

How to collapse the U.S. economy

British follow 1974 Herstatt scenario in their bid for a crash of '79

Contrary to all of Milton Friedman's horse manure about the "inevitable" recession ahead in the American economy, the U.S. is pretty tough to upset. Consider the present situation: after 22 months of the Carter Administration and a year of Fed Chairman G. William Miller, the economy is still standing. American business has survived a prime rate at a near-record 11.5 percent, a detestable foreign trade policy that has left us with the first manufactures trade deficit in 50 years, and a rampage from the Kennedy side of the regulatory agencies.

Of course, these aversive conditions have taken their toll. Business is terrified of inflation, and continues to borrow even at exorbitant rates to stockpile inventories that will become more expensive in a few months. Farm prices, through the Administration's imbecilic "set-aside" program, have pushed the Consumer Price Index up to a 10 percent annual rate of increase, while meat prices are rising at a 20 percent annual rate.

But the economy refuses to collapse. The bank newsletters which have been demanding a recession are forthrightly upset about this. The City of London must feel like the impatient heir who has poisoned, shot, and stabbed a 90-year-old rich aunt who still refuses to die.

Forget all the fairy-tales about the "business cycle." The economy is not "overheating" because there is too much economic activity, or the Federal Reserve is printing too much money. There is inflation because British-designed foreign trade policies have shut off the world market to American heavy industry, which, correspondingly, has failed to invest in more productive new facilities, and because British dope runners take \$50 billion a year, by official estimates, out of the U.S. economy. Inflation does not produce a recession. Left to its own devices, the inflation-ridden U.S. would eventually break through the political barriers designed by her British "allies" and cure the symptoms.

Extraordinary measures would be needed to bring the U.S. economy down. That is precisely what the frustrated outlets for British policy are now demanding. Today's *Wall Street Journal* lead editorial is a case in point. "Unless the Fed slows the creation of dollars," says the *Journal*, the Administration plan to defend the dollar in cooperation with our European and Japanese allies "is temporizing at best and cosmetics at worst." What pro-British analysts on Wall Street, such as Donald Wooley of Bankers Trust

and Henry Kaufman of Salomon Brothers, are now predicting is that the Federal Reserve will put the crunch on the availability of funds to the banking system, and simply shut down credit availability.

One hard-pressed treasurer of a big New York bank pointed out in a discussion that during 1974 — when the first big waves of mass layoffs started — Fed Chairman Arthur Burns wrote a letter to the banks demanding that they shut off credit. They did, and the economy took a nose-dive. If Miller does something like that, the banker said, it will be all over.

Arthur Burns's letter, dated October 1974, was the coup de grace to the American economy. Old Arthur Burns, prize scion of the Chicago School's evil founder Wesley Mitchell, pro-British to the pipestem, provided an object lesson in how you can collapse the American economy.

High oil prices didn't collapse the U.S. economy dur-

Le Monde: Euromarkets are

The weekly Economics section of Le Monde, Nov. 28, reported that the condition of the international money markets was primed for a new panic similar to that triggered by the Herstatt bank collapse of 1974. Excerpts from the article, titled "The shadow of the Herstatt bank," follow:

... The latest statistics published by the World Bank take note of the formidable increase in borrowing on the Euromarkets during the course of this year. The total of borrowing for the first six months of 1978 has reached \$51 billion, whereas the figure for 1977 as a whole was \$69 billion, and for 1976, \$63 billion. . . .

How can this new and considerable increase of foreign indebtedness be explained? It is first a consequence of the collapse of the dollar. We could cite other examples of this phenomenon from recent monetary history: a currency that is weakening is used more and more, because economic agents seek to increase their commitments denominated in a currency which is losing more of its value. When it is the dollar — whose position is already dominating — that is in question, this new illustration of the principle of a bad currency taking precedence over a good currency can take the form of a veritable tidal wave. The banks, American or not, operating on the international market, have

ing the big 1974-1975 downturn. A British special operation — the collapse of the Herstatt Bank in West Germany — did. The City of London, the polluted home of the pool of footloose dollars known as the "Eurodollar market," knows that the deciding margin of available credit for the U.S. economy is the \$400 or so billion in international dollars. The collapse of Herstatt in July 1974, a British intelligence inside job, started a panic which brought down a whole string of secondary banks, while the financial press predicted general catastrophe. Three Swiss banks went down in September. Michele Sindona's banking group in the U.S. and Italy, including Franklin National Bank of New York, went down at the same time, victim of a British inside job resulting in crushing losses on the foreign exchange markets.

Banks pulled their funds out of the Eurodollar market pool. The British-controlled Bank for

International Settlements started withdrawing its deposits from the Eurodollar market, as reported gleefully in early October by the London *Economist*. By a recently published estimate in the French newspaper *Le Monde* — which is running predictions of a Herstatt repetition — total liquidity in the Eurodollar market shrank by an incredible 30 percent within the space of weeks.

Back home in the United States, high inflation rates, much like the present ones, forced an extraordinarily high rate of borrowing. The quadrupling of oil prices a year before, a virtual doubling of major commodity prices, and double-digit inflation had put the economy through the wringer. Herstatt and its consequences provoked a liquidity squeeze on the international markets. Interest rates were at record levels. *Still the economy continued to function.*

ripe for a new 'Herstatt'

adapted their own credit policy to a sharply increased demand for credit in dollars.

A second feature characterizing this evolution has been that the greatest part of the loans have been contracted from banks, for periods which sometimes reach seven to ten years (with reviewable interest rates). As for the long-term bonds in Eurocurrencies, the bank syndicates responsible for selling them to the public have often ended up saddled with them. But, as in 1974, under circumstances similar in many respects (to today), the short term interest rates are continuing to go up on the dollar market (and therefore on the Eurodollar market); they are now higher than long-term interest rates, which is always the sign of an unhealthy situation.

It could be that, because of this "transformation" (of very short-term deposits into longer-term loans) to which it has continued to adhere, the international banking system finds itself today in a more precarious position than even the summer of 1974 when — in an event which is again being talked about — the bankruptcy of a small Cologne establishment, the Herstatt Bank, set off a movement of panic of such scope that it resulted in a withdrawal, in several weeks time, of nearly 30 percent of Euro-dollar deposits.

Burns turns off credit

At that point, Arthur Burns simply ordered the banks to shut off lending. They obeyed. At the same time they provided funds to London, as in the case of Citibank's bailout for the failing British Bank of Commerce during October 1974, to prevent London from going under. The shutoff of American credit and the rescue of London sent the U.S. economy into an immediate nose-dive, causing the fastest onset of depression in 20th century American economic history. The shutoff of credit was much, much worse than during 1929-1933.

Now the London *Financial Times*, its echo-chambers at *Le Monde*, and various other contaminated outlets are talking about a replay of the 1974 events. Luckily for the U.S., the West Germans and Japanese are too well in command of the world markets to permit any similar disaster from taking place. The situation, however, is still precarious. The *Wall Street Journal* and its co-conspirators, who want the Federal Reserve to do now what Arthur Burns did back in 1974, are trying to replay the script of America's last collapse.

Miller is trying his best to accommodate them, but he has to follow certain guidelines from the White House, which is not happy about economic collapse. Not much apart from the electoral ambitions of Jimmy Carter now stand between the economy and disaster. Either the U.S. will join the European Monetary Fund and pull itself out of the muck, or Miller will drop the blade.

— David Goldman