right mind can project a final top in such an emotion-laden environment. We suggest, therefore, locking up profits should prices turn back below \$497/oz basis Feb'80, close only. In the alternative, a weekly downside reversal from any new high should provide reason enough to abandon speculative positions. Long term holdings, equal to 25% of one's net worth, should be held regardless of near term weakness. This despite the possibility of seeing gold trade down to the \$300-350/oz sometime during 1980.



COPPER - Short term prospects .....

The advent of a cyclical economic contraction in the U.S. of indeterminate depth and duration clouds the near term copper price outlook. A somewhat bearish attitude seems to be in order at the present time. Increasingly, however, a 'premium' is being built into the price structure as the longer term bullish implications begin to unfold. This 'premium' may become significant over the course of 1980 and will, no doubt, perplex close observers of the scene who, on the basis of short term supply and demand considerations, will expect prices to dip into the high 60's, low 70's area. In our view, barring a recession of the 1974-75 magnitude, copper should not trade below 75-78 ¢/lb during 1980 with an upside potential of \$1.25/lb and a yearly average of 98¢ - \$1.01.

And longer term considerations ...

The United States has been experiencing a shortfall in its primary production which, in 1978, required imports of primary copper of 500,000 tons. As can be noted from the accompanying table, this trend is expected to continue, and will require the U.S. to import even larger amounts as domestic mine production remains fairly constant and its consumption continues to rise.

Since 1972, both production and capital costs have increased significantly in excess of inflation. It has been estimated that average net operating costs rose by 50% between 1970-1975 or by 9% in constant dollars. For Africa, the rise was 73% and in the case of the Peruvian Toquepala mine, the rise in production costs from 1971-1974 was 79%.

Table 1 - Comparison of domestic copper production and demand 1958-78  
(Thousand short tons)

U.S. Recoverable copper, in ore, by percent

%	Year	U.S. primary demand	Domestic primary production
.79	1958	1,016	979
.74	1959	1,214	825
.73	1960	1,107	1,080
.75	1961	1,237	1,165
.75	1962	1,355	1,228
.74	1963	1,425	1,213
.75	1964	1,566	1,247
.70	1965	1,613	1,352
.67	1966	1,898	1,429
.65	1967	1,549	954
.60	1968	1,540	1,205
.60	1969	1,696	1,545
.59	1970	1,572	1,720
.51	1971	1,627	1,522
.55	1972	1,951	1,665
.53	1973	1,942	1,718
.49	1974	1,953	1,597
.50	1975	1,250	1,413
.51	1976	1,725	1,606
.52	1977	1,808	1,504
.51	1978p	1,957	1,490

Copper Demand	1978 *	1979*	1983	Probable average annual growth
U.S. Primary & Secondary	2345	2440	2805	3.6%
Rest of World	8972	9391	11,019	4.2%
Total	11,318	11,831	13,894	4%
<u>Production Capacities</u>				
U.S.				
Mine	2000	2030	2140	
Smelter	2020	2020	2040	
Refinery	2890	2890	2890	
Total				
Mine	10,300	10,720	11,860	
Smelter	10,900	11,180	11,960	
Refinery	12,405	12,615	12,960	
Total World Capacity at 90% Utilization				
Mine	-	-	10,674	
Smelter	-	-	10,764	
Refinery	-	-	11,664	
Potential Deficit with secondary usage at 22% of total consumption				
Mine			- 163	
Smelter			- 614	
Refinery			- 836	

\* All Figures in Thousands of Short Tons

\* Sources: Bureau of Mines Mineral Commodity Profile Sept. 1979  
The World Copper Industry by Raymond F. Hikesell

A recent study estimated that, in 1977 dollars, only 41% of the Western World's operating costs were covered at a price of 55¢ per lb. while at 70¢ only 86% of the costs were covered. These figures suggest that mine costs were not covered at prices prevailing during 1976-1978. The Cajone Mine in Peru, which has been estimated to be one of the lowest cost producing mines in the world and whose construction was initiated in 1969 and whose first full year of production was 1977, cost \$750 million to complete. It is estimated that a price of \$1.00 in 1977 prices is required to earn it a 15% return of equity. It is further estimated that the cost of opening an equivalent mine in 1977 would have been \$1.2 billion, necessitating a copper price of \$1.35, again in 1977 dollars.

U.S. smelter and refinery capacity is expected to remain fairly constant with no new projects on tap due to the stringent pollution abatement laws, which are estimated to add 15¢ to production costs. The Bureau of Mines projected a total increase in world mine, smelter and refinery capacities of 2450, 1550 & 825 thousand tonnes for the years 1979-1985, respectively.

We do not think these increases will occur for the following reasons :

- a) total capacity in Zaire, Zambia and Peru should not increase, and in the case of Zaire and Zambia may decrease as foreign technicians depart.
- b) the estimated annual investment to assure the Bureau's projected increase is \$2 bln. Most of this money must be invested in countries such as Zambia, Zaire, Peru and Iran. In light of the political situation prevailing in these countries and their past history of mistreating foreign mining corporations, many of the projects in the planning stage will either be delayed or scrapped.
- c) The time lag required to open a new mine is approximately 10 years, while for expanding an existing site is 4-5 years. The low political and economic visibility prevailing in the world today (particularly in copper regions) require extraordinarily high rates of return to compensate for the associated risks and, in no case, can a project be undertaken showing an historically attractive 20% annual rates of return. Yet, at today's copper prices, that is by far the very best that may be hoped for on a new project.

