

Dollar Shakeout Begins

The biggest market shakeout in the post-war period is underway, and all players are scrambling for positions. Contrary to surface impressions, the great decline of the dollar on the foreign exchange markets was neither a correction for the anticipated \$30 billion U.S. trade deficit, nor a reaction to Treasury Secretary Blumenthal's much regretted remarks at the July OECD meeting concerning the Administration's willingness to let the dollar fall. The dollar fell, rather, in the wake of efforts by Fed Chairman Arthur Burns to buy time against the onset of a liquidity crisis on the Eurodollar market.

Burns' deliberate efforts to push money into the U.S. banking system, which produced the 18.5 percent rate of growth of narrowly-defined money supply over the most recent 4-week period, culminated eight months of struggle to prevent general default by a number of Third World countries. The U.S. banking system's resources have been shipped abroad: the New York banks alone, measured by clearinghouse figures, effected a net \$12 billion transfer of liquidity abroad this year, partial refinancing for about \$37 billion in debt service due this year from the Third World. The big refinancing operation benefited strongly from the first-quarter surge in commodities prices, which faded into a price shakeout over the second quarter, with devastating effects on the current-account payments capacity and deposit base of leading Third World countries.

Defaults Within Days

The liquidity crisis hit with full force in July. The Federal Funds market became the deposit pool for refinancing new debt service, at the height of the heavy third quarter payments schedule. The glut of funds on the market collapsed the dollar. Burns' efforts to sustain the dollar by hauling up interest rates have narrowed lending margins on the Eurocurrency market to between 3/4 and 1 percent, the level of extreme danger, especially considering that leading international banks have used the extremely high lending margins of the last two years to siphon interest-income into bookkeeping accruals on loans to insolvent Third World and other borrowers. This, as the leading West German daily *Frankfurter Allgemeine Zeitung* analyzed the spread squeeze on Aug. 11, "sets the conditions for a panic."

Now the European press, as a whole, is openly discussing the likelihood of a debt collapse within days.

*The *London Times* cites "international bankers" predicting an open default by Peru within days, not weeks," due to the country's refusal to accept International Monetary Fund loan conditions, and bankers' unwillingness to refinance debt further.

*The *International Herald Tribune* (Paris) predicted Aug. 12 that Brazil would default during September, when the country's coffee exporters must pay up on contracts for future delivery they bought earlier this

year in a vain effort to boost coffee prices. The coffee exporters, now on the verge of bankruptcy, will not be able to make their September payments, and the result will be major Brazilian defaults.

*The leading Argentine newspaper *Clarín* predicted Aug. 9 that debt defaults would occur "within weeks," and that "if two or more countries defaulted, the entire banking system would go up inside of 15 minutes."

*The *London Times* predicted Aug. 12 that the dismissal of the Zaire central bank governor last week would wreck all the complex loan renegotiations of the past year, leading to Zaire's default.

Burning Bridges

There should be no illusions as to the character of the situation. The liquidity crisis is the immediate result of Western European and Arab refusal to put up with a declining dollar, which forced Burns' rise in interest rates. As late as Wednesday, Federal Reserve officials pleaded with the West German monetary authorities for a drop in interest rates and similar fiscal reflation measures, in order to enable the Fed to stay the rise in interest rates and prevent a renewed plunge of the dollar. The West Germans refused point-blank, and the Bundesbank Council meeting held rates steady at its Thursday meeting. In response, the Fed began another round of rate-tightening, which may well push the Fed funds rate far above 6 percent. Burns, for all the lessons of the past 50 years, has done precisely what the Federal Reserve did prior to the great 1929 crash, i.e., first unleash a mass of liquidity, and then raise its cost.

These events have set off a scramble for existence among leading banking factions, characterized, among other developments, by a decision among the Citibank directors to survive in a situation where its "rival," Chase Manhattan, may well have to be sacrificed. Although the emerging lineup is not yet clear, a number of possibilities can be set out in advance. First, a major change in British thinking has taken place over the past week. A commentary in the *London Times* Aug. 11 by David Blake characterizes the International Monetary Fund as a "boxed-in, powerless," "formerly impressive" institution, with "disbursement commitments four or five times in excess of its resources," and proposes that the Saudis and other countries with low voting rights inside the IMF not be "suckered" by the United States.

