German monetary official. The precise details of the lending formula are still being worked out, but all sources concur that lending will fall within these tight parameters.

"The West Germans are playing tough," commented a senior World Bank staffer. "They claim that the U.S. commercial banks are too eager to lend money to developing countries, and mess things up for them by ruining these countries' credit rating. So they imposed tough conditions. Witteveen doesn't like that," the official said.

"Probably the money never will be spent," the official continued. "It's for show, like bank reserves. As long as it's there, and you can count on it, it helps confidence."

The preservation of that admittedly thin veneer of credibility, however, allows the Vance's and Brzezinski's to pursue at the risk of nuclear war their nuclear "chicken game" and blackmail and terror operations against Europe, the Middle East and the USSR — and thus despite its setbacks, the IMF came out the meeting better than many observers had expected. According to an *Agence France Presse* report Aug. 5, a minority faction in the meeting of OPEC finance ministers that week proposed to reject contributions to the IMF on the grounds that OPEC had more important commitments in the form of direct loans to the Third World, and internal development spending. This faction included Kuwait, the United Arab Emirates, and Venezuela, according to highly reliable Arab sources. State Department officials responsible for following this area doubted, prior to the meeting, that the Saudis would give anything close to the $2.5 billion they ultimately agreed to.

Highly reliable sources report that U.S. Secretary of State Cyrus Vance, who visited Saudi Arabia Aug. 5, used threats of military action and terror against the Saudi Royal family to persuade them to hand over the money. The next day, the Saudis paid $2.5 billion in protection to the IMF.

The IMF's credibility has survived, but by the thinnest of possible margins. It still has virtually no effective resources to deal with the Third World balance of payments deficit this year of over $50 billion, including at least $17 billion in repayment of debt-principal, and over $20 billion in interest (some of which is not counted into the official balance of payments numbers).

Banks Are Squeezed On International Credit Markets

In a period of increasing debt payments on the international market, total world lending volume has barely risen during the first half of 1977. International bond issues and medium-term Eurocurrency bank credits have reached $33.1 billion for the whole of 1976, reflecting an actual decrease if a 10 percent inflation rate is taken into account. This has not been due to "an improvement in the currency accounts of the Third World," as some New York bankers would still claim, but to the fact that those Third World countries have met their payments only through the 1976-1977 commodity price increase: through self-imposed or International Monetary Fund imposed austerity and through related import cuts. The burden of the debt has been partially transferred to the commodity-consuming industries of the developing sector, which in turn have increased their rate of borrowing — not for capital formation, but to maintain working capital. The structure of the borrowing has therefore been almost entirely artificial — divorced from capital-intensive, long-term development projects — and as such, has left the markets in a state of immediate vulnerability.

The maintenance of international borrowing levels was determined by an increasing presence on the markets of relatively well-off industrial countries such as France, Great Britian and Sweden, and a sharp growth of the OPEC share. The more needy Third World countries were kept out of the markets.

As a whole, the share of the non-OPEC LDC's and that of the "international organizations" involved in the Third World financing has dimished while ironically, only the petrodollar rich OPEC countries have increased their participation.

A country-by-country approach is even more revealing. The more important borrowers are industrial countries with balance-of-payments problems, trying to maintain imports for their basic industries and a certain level of investment through foreign indebtedness. In other words, while Mediterranean and Third World countries near financial collapse were willingly or unwillingly absent from the international markets, industrial countries actively borrowing were progressively putting themselves in the financial situation of Third World countries!

The case of the Scandinavian countries is especially spectacular, with debt-service ratios (annual ratio of foreign debt payments to total exports) already similar

Shares of total publicly announced international borrowing

	1976	First half 1977
Industrial countries	57.5	56.9
LDCs (non-OPEC)	20.8	19.1
International organizations	10.7	8.1
East Bloc	4.2	4.1
OPEC	6.8	11.8

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to countries like Spain and Portugal. These countries have been trying through futhur indebtedness to avoid currency devaluations demanded by the New York banks. This cannot be called sound borrowing.