Looking at the accompanying table, we estimate that by 1983 world mine capacity will total 11,860 thousand short tons. Assuming a production-capacity ratio of 90% ( to take into account labor and technical problems, wars, etc. ), total primary production will not meet expected primary demand of 10,837,000 tonnes. Furthermore, smelting capacity is shown to be deficient by some 614,000 tonnes.

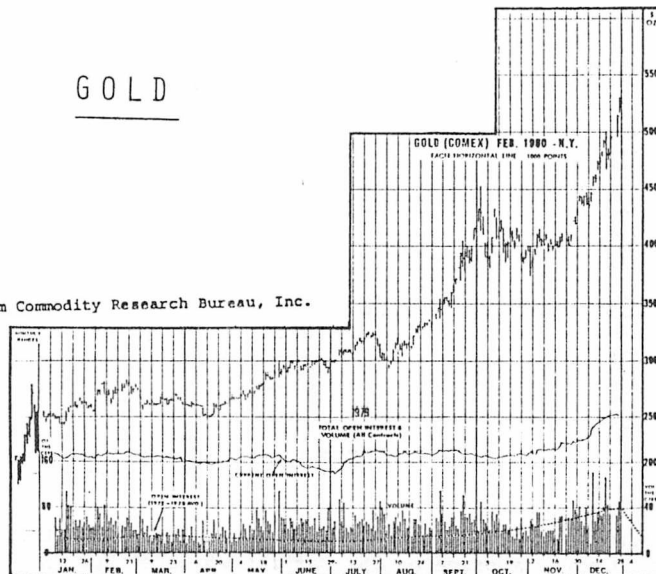
Finally, and more seriously, refining capacity may be short as much as 836 thousand short tons assuming total demand of 13,894 thousand tons.

In conclusion, grave shortages of copper, particularly refined, are looming over the near term. As soon as the present economic contraction runs its course, copper prices are seen to move substantially higher.

We strongly advise long term investment buying on any modest cyclical correction.

GOLD

Reprinted from Commodity Research Bureau, Inc.



	World Reserves at market related prices (mln of SDR's)	Gold Holdings at market related prices (mln of SDR's)	Proportion of gold holdings to Total Reserves.
Jan'79	433,948.56	184,800.36	42.60
Feb'79	446,614.91	197,966.91	44.33
Mar'79	437,309.71	189,160.71	43.26
Apr'79	440,730.31	195,100.31	44.30
May'79	460,867.83	218,698.83	47.45
Jun'79	460,474.99	217,062.99	47.14
Jul'79	473,170.53	228,972.53	48.39
Aug'79	487,684.74	243,290.74	49.89
Sep'79 E	559,953.78	302,437.56	54.01
Oct'79 E	558,220.88	294,577.83	52.77
Nov'79 E	586,406.72	320,127.24	54.59
Dec'79 E	672,519.02	403,576.74	60.01

	1973	1974	1975	1976	1977	1978
World Reserves at market related prices (mln of SDR's)	211,135.49	298,719.23	279,846.72	302,683.33	363,672.74	420,463.85
Gold Holdings at market related prices (mln of SDR's)	94,672.91	154,749.23	121,579.72	116,475.33	137,394.74	176,684.85
Proportion of gold holdings to Total Reserves	44.84	51.80	43.45	38.48	37.78	42.02

INTEREST RATES FUTURES

Having reluctantly conceded that we are about to enter ( or have already entered ) a recession, it follows that we must abandon the bearish side of Treasury Bonds, Bills and GNMA's. But, as explained in our opening paragraphs, this recession has not been caused by a credit crunch. Rather it is the result of real economic factors that were temporarily suppressed by a government induced un-anticipated inflation rate. As such, banking liquidity will not improve a great deal. The reason is this : loan demand, in nominal terms, will continue to grow while the deposit base, as interest rates ease, may not grow sufficiently to accommodate these loans, and then rebuild bank investments. Furthermore, long term interest rates are not likely to decline by more than 75 basis points from present levels giving due recognition to a firmly entrenched 'floor' in inflationary expectations. Moreover, corporate hedge financing (such as the recent IBM issue) as well as corporate reliquification efforts coupled with a growing gov't borrowing requirement (as a result of the recession's impact on the budget deficit) should provide solid support in the 9% region for long term Treasuries and 9½% for triple-A Corporates.

We do not care to follow this potential bull move in bonds. Lacking a solid base, the advance will be stunted by politically-motivated reflationary efforts and the ever-present external considerations. The latter constraint may come as soon as the second half of 1980.

