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INTERNATIONAL MARKETS NEWSLETTER

Burns Tightens The Credit Screws

Faced with a liquidity crisis which threatens a speculative spiral and a collapse of the dollar, Federal Reserve Board Chairman Arthur Burns has panicked and tightened the credit screws. In the last ten days Burns has drained the banking system of over $1 billion of lendable funds and pushed up the entire interest rate structure. Burns' intention, much like the Central Banker who occupied his chair in August 1929, is to prevent billions of dollars of foot-loose funds from feeding an imminent speculative boom-bust cycle and an international run on the dollar. His actions, however, also like his predecessor's, threatens to remove the paper facade of the currently touted U.S. "upswing" and engulf the dollar system in a deflationary spiral beyond even the imagination of people like decrepit old Burns who survived the 1930s experience.

Speculators have wasted little time in drawing such analogies. In the last two trading days the stock market has fallen by 22 points and the bond market by comparative amounts. If Burns' "fine tuning" moves continue, as most Wall Street economists expect, however, there is no reason why the downward spiral should stop there; like in 1929-31, once the paper frills of prosperity are stripped away and stocks, bonds, debt-instruments, and mortgages converge on their real worthlessness, then chain reaction liquidation sets in as everyone runs for cash to cover their bills. In domino-style, the fraudulent "upswing," the U.S. multinational banks and the entire dollar payments sytem goes down.

What Is a Liquidity Crisis?

The unavoidability of this chain reaction process lies in the nature and build-up of the liquidity crisis itself. A liquidity crisis of the kind that has erupted is not what it appears to be. To an empiricist fool like Burns, a liquidity crisis is an excess of funds with no place to go but into such speculative outlets as the stock, currency, commodities and real estate markets. According to this view, the crisis can be simply corrected by stepping on the credit brakes; no harm need be done since most of these funds allegedly represent "spare cash" for mere speculative amusements.

In reality, a liquidity crisis is the deepest expression of capitalist illiquidity; it is a situation in which there exists an actual shortage of funds relative to the debt service requirements of the dollar system itself. Under conditions such as those building since the late 1960s — in which the real economy has generated insufficient profit to meet debt payment schedules on capitalist paper stocks, bonds and loans — two "solutions" were undertaken to postpone a credit collapse. First, the Federal Reserve as the "lender of last resort" injected whatever amounts of new credit the circulation of major categories of debt required. Second, in so far as this remained insufficient, corporations rechannelled circulating capital normally used for operating expenses and real investments into debt-service. Such new credit infusions themselves bear interest costs and must earn income. But to the extent that this mass of paper expands more rapidly than the ability of shrinking production to generate profits to support them, such "excess" funds rush into whatever speculative outlets can earn them the paper profits to cover current account debt service. Such speculation becomes the life and death of the system. However, the increased profits they generate require additional paper to circulate...ad infinitum until an inflationary bankruptcy like the one currently underway. On the other hand, if credit is contracted, a payments crisis erupts overnight and the house of paper profits falls apart.

This process has been going on for several months in condensed form. To review: by the fall of 1975 the year-long depression in world production and trade — a managed liquidation to finance the debt requirements of the dollar sector — weakened and severely undermined the ability of such dollar debtors as Third World governments (Zaire, Argentina, Chile, and Peru particularly), U.S. municipalities (New York City) and bankrupt corporations (W. T. Grants) to service their debts and thus threatened an openly acknowledged chain reaction collapse. With the New York banks and their off-shore Euro-dollar branches taking the brunt of these threatened defaults, Fed Chairman Burns carried out massive credit transfusions into the banking system both to refinance the weak links of the dollar credit system and to provide New York banks with a reserve cushion against threatened deposit runs.

A sizable portion of these funds was instantly shipped abroad by the New York banks to their off-shore branches in the Euro-dollar market to refinance Third World and Italian and British debt. During the fourth quarter alone a record of $4.5 billion in such reserves were shifted abroad.