Main borrowers; eurocurrency and international bond issues

(In billions of U.S. dollars)

	1976	First half 1977
Industrial countries		
Sweden	1.551	1.803
United Kingdom	2.707	2.668
France	3.307	2.190
Norway	1.879	1.196
Denmark	1.602	1.083
Mediterranean countries		
Spain	2.281	1.040
Third World countries		
Brazil	3.500	1.293
Mexico	2.441	1.338
Philippines	1.337	396
Argentina	958	338

The case of Argentina is particularly hailed by the International Monetary Fund: the government of that country managed to cut its foreign borrowing through a drastic austerity program which impairs iits industrial development. This is the reality behind the above mentioned figures.

Lending Crisis

The nominal increase in international borrowing was entirely due to Eurocurrency credits and the Eurobond market. Eurocurrency credits reached $17.763 billion for the first six months of 1977 as against $28.850 for the whole of 1976. The Eurobond market amounted to $10.040 billion for the first six months of 1977 as against $14.328 for the whole of 1976. On the contary, international bond issues in the U.S. and other national markets have sharply fallen.

On the U.S. bond market, foreign bonds issued during the first six months of 1977 reached an amount of $3.42 billion, as against $10.604 billion for the whole of 1976. This means that during the first six months of 1977 the total was little more than half of the amount raised during the equivalent period of 1976. This mainly reflects a decline for Canada, which raised $1.6 billion in January-July 1976.

The trend was even more spectacular in the foreign sectors. Switzerland raised $1.097 billion this year (as against $5.36 billion for the whole of 1976) and West Germany raised $488 million this year (as against $1.29 billion for the whole of 1976). This is to say that a country like Switzerland raised less during the first seven months of 1977 than they had done during the last quarter of 1976.

This was not because drastic conditions were imposed on foreign borrowers. Despite low interest rates and available 8-10 years credits, there was still no significant demand. The conditions were in fact even better on the U.S. market than on the Euromarkets, and several foreign borrowers obtained Eurocurrency bank credit commitments as a backing to issue commercial paper in the U.S.. The simple truth is that potential borrowers were economically exhausted and unwilling to invest in real production given the narrowing rates of profit.

The West German bond market is the most revealing example of this situation. Speculative liquidities flowing into investments in deutschemarks, while West German industry borrows only what it needs for sheer survival. As a result, there is a "borrowers' market" in which maturities of the obligations grow longer and longer. *Handelsblatt*, the journalistic spokesman of the West German industrial community, is satisfied, because whereas in 1974 only about 15 percent of the securities' terms were 10 years or over, now that category is over 50 percent of the notes issued, and almost nothing remains under two years.

This would be all very well if West German industrialists were investing; but the West German industry, as well as the U.S. and the Third World countries, are actually deinvesting, and this is reflected on the bond markets. All new bond issues are now over-suscribed and interest rates continued to go down.

There was so much liquidity around and so few potential borrowers that the recent fall of the dollar on the exchange markets does not appear to have caused much of a problem, if any, for dollar-donominated Eurobonds. New issues offered in the midst of the dollar decline were in sufficient demand to permit increases in the sizes of issues and reduction in the coupon-rates.

Banks Squeeze

Thus the ironic problem for the banks at this point is a glut of funds available to be lent and not enough borrowers on the market. As a consequence, the differential between the lending rate and the rate at which the banks borrow money is falling; it has now reached one percent, barely enough for the banks not to lose money.

The banks' extreme vulnerability is aggravated by the recent shift in the markets. Starting in July, there is already a push for more credit from Third World, East Bloc and Mediterranean countries. The decrease in commodity prices which started by the middle of the second quarter has impaired the export resources of those countries, while certain governments have decided to borrow again whatever the consequences in order to maintain their industrial capability.

For example, various East Bloc countries tried to reduce their borrowing at the end of 1976 and during the first quarter of 1977. But seeing that this was impossible without impairing their economic growth, they have restarted borrowing again— and the amounts borrowed have doubled between the first and the second quarters of this year. Moreover, Poland and the USSR, which have the most dramatic need for credit, have now to rely heavily on short-term bank credit. The case of Turkey is worse: it has based its industrial development on short-term bank credit (convertible accounts in Turkish lira) and is now unable to service its debts— except by borrowing more.