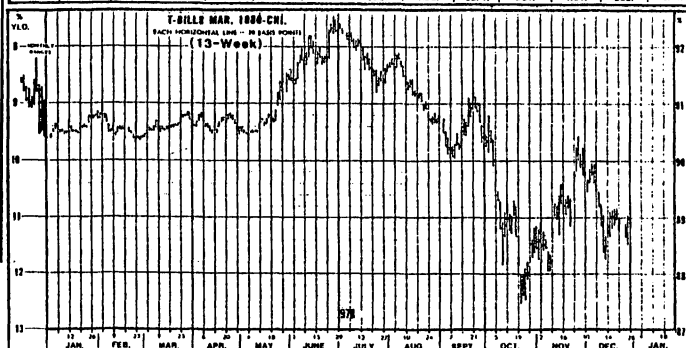
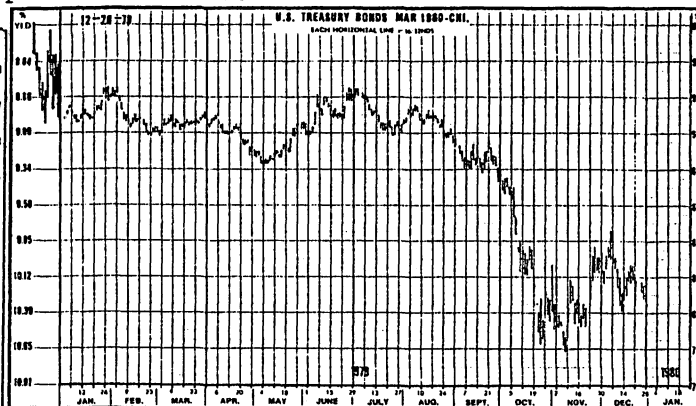
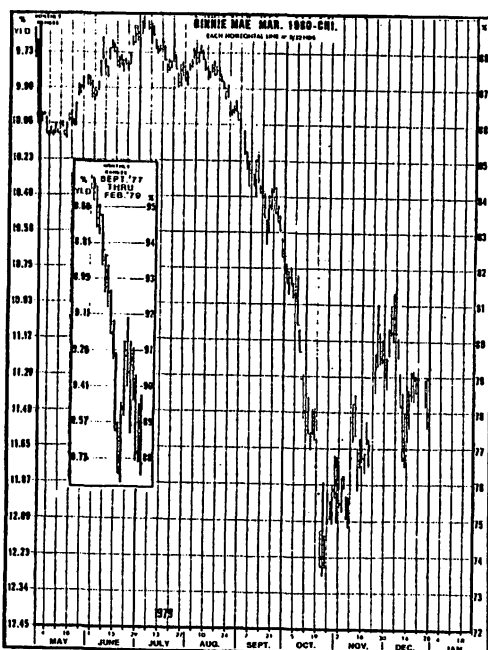
Long-term STRATEGY:

Cover all short positions in bonds and bills at the market.

Look to sell December '80 U.S. Treasury Bonds at 90 ob. and December '80 GNMA's at 89 ob, if given the opportunity.

As of Dec.31st, 1979

GNMA	Settle	Yield	Treasury Bonds		Treasury Bills			
Dec.	-	-	Mar'80	82-06	10.089	Mar'80	89.14	10.86
Mar'80	79-06	11.266	Jun	82-29	9.991	Jun	90.17	9.83
Jun	79-18	11.196	Sep	83-14	9.920	Sep	90.84	9.16
Sept	80-00	11.185	Dec	83-21	9.891	Dec	91.07	8.93
Dec	80-06	11.150	Mar'81	83-19	9.899	Mar'81	91.13	8.87
Mar'81	80-00	11.185	Jun	83-16	9.912	Jun	91.10	8.90
Jun	79-05	11.220	Sep	83-12	9.912	Sep	91.02	8.98
Sept	79-17	11.260	Dec	83-09	9.928	Dec	90.97	9.03
Dec	79-09	11.307	Mar'82	83-06	9.953			
Mar'82	79-01	11.296	Jun	83-03	9.966			
Jun	78-25	11.343	Sep	83-00	9.979			
Sep	78-17	11.390						



Currencies

There are five major factors to consider as we attempt to analyze the 1980 outlook for the U.S. dollar and other currencies. Four of these are distinctively bullish for the U.S. dollar, two are also bullish for the Yen and BP, one is bullish for the BP alone and one is clearly bearish for the U.S.

In order of immediacy and importance :

- a) a substantial move to surplus in the U.S. current account, at least for the next 6 months. Bullish for the U.S.\$, bearish for the rest.
- b) a temporary topping out of oil prices, with OPEC quotes settling in the \$26-32/barrel and free market prices (Rotterdam) dipping to the low \$20's. Short term bullish for the U.S. \$ and the Japanese Yen (at least perceptually so), bearish for the Mexican Peso, slightly bearish for the BP and neutral for the rest.
- c) the prevailing high gold price, raising the issue of eventual dollar convertibility (see Gold). Bullish for the U.S.\$, Switzerland and the EMS countries, neutral for the rest.
- d) the slow but powerful Soviet encroachment of Western Europe raising the possibility of a long term military invasion or political blackmail. Bullish for the U.S.\$ and Japanese Yen ( in a negative way ), bearish for the continental European currencies, neutral for the BP.
- e) Domestic political considerations, Bearish for the U.S.\$, where a Carter or Kennedy victory is almost assured, bearish for the continental European currencies- where parliamentary governments are hopelessly splintered -bullish for the BP, since the UK enjoys a broad, determined and intelligent conservative Government.

Our choices for 1980 :

1. The British Pound
2. The Japanese Yen
3. The U.S. Dollar
4. The Deutsche Mark

BRITISH POUND

The British Steel Corporation strike that began today will represent the government's first important test in the area of industrial relations. Heretofore, the Conservative Government has battled wage demands in a rather indirect fashion - i.e. by restrictive economic policies. Aside from the recently awarded 21% & 20% wage settlements awarded in the coal miners' and Ford's cases, union demands have only met modest success. The present walkout is expected to be relatively long and can only be effective in moderating wage demands if little or no impediments are placed in the way of steel imports. A settlement under double-digit figures will represent a notable achievement and might, by itself, push Sterling above its Summer highs.