"Got to Loan to Someone ... "

The expansion of such credit under conditions of relative economic stagnation has produced the very crisis which so alarms Chairman Burns. First, this mass of newly created bank reserves on which banks must themselves pay interest costs have no outlets but in refinancing operations of these sectors which earn them no income returns. Second, the run-off of outstanding good loans by corporations, which have no recovery expectations and therefore no need to borrow, has only piled them up with more reserves on which they can earn next to nothing. As a hysterical New York banker observed, "As long as the Fed keeps the money pumping in the U.S., the banks have got to loan to someone...but the real problem is who else do the banks have to lend to but bankrupt Third World countries? Certainly industrial loan demand in the U.S. will remain flat."

To offset such unwanted accumulations of reserves these banks have liquidated their "purchased deposits" (blocs of $100,000 deposits usually purchased by corporations) as fast as they mature. While this momentarily eases the problems of the banks, it simply transfers it to corporations who are themselves left with excess of short-term money on which they cannot earn income to meet their own bills (to the banks).

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Predictably, this has produced a panic spiral as financial intermediaries rush into whatever speculative outlets they can get their hands on. Thus the present speculative binge; billions of dollars have poured into the stock and bond markets creating a "bull" market rally. This, however, does not represent confidence in the soundness of the market as it is currently being interpreted. "The basic reason for this long rally," notes one of the few Wall Street bond traders not hanging from the ceiling, "is not a conviction by institutions that rates will be coming down, but rather an abundance of cash." What are the corporations doing with the money they are raising on the bond market? Spending it on plant and equipment as is normally done? Wrong. They are reinvesting in the stock market!

It is this speculative hysteria that has produced the fraudulent consumer-led "upswing." Individuals invest in stocks whose price skyrockets. The individual thinks he is wealthier so he decides to buy appliances and a car, and the banks desperate for borrowers to pay 13.38 per cent interest lends them the money to do so. Corporations such as the auto companies take this as a sign of consumer confidence and run up production schedules. In turn, the increase in production becomes a sign of "economic recovery," and further fuels the stock market rally.

All this has produced gross pyramiding otherwise referred to as the economic recovery of 1976. The incompetent, Democratic Party-linked economic think tank, the Brookings Institute, has produced a "theory of recovery" on this basis suggesting that the stock market's 180 point rise over the past six months has increased the paper value of equities by $225 billion, which they project will produce collateral for additional $27 billion of consumer loans and subsequent spending. This in spite of the continued erosion of the real issues of the population.

This process cannot continue without greater and greater credit infusions to circulate such paper-inflated wealth. When this happens, the speculative bubble feeds on itself until the dollar itself faces collapse.

This is precisely what is happening and Burns understands at least this much; to quote from a May 6, 1975 speech: "While inflation may begin slowly in an economy operating at high pressure, it inevitably gathers momentum. A state of euphoria tends to develop, economic decision-making becomes distorted, managerial and financial practices deteriorate, speculation becomes rampant, industrial and financial imbalances pile up, and the strength of the national economy is slowly but surely sapped. That is the harsh truth that the history of business cycles teaches us."

The much harsher truth Burns does not want to or is not equipped to see. The attenuation of monetary expansion he is committed to for the moment will instantly produce precisely the collapse that such credit infusions over the past several months were designed to avert. The apparent prosperity of the upswing will blow to pieces as consumers and producers follow in suit with the stock market crash. Banks faced with a shortage of reserve to cover the corporate defaults which will ensue will return the billions of dollars previously shipped abroad to cover their positions; the rest of the dollar sector, meanwhile, will thus be deprived of the funds with which to finance an account deficit itself ensued by the collapse of exports to the United States. In a replay of 1931 the reflow of dollars to the United States will starve Europe, Japan, and the Third World of needed credit. Chain reaction defaults, a precipitous contraction of world trade and the final collapse of the dollar empire will follow.