A one-shot order related to the West German-Brazil nuclear deal indicates what could have happened. The BRD government's index of foreign capital goods orders hit 379.6 in July 1976 — nearly four times the 1970 base level. The index never regained that level and was down to 197.3 as of June 1977.

West German corporate profits have already shrunk, due to the production drop and the necessity of keeping prices down to remain competitive under conditions of a rising deutschemark. According to a Reynolds Securities report, the drifting West German stockmarket "reflects increasing disquiet about the trend of profits. In previous reports, we estimated that these rose by 20 percent in 1976 and that they would probably rise by some 8 percent or so in 1977, but this latter estimate must now be reduced to somewhere in the region of zero to plus 5 percent, averaging 2.5 percent."

Rather than investing in new plant and equipment, BRD corporations have been purchasing fixed-interest BRD government securities instead. The "excess liquidity" conditions have resulted in the lowest federal government bond rates since 1964, but this bond market "boom" only covers over the contraction in productive economic activity.

France: "Hard" Franc Policy Guts Consumption

In France, the Barre plan, a domestic austerity program to maintain a stable franc and reduce inflation, has "succeeded" in touching off a 5.8 percent drop in domestic demand. The internal consumption cuts, combined with sluggish export markets, have already produced an upward surge of inventories and production cutbacks. French industrialists, however, have few illusions that Barre's new stimulus plan will have any effect. "Much is made of internal economic problems such as unemployment," stated a spokesman for Usinor, France's steel giant, "but those problems could be quickly solved. The main difficulty is the slowdown of other key world economies. Without a pickup outside France we can't begin to solve our problems."

Although the French trade deficit has gradually narrowed since the third quarter of 1976, this has merely tended to reflect decreased economic activity. In July, both imports and exports fell by 7 percent and 1.5 percent respectively.

The world's financial press stupidly gloats that insolvent Italy is "recovering" since the country ran a trade surplus for two months-running, including a $322.5 million surplus in July. In reality, a sharp production decline has allowed the country to reduce imports of raw materials. The production cutbacks would have been even deeper if it were not for the fact that Italian banks have accumulated a short-term foreign indebtedness of $7.9 billion.

According to a recent survey taken by the Turin Industrialist's Union, representing mainly small businesses, 40 percent of Turin businesses expect a drop in orders and only 15 percent predict increases. Meanwhile, whole chunks of Italy's public sector industry have gone bankrupt and are being placed on the auction block for sale to Lazard Frères-associated banking networks. The government steel and metals company (EGAM) was recently liquidated and the giant holding company (IRI) has requested a $1.3 billion group bailout.

In August, Britain recorded its first trade surplus since 1972 and its largest since July 1970 ($551 million). Although this news was the cause of more speculative euphoria on the British stock market — taking the *Financial Times* 30-stock index beyond its previous May 1972 peak — the sad truth is that imports plunged 12 percent while exports dropped slightly, hardly a sign of industrial recovery. Britain's industrial production index is now precisely where it was seven years ago.

—Alice Roth

Flow Of Third World Loans Go To Debt Payment As Economic Crises Worsens

BANKING

Contrary to statements made by West German, Japanese, and U.S. bankers at the Bank of America-organized Tokyo conference of the American Bankers Association last May, the new series of significant loans granted now to leading Third World countries such as Mexico, the Ivory Coast, and Brazil do not follow a coherent strategy for industrial investment. The loans are being deliberately made to permit further debt repayment. This intervention of international banks, which reverses the pattern of an LDC decrease in borrowing during the first half of 1977, is not a response to the urgent needs of the Third World. Instead bankers are seeking a way to increase their volume of operations so as to artificially compensate for their half dead lending markets in the advanced sector, dried up by the lack of capital formation.

The fact that most of the loans are nominally tied to development projects does not hide the actual debt repayment which is to proceed.

First, all available national resources are now allocated by the planning agencies of the Third World countries to debt repayment. Investments eventually generated by project loans, if any, are not used to create further productive capacities but to replace national investments triaged in favor of debt repayment. This is exactly what Carlos Villares, President of the Brazilian Association of Manufacturers (ABIB), was referring to when he told the press after his speech to the Escola Superior da Guerra last week: "Our basic industry is now denationalized, Brazil must develop its own technology."

