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bank governors want to do something about regulation. The Dutch governor asked the BIS to initiate a study on Euromarket regulation. On the U.S. side, Tony Solomon seems to like the idea—in view of current Euromarket spreads—but all of the G-10 and Switzerland have to agree or regulation is an impossibility.

Spreads are too low in the Eurodollar market relative to risk. This requires more stringent regulation and a more vigorous regulatory environment. Bank loans to "problem countries" have to be scrutinized.

This is the problem Wallich is addressing. However, he doesn't have the whole international banking community behind him. It's not U.S. banks which are pushing the rates down. He has to persuade the Japanese and West Germans not to push rates down.

Our bank drew the line at three quarter percent spreads—that only leaves around 35-40 basis points net, after taxes and other costs. The whole discussion of Eurodollar market regulation is more preaching to the foreigners than to U.S. banks. ...

Q: *Isn't it unusual that it was the U.S. which presented a proposal to the BIS meeting on May 6 in favor of imposing reserve requirements for the Eurodollar market?*
Bankers Trust: Well, the Fed has done a research paper on the subject—one that's in the public domain—we participated in educating them on what goes on in the Eurodollar market.

Q: *You have been suggesting that the large New York commercial banks wouldn't be opposed to greater regulation of the Eurodollar market, including the imposition of reserve requirements.*
Bankers Trust: The problem we face is that current interest rates don't justify assets employed. Foreign banks are growing rapidly and will accept lower and lower spreads. What will force the market to take a more sober view of risks? If we move to a set of developments which alert everybody to the consequences of taking big risks, or if Japan and Germany decide to become tougher. Regulation or reserve requirements in themselves won't keep banks from taking risks. We sincerely hope that the market will turn around—of course, we've been hoping that for about 1 1/2 years. ...

Reserve requirements will just increase the cost of credit—to have a credit squeeze, we have to stick it to them.

Q: *It appears that Muriel Siebert is going to deny the HongShang bid for Marine Midland. What will the effect be on foreign investment in the U.S.?*
Bankers Trust: It would be very unfortunate indeed. It would inhibit the international flow of capital.

3. Deregulation part of London bank grab

Jerry Jordan, the chief economist of the Pittsburgh National Bank and member of the so-called Shadow Open Market Committee, an offshoot of the Mount Pelerin Society, told a reporter May 16 that "the U.S. banking system is overregulated. This has led credit to

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seek other channels," and in turn, he stated, is whipping up inflation. Jordan then proposed that the Federal Reserve Board drastically slash its supply of reserves to the U.S. banking system, which would greatly cut overall lending.

An aspect of the attempted British banking grab, Jordan's proposals are the "right-wing" expression of an overall City of London plan to *deregulate* the U.S. banking system, precipitating chaos, while shaking out the U.S. economy through *severe credit contraction.* Before one could say "bankruptcy court," the U.S. banking system would be put under British top-down reorganization.

Backing up Jordan, president of the Bank of America, A. W. Clausen in a May 14 speech to the Financial Analysts Federation in San Francisco, fell into the "deregulator" trap. Stating that "anti-competitive (regulatory) barriers" are costing "the public billions of dollars each year," Clausen called for battering down the most significant distinctions in function between commercial banking, investment banking and savings and loan banking. According to the May 15 *Journal of Commerce,* the usually shrewd Clausen asked the FAF, "Why does this country differentiate so minutely among powers of commercial banks, mutual savings banks, savings and loan firms, finance companies, industrial banks and to what end? Why shouldn't each," Clausen continued, "be able to take in all types of deposits and make all types of loans through offices anywhere in the nation?"

Were Clausen's call for cut-throat competition to be implemented, a fullscale buy-up of bankrupted institutions would follow. Indeed, Clausen further advocated the right of large commercial banks to buy not only out-of-state commercial banks, but also investment banks and thrift institutions, all of which they are currently prohibited from doing. For opponents of "dereg," sweeteners are on the table including the lifting of maximum interest rate ceilings, lowered reserve requirements, and repeal of the Glass-Steagle Act.