In a pungent bit of financial wisdom, the UK Treasury suggested the following : " With a rising contribution to the visible account from North Sea Oil the rest of the balance of payments has to adjust. With a floating exchange rate this must occur either by a deterioration in our non-oil trade or by a net capital outflow. Exchange controls prevented any substantial adjustment coming about through the capital account and forced most of it to come through a deterioration in non-oil trade. " Furthermore, it added that " removing exchange controls gives the private sector the opportunity to save some of the income from North Sea Oil and invest it overseas, rather than spending it on imports. " The logic is impeccable and the implications quite bullish. A surplus on current account and a long term capital outflow are viewed infinitely more bullishly than a similar net result accomplished by a current account deficit and a long term capital inflow, especially if the latter represents primarily government borrowing.

Sterling continues to be a wild buy. Our \$2.40 objective is a minimum expectation while \$2.75 would not surprise us.

Remain long, add on corrections.

	Visible Balance (\$bn)	Current Balance (\$bn)	O/I Balance (\$bn)	M1*	M3*	DCF (\$M)	Reserves US\$bn	MLR %	Food Index	FT Comdty.
1978 ---										
3rd Qtr.	-0.367	+0.299	-501	17.2	8.1	+ 572	16.55	10	206.2	253.74
4th Qtr.	-0.039	+0.614	-480	14.9	11.9	+1,774	15.77	12½	208.0	257.69
1979 ---										
1st Qtr.	-1.579	-1,207	-234	7.6	9.3	+1,524	16.78	13	218.8	268.83
2nd Qtr.	-0.714	-0.607	-227	9.7	17.2	+2,705	21.69	14	225.2	293.55
3rd Qtr.	-0.311	-0.211	-166	11.5	9.9	+2,414	23.18	14	231.9	301.66
Apr.	-0.159		-123	16.8	6.4	+ 825	21.47	12	221.6	277.11
May	-0.310		- 54	13.9	8.1	+ 997	21.53	12	224.0	279.20
Jun.	-0.245	-0.209	- 50	9.7	17.2	+ 885	22.07	14	230.0	293.55
Jul.	-0.046	-0.012	- 44	7.1	14.3	+ 439	23.49	14	231.2	278.92
Aug.	-0.147	-0.114	-130	6.1	12.4	+1,052	23.30	14	231.8	290.04
Sep.	-0.118	-0.085	+ 8	11.5	9.9	+ 923	22.75	14	232.6	301.66
Oct.	-0.339	-0.289	- 85	15.7	15.1	+1,566	22.49	14	234.8	291.34
Nov.	-0.056	-0.006	- 12				22.42	17	237.0	297.22

\* Three month's growth at annual rate.

Japanese Yen

Begin to accumulate long positions.

Deutsche Mark

Continued strength is foreseen. Raise sights to 63.00 and sell stops to 58.00, all basis March '80, close only.

Swiss Franc

Modestly bullish. Protect longs at 63.00, basis March '80.

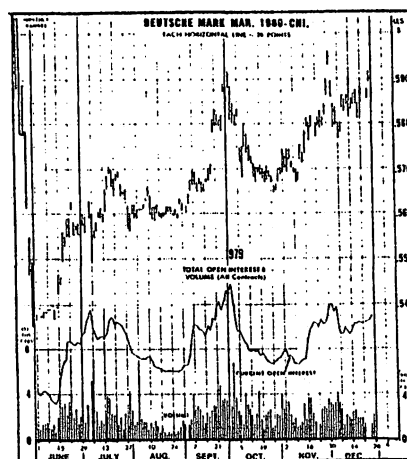
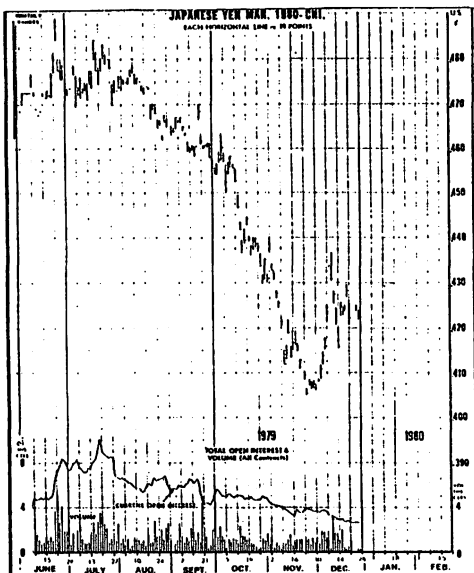
Canadian Dollar

An ineffectual, politically insensitive, populist-in spite of its Conservative nomenclature Government-has fallen and, with it, an incredibly farcical Budget. It neither unshackled the economy from its onerous tax burden nor did it outline the most civil gesture to reduce government spending. In the hope of increasing energy costs ( a correct policy from a demand standpoint ) it fell into the trap of catering to politically powerful consumer lobbies, including the Province of Ontario (for not raising prices to world levels) and smudged its conservative label by taking away from the private sector the much needed ' obscene' profits.

Following we take pleasure in quoting a letter to the G&M written by a long-standing client of our firm, Mrs Frances Dance : " it is really a good thing that timid Mr. Clark's Government has been brought down : Mr. Crosbie's budget proposals were not stringent enough, and the inflationary spiral would only have been prolonged. Hopefully, the N.D.P. will now be elected, with the result that the policies of the bold Mr. Broadbent will bring inflation quickly to a climax. It will be amusing to observe the antics Messrs. Broadbent, Knowles and Co. will get up to, in order to continue their laudable policies of supporting the low-producers and non-producers of society at the expense of wicked, international big business; now that international big business itself, in the shape of the Chrysler Corporation, with other companies soon to follow, will also be in the lineup for handout. "

The upcoming Federal election- where a strong probability exists of seeing the N.D.P. in the king-maker position- and Quebec referendum, a Federal budget well out of control, ludicrously low energy prices, and worse of all, NO END IN SIGHT, augur poorly for the CD\$. Accelerating inflation in Canada may prove as stimulative to the real economy as it was in the U.S. during 1979. If so, interest rates differentials will favor Canada in a significant way and might offset, and then some, the above negatives as well as the continued deterioration in the balance of trade.