Arab tolerance for the dollar mess is at a low, despite the Saudis' reluctant agreement, under direct threats from terrorist Cyrus Vance, to give the IMF \$2.5 billion last week. A group inside OPEC is dead-set against helping the Fund. An *Agence France Presse* report notes that a faction inside OPEC demanded no contributions to the Fund, while the Venezuelan oil minister Hernandez Acosta and the Emirates minister al-Otaiba jointly stated

at a press conference Aug. 6 that if the dollar kept depreciating they would switch oil payments to a new OPEC currency.

The British are in an immediate squeeze, since certain of their banks are among the most vulnerable to a profit-squeeze on dollar lending. However, Lloyds' and a number of other large banks are considering a return to sterling lending to the Third World, with backing for the British currency by the Arabs. Indeed, the Italian business daily *Il Sole* Aug. 12 linked the recent credit-easing moves by the Bank of England to a greater international lending role for the British pound.

It is still doubtful that the immediate reactions of the

banking community to the imminent mess ahead constitute a final answer. Most of what is now underway is improvisation and scramble. Analysts at Kidder Peabody believe that first-tier banks like Citibank will survive in the short-run through triage of second and third-tier institutions. But such exercises in lifeboat economics have obvious limitations. What must be seen is whether the proposals for a joint European-Arab-Comecon currency arrangement with some form of gold peg take off, or whether the U.S. Administration succeeds in crushing them. In the latter case the world situation will almost certainly deteriorate into chaos within weeks, with the most extreme dangers at hand for the avoidance of a war confrontation.

— David Goldman

Mr. Witteveen's Partial Victory At Paris

Although International Monetary Fund Managing Director Johannes Witteveen left the Aug. 6 meeting of rich countries in Paris claiming to have \$9.6 billion in hand for a special IMF fund, the IMF will neither be able to collect or spend the money until well into 1978. According to senior IMF and World Bank sources, the availability of hard cash to the IMF will be delayed pending appropriation of the American share by Congress, and extremely difficult to spend under conditions set by the West Germans.

Witteveen called the meeting to raise funds for the so-called "Special Facility" for countries pressed by balance of payments deficits, originally projected to comprise \$16 billion at the April 26 meeting of the IMF's Interim Committee in Washington, D.C.

As those countries with heavy deficits are not coincidentally among those with large outstanding — and uncollectable — loans from the New York banks, it is hardly surprising that many in Europe and the Third World view the "Witteveen Facility" as a bailout fund for David Rockefeller and friends.

Forced to scale down his original demands, Witteveen extracted commitments totalling SDR 8.15 billion, or \$9.6 billion, from the following countries:

Saudi Arabia	SDR 2.15 billion
United States	1.45
West Germany	1.05
Japan	0.90
Switzerland	0.65
Venezuela	0.50
Abu Dhabi	0.10
Canada	0.20
Belgium	0.15
Holland	0.10
Qatar	0.10

France and Britain had been excluded from the meeting, on the grounds that the two countries would be potential borrowers, not donors to the fund, despite some British objections, as the British press noted with some

malice. Nonetheless, West German Finance Minister Hans Apel announced in a press conference Aug. 6 after the meeting that his position had been entirely coordinated with his European community partners, Britain and France. The conspicuous absence from the donor list of Nigeria and Kuwait, the OPEC countries with the closest ties to London, indicates that the British had their revenge in any case.

Details of the Fund's operations have not yet been released, and the Executive Directors, the national representatives who manage the IMF's affairs, are still hammering out points of difference. But numerous IMF sources report that the money will be unspendable for the critical months ahead. First of all, in the best-case scenario of the IMF Secretariat staff, the U.S. Congress will require a minimum of six months to appropriate its share. The London *Sunday Telegraph* gloated Aug. 7 that Congress could not even consider the issue under the current tight legislative schedule before its recess in October. Witteveen lost on a crucial procedural point: the special fund will not be "open-ended," that is, Witteveen cannot spend any of the \$9.6 billion until the full complement has been gathered. So the Saudi contribution cannot be spent until the U.S. contribution is through.

Secondly, as Apel emphasized in his press conference, the new money will not function as a special fund to be lent at Witteveen's discretion, but will only be lent out under the existing procedures for normal IMF lending, and under tight conditions. IMF member countries may draw from their quota at the IMF in four tranches, each requiring approval by the Executive Directors, and increasingly strict conditions. The much publicized loans this year to Britain and Italy took place under fourth-tranche conditions, which require the borrowing country to submit its entire domestic economic policy to IMF approval. Apel emphasized that the same strict procedures will be employed for the new money, which will only add to member borrowing capacity under the existing tranches, which have been virtually exhausted. "The money may never be spent," commented a West