Behind the calls for tight money

Will the U.S. be Britain's pawn against the EMS?

Behind the obsessive talk about the need for tight money in the U.S. lies a critical fight over international credit policies and control of the $600 billion-plus in Eurodollar liquidity. In an attempt to obstruct the European Monetary System and head off the complementary Japanese plan for recycling Eurodollar liquidity into long-term productive loans, the British and their allies are circulating scare stories about "new Herstatts" and plotting ways to bring the "volatile" Eurodollar market under International Monetary Fund control. Parallel with this effort, British and allied sources are simultaneously demanding a drastic shrinkage in the U.S. credit base on the spurious grounds that the dollar will be stabilized through the ensuing capital reflow.

Apparently one part of this operation was the proposal by the new Japanese Prime Minister, Masayoshi Ohira, at a press conference Nov. 28, that the mass of foreign-held dollars in the Euromarkets be cleaned up by replacing them with the International Monetary Fund's Special Drawing Rights. Ironically, the target of Ohira's proposal is the so-called consolidation plan now being pioneered by Japan's central bank to soak up much of the over $600 billion in footloose Eurodollar deposits and direct the funds into low-cost trade and investment credits for mammoth industrialization projects — a plan which plainly runs directly counter to the "free market" lending activities of the City of London, its New York satellites, and its policy enforcers at the IMF.

Yale University economist Robert Triffin aired his perennial plan for "stabilizing" the Eurodollar market under IMF auspices in a speech before the New York Council on Foreign Relations Nov. 14 — the CFR's inaugural John J. McCloy lecture. Triffin's plan for phasing out the dollar's role as the world's leading reserve currency and asserting IMF control and "conditionality" over national credit systems and especially off-shore markets is, in fact, the model for the anti-EMF, anti-dollar schemes that have surfaced recently.

Any long-term stability of the U.S. dollar and the international economy indeed depends on doing something about the unstable pool of hot money known as the Eurodollar market. The Japanese strategy of rechanneling Japan's sizable dollar reserves into natural resource development and other project loans at one-half the prevailing Eurodollar rates is precisely the right approach: put the dollars to use in long-term, profit-generating investments. The antidollar, anti-EMS approach consists in an across-the-board crackdown on credit creation in the U.S. and a forced reflow of dollars, on the theory that the only solution to the dollar's chronic weakness is to eliminate the dollar from the international arena and shut down whole sections of the U.S. economy as well.

The only climate in which an IMF Eurodollar market restructuring could be imposed would be a new Eurodollar panic. Hence, on Nov. 28 *Le Monde* predicted a new "Herstatt crisis" — referring to the 1974 failure of a West German bank engaged in currency speculation that almost turned into a classic banking panic. This followed the *Financial Times's* warning the previous week of an "uncanny" resemblance between the present Eurodollar situation and the 1974 crisis. The alternative to a new Herstatt is supposed to be the imposition of reserve requirements on U.S. banks' Euromarket operations; this controlled version of the collapse of their business was mooted by U.S. Federal Reserve Chairman G. William Miller last spring and was elaborated by Robert Triffin in his CFR speech.

U.S. credit clampdown

Triffin, Miller, and Lazard Freres's Felix Rohatyn — who bluntly called for U.S. credit controls in the Nov. 28 *New York Times* — cannot snap their fingers and politically implement the whole IMF antidollar machinery. What they can do is clamp down on the availability of credit in the U.S. and starve credit-hungry U.S. business to the breaking point. This strategy was formulated in the recent American Express Bank (Amex) report, which prescribed a

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drastic shrinkage of the U.S. credit base to be ameliorated by an inflow of foreign funds. Speaking in Zurich Nov. 29 Hans Mast of Crédit Suisse predicted an imminent capital reflow to the U.S. based on still widening interest rate differentials and the successful completion of the new monetary arrangements — Mast like Triffin hopes to pervert the EMS into an austerity-based currency stabilization system.

In the U.S. itself, prevailing thinking has converged on the position held by the Friedmanite cultists at the *Wall Street Journal.* Economists are prescribing an abrupt clampdown on the availability of credit — on the creation of banking reserves — having realized that rising interest rates have in no way deterred bank lending, and have in fact only fueled an inflationary bubble in the economy. "... if the need for money is there, corporate treasurers will pay the price," the Manufacturers Hanover Trust Financial Digest observed last week.

On Nov. 29 the *Wall Street Journal* editors sounded their own familiar litany, demanding that the Fed categorically establish control over "the dollar money supply": "A real defense of the dollar would attack the root problem of its decline, which is that too many dollars have been created. Unless the Fed slows the creation of dollars, the rest of the (dollar support — ed.) plan is temporizing at best and cosmetics at worst."

The *Journal* was apoplectic over the fate of the higher reserve requirements on large certificates of deposit announced by the Fed and the Administration on Nov. 1 as part of the dollar defense package, which was supposed to immobilize some $3 billion in banking reserves, and hence was expected to contribute to a decline in the monetary base. The *Journal* editors and other commentators interpreted the $700 million increase in the monetary base, which consists of banking reserves and currency, in the statement week which ended Nov. 22 as a sign that the Fed was moving to offset the credit tightening measure.