Second, in most cases the funds generated by project loans are themselves used for debt repayment. Project loans are granted for activities that will not begin for two or more years, and in the interim they are oriented toward debt repayment. The best example is the $250 million loan for the Brazilian electricity company Electrobras, for which the lead banks are Bank of America and West Germany's Dresdner Bank. It is the largest loan ever to a Brazilian company which is not tied to exports. and it is announced for "immediate disbursement." The president of Electrobras admitted that the loan is of financial character and unlinked to any purchase of equipment, but scheduled to be used for "ongoing projects." The precise list of projects is unavailable, a key sign to those in the know that the funds are diverted toward debt repayment.

Countries such as Mexico and Brazil will borrow formidable amounts this year, despite the apparent decrease in the figures publicly announced for the first half of the year, amounts which roughly correspond to the total of their current account deficit and debt service requirements on both short and long-term debt.

Mexico, with its recent $1.2 billion loan, has now reached its $3 billion borrowing quota imposed by the International Monetary Fund (IMF). But this amount was not enough to keep the national economy afloat and at the same time pay the $4-5 billion debt coming due this year. The Mexican government is now "solving" the dilemma with money obtained under the table. Officials at the World Bank estimate that Mexico may receive about $2.5 billion by the year-end from non-public sources, part of it from "private placing" — mainly the purchase of government securities by U.S. insurance companies such as Prudential Life Insurance, and the rest from unreported direct loans granted by U.S. banks — both in flagrant violation of the IMF lending limits. Bankers therefore estimate that Mexico will borrow a gross total of $7-8 billion this year, furthering the weight of its debt burden for the coming period.

Brazil, beyond the $250 million obtained by Electrobras, is getting a $320 million loan from a consortium headed by Bank of America, Morgan Guaranty, and Manufacturers Hanover, and a $210 million loan for the future Rio de Janeiro subway. If the country has "only" borrowed $2 billion in loans during the first half of this year — significantly under the corresponding figures for 1976 — in the second half it will take $4-5 billion, the required amount to pay its current account deficit and debt service and run up its foreign reserves by about $1 billion.

Third World Scramble

This new bank intervention into the Third World is only made possible by the production collapse in the U.S. and in the industrial sector of Western Europe, which frees up liquidities. There is in fact a drunken-sailor lending spree on in the Third World. According to a First Boston official, Bank of America has looked at its deposit base, and then at the collapse of loan demand in the U.S. economy, and decided to move into international lending.

It is both the relatively less exposed banks and those over-exposed which are the most active in the markets, for entirely different reasons.

On one side, Bank of America, Morgan Guaranty, the British clearing houses and the West German banks are going after volume to try to control the whole market, using their relatively limited exposure as leverage. It is this group of banks who took most of the recent loans to Mexico and Brazil. As a result of their pressure to lend, bank profitability is rapidly falling, as reflected in the decrease of the "spread" over Libor (London Interbank interest rate) — the difference between the cost of borrowing money for a bank and its rate of lending. The spread is now barely over 1 percent for average Third World countries, and under 1 percent for all oil-producing countries, including Venezuela and Nigeria. Bank of America even granted a $150 million loan to the Bolivian oil company at a low 1.5 percent over Libor given the problems of the country, a bet on future oil production in the Santa Cruz region and an effort to underbid everybody in a grab for markets.

Under such circumstances, over exposed banks in bad financial shape, for example Chase Manhattan and Chemical Bank, are being squeezed. They need volume to make up their spread losses and compensate for their increasing losses on bad loans, but the more they intervene, the more they add their own weight to that of Bank of America and others to send the spread rates down. At every new lending round they need more volume, but it is now doubtful how long they will be able to continue given the progressive cutoff of their sources of new Arab funds. Such qualified analysts as Salomon Brothers and Kidder Peabody predict a disaster for profitability, which will trigger a massive withdrawal of Arab deposits — an unavoidable situation of bankruptcy.

Citibank, caught in the middle of the storm with a relatively solid financial structure but high exposure in Third World lending, is holding back, hoping that the loans of other banks will help the payment of their own past debts. Its position has fallen from number 1 to number 9 in Eurodollar syndications, although their volume of international lending is still massive, especially to Algeria and the Ivory Coast. But their strategy of "wait, consolidate and see" is extremely dangerous for their own interests, as shown by the fact that their Zaire loan is still up in the air, with a destabilized situation in the country after the arrest of Foreign Minister Nguza Karl-I-Bond, and purge of the Central Bank head. This failure can immediately harm the plans made by Citibank's Senior Vice-President Irving Friedman to stabilize the debt situation of such countries as Peru, Turkey or Zaire. The declaration made by a Citibank official to the *Neue Zürcher Zeitung* according to which "the portfolios of U.S. banks are strong enough to take a massive consolidation of Third World debt" should be seen more as a show of confidence made for the Swiss banking community than as a proof of deep financial solidity.