But the significant question is whether the U.S.

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economy and credit markets will survive the effects of banking deregulation, in the face of Fed chairman Miller's constant jack-up in interest rates and the build-up of recessionary pressures.

At the moment the U.S. economy is flush with liquidity, but in a particularly troublesome way. The business community has borrowed very heavily during the last 12 months, racking up more than $18 billion in new commercial and industrial (C&I) loans since April 1978. In addition, corporations have borrowed in the range of $3 to $5 billion on the commercial paper market since January of this year.

However, banks have not garnered their liquidity from inside the United States. Indeed, since Jan. 3, corporations have sold back to the banking system a staggering $19.38 billion in large Certificates of Deposit, diminishing bank liquidity. To partially make up the loss of funds, commercial banks have stepped up their Eurodollar borrowing from foreign branches to the tune of $14 billion since Jan 1.

What if the U.S. banks, which are holding up U.S. liquidity through huge foreign indebtedness, are hit with a credit-crunch induced recession?

Just such a likelihood of recession increased with the May 16 release of Federal Reserve Board figures on the economy. According to the Fed, in April, U.S. auto production fell 16% over March levels to an annual rate of 7.9 million units per year. The auto fall is not attributable to the short-lived Teamster strike, but rather to the zooming cost of oil, a more permanent factor. In April, for the first time, more than 50 percent of domestic auto market share went to small-sized cars, as the market for large- and medium-sized models collapsed.

At the same time, in April, because of rising interest rates the number of housing starts dropped by 2.1 percent. Savings and loan associations experienced a new outflow of funds of $400 million in April, reportedly due to disintermediation. Moreover, this year most of corporate borrowing—and indeed, business activity—has gone to finance a gigantic inventory accumulation, which will be dumped on the first serious signs of financial downturn. In these circumstances, U.S. banks will find their large C&I portfolio liquidated, while still being socked with a huge foreign indebtedness. These classic banking collapse conditions, when intersected with the bank "deregulation" movement, will leave U.S. banking in a pulverized mess.

—*Richard Freeman*

Britain is the example

This interview with Jerry Jordan, chief economist of Pittsburgh National Bank, was provided by an independent journalist.

Q: *What do you think about the recent calls for regulating the Eurodollar market by Fed Governor Henry Wallich, Treasury Undersecretary Tony Solomon and others?*
A: There is a serious effort to introduce greater regulation, as there was in 1969-70, 1973-74, and other periods of high interest rates. Such an action would be consistent with the other things the Fed is doing—such as their desire to put reserve requirements on federal funds and repurchase agreements. The dominant focus of Fed policy is to limit credit extension through the monetary system. However, this just forces credit to flow through other channels—through commercial paper, for example, or whatever new instrument they can think of....The growth of the Eurodollar market in the first place was related to the overregulation of the U.S. banking system—onerous reserve requirements on financial institutions, Regulation Q ceilings, and so forth. This just forces credit to seek other channels.

Q: *What should the Fed be doing in your view?*
A: Controlling the growth of the monetary base—high-powered money. Every Eurodollar asset is related to actual dollar balances back home, and then there is the multiplier effect.

Q: *I've heard that the Fed is thinking about putting reserve requirements on the deposits of foreign bank branches, not just foreign branch borrowings from foreign branches.*
A: That would reduce the multiplier. However, when the Fed put higher reserve requirements on certificates of deposit last fall, they monetized that much government debt and completely offset the effect. What has to happen is for central banks to contract their own portfolios of government debt. Emminger and Leutwiler understand this better than anyone. If they are supporting the proposal for Eurodollar market regulation at this time, they're probably doing it to get the Fed to do something that it wouldn't do otherwise (contract their holdings of government debt—i.e., stop supplying reserves to the banking system).

Q: *Do you think the change in government in England will have an effect on U.S. monetary and fiscal policy?*
A: Britain will set a pretty good example for central bank conduct. The Bank of England is one of the stronger central banks....Yes, they would be reluctant to see greater regulation of the London Eurodollar market. It's their way to encourage others to regulate and reap the benefits themselves.