The CD\$ has become a trading affair : a sale in the 85.75 -86.50 range, a buy if and when it moves above 86.50; a buy in the 83-84 range, a sale below 83¢. Come to think of it, not a great way to make money....



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YEN		Balance of Trade	Balance of Overall Account	Balance of Current Account	Reserves (Min US\$)	W.P.I.** (%)	Unemployment
1979 ---		( Min US\$ )	( Min US\$ )	( Min US\$ )			
Open Interest (Dec.31/79 ):	2,708	May + 53	- 754	- 828	24,190	3.50	2.01
Daily Volume (Dec.31/79 ):	309	Jun. +1,110	- 380	+ 120	24,980	5.23	2.01
Contract Size : Yen	12,500,000.00	Jul. + 197	-1,000	+ 878	25,120	8.26	2.26
Approx. US\$	\$ 52,500.00	Aug. - 669	- 387	-1,530	25,170	10.94	2.23
Minimum Fluctuation :	.000010 (\$12.50)	Sep. + 147	-2,330	- 792	25,330	12.61	2.03
Daily Limit (Normal) :	.0001 (\$1,250.00)	Oct. - 350	-3,470	-1,120	23,270	14.54	2.15
Margin Required :	US\$ 3,750.00	Nov. -1,220	-1,560	-2,220	20,17	16.07	
Commissions :	US\$ 55.00						
Trading Hours :	8:25 am - 1:25 pm						
Delivery Months :	Mar., Jun., Sep., Dec.						

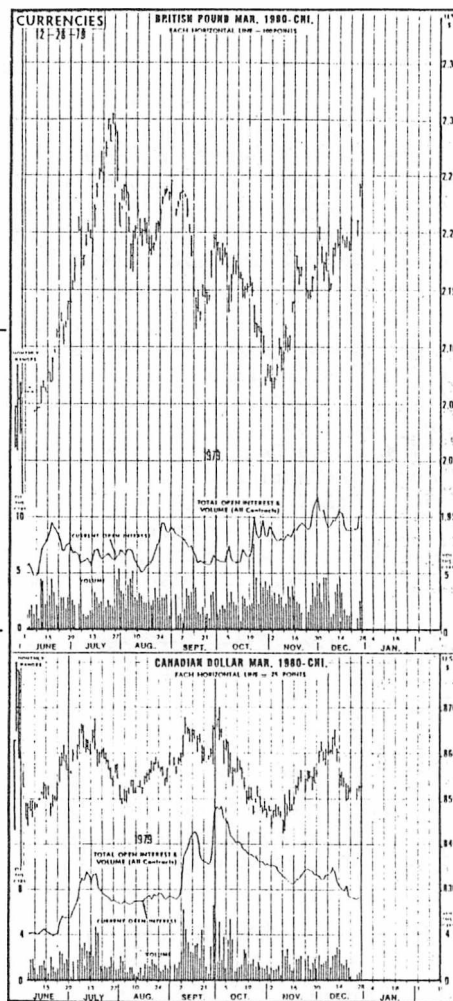
\*\* Year-over-year % change.

DM		Balance of Trade	Balance of Payments	Unemployment Rate
1979 ---		( Min Marks )	( Min Marks )	
Open Interest (Dec.31/79 ):	11,294	May +2,000	- 300	3.4
Daily Volume (Dec.31/79 ):	641	Jun. 1,730	-3,200	3.3
Contract Size : DM	125,000.00	Jul. 607	-2,080	3.5
Approx. US\$ : US	73,750.00	Aug. 976	-2,900	3.5
Minimum Fluctuation :	.00010 (\$12.50)	Sep. 1,900	-2,400	3.2
Daily Limit (Normal) :	.010 (\$1,250.00)	Oct. 1,800	- 800 r	3.3
Margin Required :	US\$ 3,500.00	Nov. 1,510	- 900	3.5
Commissions :	US\$ 55.00			
Trading Hours :	8:19 am - 1:19 pm			
Delivery Months :	Mar., Jun., Sep., Dec.			

\*\* Year-over-year % change.

SF		Balance of Trade	W.P.I.** (%)	Unemployment
1979 ---		( Min SF )		
Open Interest (Dec.31/79 ):	10,985	May -219	3.13	0.4
Daily Volume (Dec.31/79 ):	682	Jun. - 78	3.83	0.3
Contract Size : SFR	125,000.00	Jul. -586	4.2	0.3
Approx. US\$ : \$	80,000.00	Aug. -667	4.9	0.3
Minimum Fluctuation :	.00010 (\$12.50)	Sep. -445	6.9	0.3
Daily Limit (Normal) :	.0150 (\$1,875.00)	Oct. -593	6.75	0.3
Margin Required :	US\$ 5,000.00	Nov. -386	6.83	0.3
Commissions :	US\$ 55.00			
Trading Hours :	8:15 am - 1:15 pm			
Delivery Months :	Mar., Jun., Sep., Dec.			