In fact, there is considerable concern among tight money advocates over whether the Fed will "stick to its guns" and move to squeeze the monetary base — as former Fed Chairman Arthur Burns did back in 1974 (see "How to collapse the U.S. economy"). Donald Wooley, chief economist of Bankers Trust, said in an interview this week that the Fed governors know their every move is being scrutinized by the foreign exchange markets. "They can't back off now, they feel, or they'll undo all the good they've done so far." As for any residual opposition to tight money coming from Carter's close "political advisors," Wooley believes that the tumult in the financial markets in the week leading up to Nov. 1 gave the Administration a good scare, and Carter is now listening to his "economic advisors."

The key issue is what the Fed is going to do with respect to the availability of credit. "Availability is still there," according to Wooley. "But I think we may be about to enter a period where availability may be impinged."

Apart from the Fed's upcoming actions on monetary reserves and interest rates — this past week the Federal funds rate inched up again to 9⅞ percent — there are a number of other factors in the balance. The six-month certificates that savings banks began issuing last spring to prevent disintermediation have begun to mature and must be rolled over — at 200 basis points above the original interest rates! Thus, it is questionable whether the banks, which are already losing money on these high-interest-rate certificates, will continue to issue them. On this hinges the continued availability of mortgage money and the housing market, which has held to a two million starts per annum rate this year. Also, smaller regional banks are already fully loaned up and have been selling loan participations to money center banks to meet heavy loan demand. As a whole, the banking system is liquidating its holdings of government securities to accommodate loan demand. Under these conditions, a squeeze on banking reserves, credit controls, or other pseudosolutions to stabilize the dollar will simply guarantee a U.S. recession.

— Lydia Dittler

Salomon Bros. analyst recommends limited credit availability

In an interview with Executive Intelligence Review *on the U.S. banking and credit picture this week, Salomon Brothers bank analyst Warren Marcus recommended a program of recessionary credit cut-off* as a *remedy for inflation and dollar instability.*

Q: We have a report that some people would like to use the Citibank scandal around David Edwards to open up banks' foreign lending portfolios for investigation. Have you heard about this? Also, that Citibank would like to distract attention from their foreign portfolios.
A: No, but I wouldn't be terribly surprised. I often wonder whether banks even fully understand the logistics of foreign lending. I doubt if anyone really knows what's actually going on here. The data basis is pretty poor. It's an issue over which people get pretty emotional. . . . Our chief problem right now is that the world is a borrower's market — flush with liquidity.

Q: How are we going to deal with this?
A: We have the whole anti-inflation program. And I think they're serious about it. . . . Over the past two or three years, there has been a decline in credit quality. Lenders have been under pressure to put money to work rather than look for money. The situation is not alarming.

Q: When you talk about the anti-inflation program, do you mean the interest rates?
A: We're talking about the whole package.

Q: Miller seems to have taken a very soft position on interest rates, after everybody seemed to be concentrating on that after the program was announced. Is that because he's more concerned with other aspects of the program?
A: Well, Miller is also trying to deal with domestic political realities. We've had moves in Congress to eclipse the independence of the Fed. . . . There are always intimations that the Fed was too independent. Burns knew how to gain the confidence of Congress, which is always trying to promote expansion while the Fed they claim is always trying too mute it. . . . I'm thinking back particularly to '74, when a number of Congressmen thought the Fed was the major political problem, and blamed them for everything.

Q: To be specific, what technicalities are needed right now to ensure the Administration's anti-inflation program besides interest rate increases?
A: A more contained, more reduced rate of monetary expansion. Also, one of the planks of the program is to increase reserve requirements, which became effective in the middle of the month. . . . Everybody agrees that if the program is technically unable to do the job, all it does is buy time. Then you have to deal with the basic problem — inflation. . . . Everything revolves around inflation. . . . If we had a Herstatt crisis it would strengthen the dollar. Countries do not disappear. Despite the U.S. dollar weakness, there have been massive acquisitions in the U.S. The U.S. is still the last bastion of capitalism, a huge, power economic force. If we get our act together on inflation, then indeed we will get capital inflows.

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Couched in Delphic predictions of another major monetary crisis that could "bring down the existing system" Yale economist Robert Triffin's John J. McCloy lecture Nov. 14 made three major allegations: (1) the dollar's role as a reserve currency should be ended; (2) control over liquidity creation should be taken over by an IMF with greatly expanded surveillance and enforcement powers; and (3) IMF controls should be extended to "offshore operations" in particular.

Triffin's drill session with the Council on Foreign Relations which is to appear as the lead item in that organization's December *Foreign Affairs* organ, led up to a slanderous commentary on the EMS, based on the "kill by cooption" approach associated with Britain's Brian Jenkins. Triffin misrepresented the EMS as an updated version of his own rejected schemes for an antidollar, austerity-based European regional currency bloc.

Three days later the *New York Times'* Leonard Silk retailed Triffin's CFR briefing in the context of a high-profile promotional pitch for Triffin's recognition as the "successful Cassandra."

Triffin is playing the same role today as he did in the early 1960s, when he launched a push for the reorganization of the teetering international monetary order under the auspices of the IMF. Having established his soothsayer credentials through the publication of *Gold and the Dollar Crisis* in 1960, Triffin worked with elements of the Kennedy Administration — including the scores of actual British civil servants brought into the White House and U.S. Treasury — to effect world monetary "reform" through replacing the U.S. dollar with the IMF's Special Drawing Right liquidity.