Another token of credit-for-rollover needs is the situation of the U.S. bond market. Foreign bonds issued in the U.S. reached $1.3 billion during the first quarter of 1977 and $2.1 billion during the second quarter. Despite the increase, the total was 40 percent inferior to that of 1976. But in July only $1.2 billion foreign notes were issued on the market — much more than than in 1976.

To meet those new requirements, the money supply has been drastically increased in the U.S., and now interst rates have been raised to save the dollar.

The banks are therefore facing the following dilemma: on one side, their cost of borrowing is increasing despite overflowing liquidities, while on the other side a new round of bankrupt borrowers is coming back to the markets and pressing for low interest rates.

Burns Tries To Save New York Banks; Ruins The Dollar

While Treasury Secretary Blumenthal has been lashed for the last month in the international press, with some justice, for destroying the dollar, Federal Reserve Board chairman Arthur Burns has been quietly and deliberately acting as the real force bringing on the dollar's downfall.

Since the beginning of this year, Burns and his Wall Street cohorts have been rushing to plug the widening holes in the badly leaking New York banks' real asset picture, using any means at their disposal, no matter how illegal or damaging to the nation's economy and credit.

Under Burn's direction, two complementary strategies have been followed. First, with Burns' active approval, the largest New York commercial banks have violated sound banking principles — and perhaps several laws — to transfer huge volumes of deposits from domestic accounts at their New York head offices to their foreign branches. Between January and August, a net swing of $12 billion of liquidity of the ten largest New York clearing house banks has been effected. Second, beginning approximately June 1, Burns started a policy of pumping federal funds into the accounts of the Wall Street banks at artificially cheap prices.

The net effect of these policies: the deposits and federal funds have been pumped into the Eurodollar market. There, unencumbered by reserve requirements, they have been re-lent several times over to prop up the swollen book value of New York's bank loans to notably over-indebted Third World countries.

Why the Money Supply Has Shot Skyward

The most immediately visible of the Burns' solutions to save Wall Street has been manipulation of the federal funds rate by the Federal Reserve's Open Market Committee (FMOC).

Since June 1, the FMOC has been making increasingly heavy purchases of Treasury Securities in order to hold down the rate at which banks borrow money from each other — the federal funds rate. Until the first week of August, the FMOC kept the federal funds rate for the two previous months to between a narrow range of 5.3 percent and 5.4 percent. Consequently, for the month of July, bank reserves increased at a stunning 18 percent rate, and since June 1, the monetary base has grown at an annual rate of 12 percent.

But this easy-money policy immediately reverberated throughout the economy, pushing skyward the monetary aggregates, which strongly reflect the amount of new reserves pumped into the economy. According to the latest Federal Reserve weekly figures, M1, consisting of currency in circulation and demand deposits, has been growing at a staggering 18.5 percent rate for the last four weeks, and M2, consisting of M1 and savings deposits, has skyrocketed at a 12.9 percent rate for the last four weeks. The eight-week averages of these aggregates have been equally high.

Business Week senior editor Bill Wollman, in an Aug. 15 commentary in that magazine, titled "Has the Fed Made A Costly Blunder?" points out that "the Fed has been indulging in a binge of money creation that ...threatens the world economy with sharply higher prices, soaring interests rates and unstable currencies." "Why did the Fed indulge in a cheap money policy" which is clearly so destructive, Wollman asks.

The answer has nothing to do with the domestic economy. By holding the federal funds rate low, the Fed kept the New York banks flush with a supply of cheap and abundant funds. Because of the highly competitive conditions existing in Europe, which have lowered the bank spread between obtaining and lending funds to 1 percent interest, the Fed policy gave the New York banks an extraordinarily important marginal advantage in the price they paid for funds.

And borrow Fed funds the New York banks have done, in record amounts. By the week ending Aug. 3, the ten largest weekly reporting New York commercial banks had a cumulative purchased position of over $20 billion in federal funds, more than 15 percent of their total liabilities! No other regional group of banks even approaches this figure.