London Euro Deposits : (1979)				
	Dec.7	Dec.14	Dec.21	Dec.28
U.S.				
1 Mo.	14 5/8	15 9/16	14 13/16	14 9/16
3 Mo.	14 1/16	14 15/16	14 13/16	14 3/4
6 Mo.	13 5/8	13 5/8	14 11/16	14 5/8
12 Mo.	12 9/16	12 9/16	13 1/16	13 3/16
U.K.				
1 Mo.	16 1/2	16 3/8	16 1/2	16
3 Mo.	16 5/8	16 3/8	16 1/2	16 1/8
6 Mo.	16 1/8	16 1/4	16 1/2	16 1/8
12 Mo.	15 1/4	15 1/4	15 1/8	15 1/8
C.D.				
1 Mo.	13 3/4	13 7/8	13 7/8	14.
3 Mo.	13 3/4	14.	13 7/8	14 1/8
6 Mo.	13 5/8	13 3/4	13 5/8	13 3/4
12 Mo.	12 5/8	12 7/8	12 3/4	12 7/8
DM				
1 Mo.	9 9/16	9 5/16	9 3/8	8 7/8
3 Mo.	9 5/16	9 1/8	9 1/16	8 15/16
6 Mo.	8 7/8	8 3/4	8 3/4	8 11/16
12 Mo.	8 5/16	8 5/16	8 1/4	8 15/16
SF				
1 Mo.	6 1/2	6 5/16	6 3/8	5 1/2
3 Mo.	5 7/8	6 5/16	6 3/8	5 15/16
6 Mo.	5 7/8	6 3/16	6 3/8	6 1/16
12 Mo.	5 5/8	5 7/8	5 1/2	6 1/2



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BP

Open Interest (Dec.31/79 ) : 10,000  
 Daily Volume (Dec.31/79 ) : 2,041  
 Contract Size : BP 25,000.00  
 Approx. US\$ : US 55,000.00  
 Minimum Fluctuation : .00050 (\$12.50)  
 Daily Limit (Normal) : .05 (\$1,250.00)  
 Margin Required : US\$ 3,500.00  
 Commissions : US\$ 55.00  
 Trading Hours : 8:23 am - 1:23 pm  
 Delivery Months : Mar., Jun., Sep., Dec.

CD

Open Interest (Dec.31/79 ) : 7,287  
 Daily Volume (Dec.31/79 ) : 918  
 Contract Size : CDS100,000.00  
 Approx. US\$ : US 86,000.00  
 Minimum Fluctuation : .00010 (\$10.00)  
 Daily Limit (Normal) : .0075 (\$750.00)  
 Margin Required : US\$ 2,000.00  
 Commissions : US\$ 55.00  
 Trading Hours : 8:21am - 1:21 pm  
 Delivery Months : Mar., Jun., Sep., Dec.

MP

Open Interest (Dec.31/79) : 3,228  
 Daily Volume (Dec.31/79) : 29  
 Contract Size : MP 1,000,000.00  
 Approx. US\$ : US 42,000.00  
 Minimum Fluctuation : .0001 (US\$10.00)  
 Daily Limit (Normal) : .0015 (\$1,500.00)  
 Trading Hours : 8:15 am - 1:17 pm  
 Margin Required : US\$ 5,000.00  
 Commissions : US\$ 55.00  
 Delivery Months : Mar., Jun., Sep., Dec.

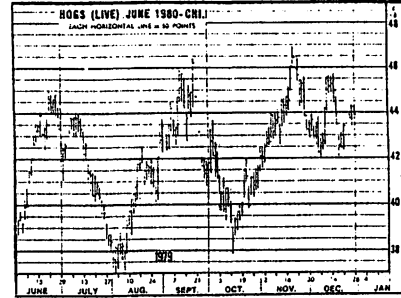
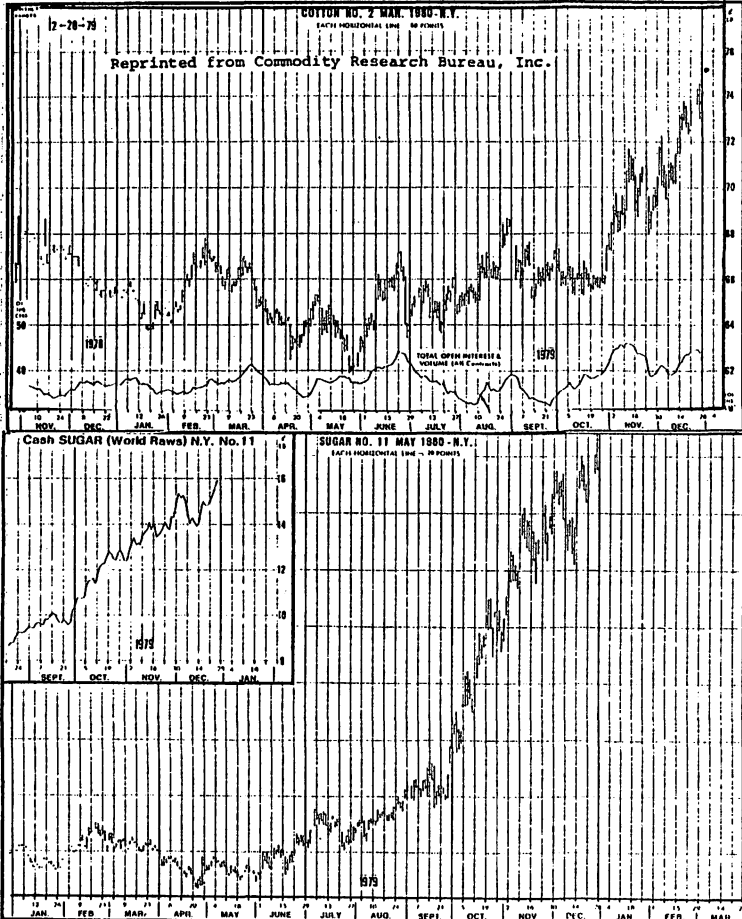
**POTPOURRI** - In retrospect, last month's suggestion to sell March '80 Sugar at the 15.75 was a bit premature and our stop was triggered at 16.20 basis the close. In the interim, the technical structure of the market continues to deteriorate: open interest has climbed to a new high (an incredible 91,000 contracts) while the March '80 has now moved to a substantial discount to the May '80.