The general destabilization of the markets is best shown by the case of Brazil. Brazil is now offering a high interest rate spread (at around 2 percent) which induces the banks to lend heavily. The Brazilian government is doing nothing to pressure the banks to lower the rates, with the result that the country accumulates funds at a very high cost. But the competition to go into Brazil's debt is such among the banks that the "widespread feeling" is that spreads for the next Brazil loan will be much slimmer. In terms of actual economic sanity, we have therefore the following: the more Brazil indebts itself at a high cost, the more banks lend, and as a result, the cost diminishes and the profitability of the banks falls. At the end of the process, if nothing stops it, such countries will be unable to pay their debts and the banks will be, as a whole, ruined over a mountain of paper!

Economic Insanity

This Third World scramble by the chief international banks, this internecine warfare in the banking community, does not take into account the actual situation of the world economy.

With respect to Brazil, two figures are enough to indicate what is really happening. Capital good imports are down 7.2 percent in the first half of this year from the same period last year in dollar value. Meanwhile, the government has to *import* 330,000 sacks of coffee for domestic use, because the proper region for coffee cultivation has seen its soils exhausted for lack of fertilizers and adequate care, with the result that now coffee is planted too far to the South and has suffered a major winter freeze.

Confronted with such examples of worldscale breakdown in economic processes, Arab money is still typically reacting in monetarist terms: instead of going into long term, capital-intensive investments susceptible to prepare the conditions for an economic recovery, it becomes more and more liquid and runs after higher and higher short-term return on investments, thus contributing to further aggravation of the crisis.

Ths Saudis keep putting over 90 percent of their funds into London and New York, well under a 36-month basis. According to a top Italian banker, they won't make direct loans to the Third World without international agencies' guarantees, and they are even very reticent to invest in Italy. Generally, they are still sticking to Treasury notes and bank deposits and fear to use their financial power according to a coherent political strategy.

The West European money coming to the U.S. suffers from a very similar problem. Sources close to the European-American bank revealed that their "strategy" is similar to that of the Arabs — "make money" through "good short-term paper," whatever its use. A West German banking source informed NSIPS that West German and other European banks had been offered an opportunity to buy Bert Lance's National Bank of Georgia, which would have given to Europe a decisive strategic position in the U.S. Sunbelt to be used to counter the New York banks, with the support of the London clearing houses and Swiss banks traditionally strong in the Atlanta region. But after the murder of Dresdner Bank Chairman Jürgen Ponto, West German bankers drew back from the political implications of the purchase and dropped the project. They "did not want to intervene in U.S. politics," as if the U.S. were not intervening every day in West German and European politics.

Given the blindness of all financial decision-makers, the present situation can only be maintained by pumping into the artificial flow of liquidity coming on the market due to the lack of actual investment opportunities. But the coming deflation threatens precisely to rapidly wipe out the excess liquidity that makes the lending spree possible, most probably sometime during the fourth quarter of this year. Such a breakdown deflation can in turn be avoided within the present dollar monetary system only through a sharp "reflation" (money-printing) which would transform the markets into gambling casinos heading for a collapse.

France Signs Deals With Iran, East Bloc

WORLD TRADE

A huge nuclear energy deal was finalized last week between Iran and France. Contrary to expectations, the final amount will be much more than originally planned: 15 billion francs ($3 billion) instead of 10 billion francs. The contract not only involves infrastructure development and nuclear fuel production, but also the training of Iranian personnel in some of the French State Electricity Company (EDF) plants. The French corporations concerned are Creusot-Loire-Framatome (core of the reactors), Alsthom-Atlantique (turbo-alternators), Spie Batignolles (infrastructure and engineering), Cogema (a subsidiary of the state Atomic Energy Commision — CEA) will provide the uranium fuel.

Three billion francs ($600 million) worth of contracts were discussed at the Leipzig, East Germany trade fair between the French Foreign Trade Minister André Rossi and his East German counterpart. Three big contracts are under negotiation and should be finalized by the end of the year (the three billion franc credit line involved represents twice the amount of French exports to East Germany last year). The financial conditions offered by the French COFACE are reported to be better than usual, given the support extended to the deals by a consortium of banks led by the Belgian Baron Empain-Schneider.

The first deal involves the construction of a chemical plant in East Germany by Rhone-Poulenc; part of its output would be re-exported to France. The second contract under negotiation bears upon the export of 6,000 boxcars to East Germany. Last, the French automaker Citroen would build a plant producing special auto parts in East Germany. Later, the firm would assemble part of its production there.