We are now quite certain that Sugar will not be able to sustain present levels.

Sell March '80 at market looking to cover at 9½¢/lb. Place stops at 17.20 basis '80, close only.

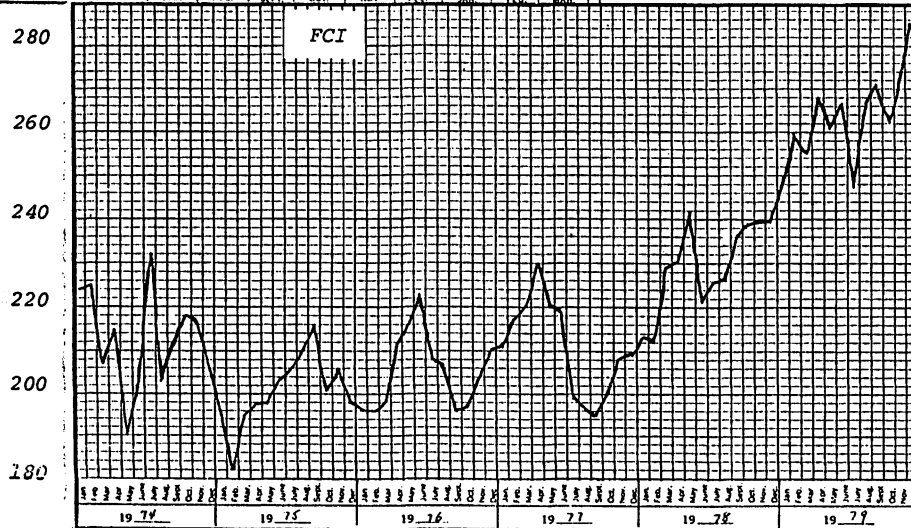
**LIVESTOCK** - The long awaited bull move will require a bit more patience. Purchases on sharp dips are still recommended.

**COTTON** - A significant long term upside breakout has taken place. We are friendly to this market and expect to see a move to 87¢/lb basis March '80. Protect longs will stops at 71¢.



\*\*\*\*\*  
 All statements made herein, while not guaranteed, are based on information considered reliable and are believed by us to be accurate.  
 \*\*\*\*\*

Albert D. Friedberg



# Mr. Carter and Iran

By IRVING KRISTOL

Though the White House and the State Department are being curiously modest about it, they have during these past two months made a most interesting innovation in American foreign policy. Having learned the lesson of Vietnam, where a "graduated-escalated response" failed to work, they have inaugurated a policy of Reverse Graduated Response. Under such a policy, you begin with your maximum response—in this case, unambiguous threats of, and motions toward, military action—and then gradually wind down both your rhetoric and your actions to ground zero. The obvious advantage of this new policy is that it is both riskless and economical: It ensures one's own defeat at no military cost whatsoever.

Now, I know it is dangerous to assume—as I am doing—that the Iranian crisis is over, to all intents and purposes. The Carter administration, in requesting limited economic sanctions from the United Nations, has dropped hints here and there (none for attribution, of course) that, without such sanctions, military action against Iran is very probable. But, in truth, with every passing day such threats become more and more incredible. It is not only that American passions are gradually cooling. There is also the fact to be considered that, by the time our whispered ultimatum to the Security Council has expired, there will be so many American clergymen, professors, and journalists in Iran that any action which might endanger *their* lives becomes an ever more remote prospect. In effect, over these past two months the number of American hostages in Iran has multiplied like rabbits, with our bland consent.

## Larger Ideological Intention

To be sure, it is conceivable that those "students" in Tehran will engage in some demented enterprise (like executing one or more hostages) that might force our hand. But that prospect seems unlikely. Those "students" may look and sound a bit demented on our TV screens, but in truth they have been behaving with a quite far-sighted cunning. They read correctly our original disinclination to any military response, which made those bombastic speeches about their desire for "martyrdom" so easy to declaim. They have manipulated our media with a skill that suggests they may actually once have been university students. And they are now in a very strong position indeed, as visiting clergymen (and perhaps, soon, even TV reporters) reassure us that the hostages in the embassy are, under the circumstances, being treated not too badly after all. True, they haven't got their Shah back—but it is not far-fetched to think that they never really gave a damn about the Shah, but rather had the larger ideological intention of inflicting a political defeat on the United States and the West.

Meanwhile, back at the United Nations, the debate will go on (and on) over our request for economic sanctions. It will be a sham debate, as everyone at the UN knows, and as the White House and the State Department also surely know. Even if those sanctions were voted, they would be utterly ineffectual, as such sanctions always are, and as they are especially bound to be in this case where Iran possesses oil that the world needs and wants. But whether those sanctions are voted or not (and the odds are against), there presumably will be some sort of a trial in Tehran of our embassy hostages which will, of course, be the occasion for a vehement indictment of the American nation—all doubtless broadcast "live" via world-wide television.

Originally, one may recall, the White House had said that any such trial would have the "most serious consequences." Such statements have been noticeably absent more recently. So a plausible scenario is a trial, perhaps a brief one, after which most of the hostages will be released, to be

greeted as they deplane by a tearful Secretary Vance and a grinning President. A few, identified as "spies," will be sentenced by the Iranians to jail terms, and perhaps a few others will simply remain unaccounted for. The administration will vow to strive ceaselessly, through diplomatic channels and appeals to "world opinion," for a fuller accounting and for the release of those imprisoned. The charade will be over.

And a charade—on the part of the United States, that is—is exactly what we shall have witnessed. I am now convinced that this administration never had the slightest intention of intervening militarily.

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unless it was absolutely forced to by something like an embassy massacre. All of the original growling, and the redeployment of our fleet, was a bluff—not against the Iranians, who were wholly and correctly unimpressed, but against the American people, who thought we ought not to stand by idly and watch our nation be subject to gross humiliation. "Keep calm," the White House urged as it proceeded silently with its strategy of appeasement, while beating an occasional tom-tom. And this policy is working. Once those hostages are released the administration will claim "victory" for its fortitude and patience. All talk of "retribution" will quickly be forgotten, as it has already been muted. And, with all those reunited families hugging one another on television, it is not going to be easy to strike a sour, if truthful, note.

But, it will be asked: Was there any alternative course of action? What an extraordinary question! The United States may not be the incomparably strongest military power it once was, but it is still very powerful indeed, whereas Iran after its destructive turbulence of the last months is very weak indeed. If we had mined one (just one!) of the secondary Iranian ports—a bloodless operation—this would have been a far more effective economic sanction than anything the United Nations could possibly do. Most of the shipping companies all over the world would have promptly cancelled their shipments to all the other Iranian ports, lest their ships and crews end up stranded there indefinitely.

Mightn't, however, the "students" then have been provoked to harm at least some of the hostages? There is good reason to doubt this if one believes, as I do, that those "students" have it as their rational political aim to harm the United States as a Western world-power, not senselessly to butcher a few defenseless Americans. But, I have to add quickly, there is no way of being certain about this, and the hostages were definitely at risk. To what degree, then, should our policy have been orchestrated to minimize that risk?

I happen to think that is the wrong question, which, once asked, can only provoke a wrong answer. To begin with, we simply have no way of knowing which policy has had, will have, or would have what effects on the situation of the hostages. Moreover, once the issue was joined, the safety of the hostages was a secondary consideration. There is nothing "cold-blooded" about such a statement. When a nation finds itself confronted with a hostile action by another nation—an action which, in an earlier and perhaps less bewildered

time, would have been recognized by all as tantamount to an act of war—the safety of a few dozen internees, or even a few hundred for that matter, is *always* a secondary consideration. We didn't conduct our operations during the Korean war in such a way as to give primary consideration to the thousands of American soldiers (and quite a few civilians, too, incidentally) held prisoner in North Korea. We held the enemy responsible for their treatment—that is all we were morally obligated to do or could in fact do.

After all, in Iran we are not dealing with an instance of 50 Americans being kidnaped by some terrorist group or other. We are facing an action which, if it was not actually instigated by the highest Iranian officials, is publicly, officially, and loudly approved by them. These officials are clearly out to damage American prestige and weaken American influence in the world. Only the naive would believe that they are doing what they are doing because they are hysterical Middle Easterners whose pathology requires a calm, therapeutic approach. They know exactly what they are doing—it is exactly what the new leaders of Iran, when in exile and opposition, always explicitly said they intended to do, and what it is in their interests, as newly installed revolutionary leaders, to do now. But do we know what we are doing?

I think we do, though I realize I may be in a minority on this score. I propose the hypothesis that Mr. Carter is carrying out a foreign policy that he profoundly believes in. It is not, as some seem to think, a foreign policy that flows from Mr. Carter's Christian beliefs. Mr. Carter seems quite capable of disengaging himself from those beliefs when he is disposed to do so—our Christian President placidly inhabits a White House thickly populated with young countercultural types more interested in pot than in pastoral theology; and there is, in any case, little pacifist spirit in our Southern Baptist churches. Nor is his policy derived from a cool estimate of the military and political realities we face in Iran. One knows that the Pentagon and the National Security Council and the CIA are providing him with estimates of those realities that could easily justify another course of action. Even the State Department is aware that the Saudis would prefer, their outward protestations to the contrary notwithstanding, that Americans act so as to defend their honor in the Middle East—a part of the world where national honor is still taken very seriously indeed.

## Left-Liberal Foreign Policy

One is therefore moved to speculate that Mr. Carter's thinking about foreign policy may well be derived from the kind of left-liberal ideology popular in the 1960s, according to which the United States is a nation so guilty of transgressions, past and present, against the true and best interests of humanity that we *have no right* to defend our own specific national interests. Nor have we any right to the status and influence once thought appropriate to a Great Power. Our mission, instead, is to make amends to the rest of the world, and especially to that portion of the world governed by "progressive"—and, naturally, anti-American—regimes. Even when such nations turn nasty, it is our duty to wait patiently until their tantrums—surely, in some ultimate sense, our responsibility—have subsided.

The virtue of this hypothesis is that it makes sense of Mr. Carter's behavior, gives it some intellectual substance and coherent meaning—which is something that most observers have vainly been searching for. Its disadvantage is that, if true, it is so profoundly depressing.

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