New tremors in the underground economy

by David Goldman, Economics Editor

How useful are discussions of the international markets which do not take into account a flowthrough of perhaps $400 billion in illegal or quasi-legal funds? The "slow-motion collapse" of the Eurodollar market in progress since the second quarter of 1982, when the interbank market contracted for the first time since 1974, appears sufficient to account for the current problems of the "offshore" banking centers. The Cayman Islands, Panama, the Bahamas, the Netherlands Antilles, Liechtenstein, Luxembourg, Hong Kong, and Singapore handle over $200 billion of the $1.8 trillion Eurodollar market. But the May failure of the Banco Ambrosiano's Luxembourg branch, followed shortly by the failure of its Bahamian subsidiary, and the failure of the parent bank to meet about $500 million in obligations to other banks, brought up a problem that has since become the staple diet of central-bank discussions: no central bank is responsible for the offshore centers.

In the case of Hong Kong, whose banking problems came to light in November, no central bank exists, only the Hongkong and Shanghai Bank, the century-old mistress of the Far Eastern narcotics traffic, which issues most of the colony's currency. The "HongShang" is now in the uncomfortable position of lender of last resort for the more than 200 "Deposit-Taking Corporations," at least 30 of which are at the point of failure due to the bursting of Hong Kong's real estate investment bubble. Anticipating trouble, HongShang began moving as much of its portfolio as possible into highly-liquid instruments as early as last spring; the extent to which it is experiencing funding difficulties now is not known. Some Bank of England specialists are already predicting that it will fail—an event which would not only terminate the Hong Kong banking center, but dynamite the Dubai off-shore market, where HongShang's subsidiary, the British Bank of the Middle East, is the dominant banking presence.

Indeed, some specialists see a connection between the perilous status of Hong Kong, and the collapse of the $92 billion Kuwait stock market during the final week of November. The Kuwaiti exchange, on which equities were traded on the presentation of checks postdated in some cases for years, was long due for big trouble; but it is ventured by some observers that HongShang was compelled to draw on the resources of its Mideast subsidiary, and triggered a result that was long in the making in any event.

For that matter, the 40 percent devaluation of the Uruguayan peso Nov. 28, and the collapse of Venezuela's largest bank, the Banco de Trabajadores Nov. 25, suggest a basic change in the nature of the *flight-capital flows* that have dominated Ibero-American finance for the past two years. During 1979, Uruguay built up over $7 billion in foreign bank accounts, largely due to flight capital from Argentina; during the same period, Venezuelan banks became recipients (both in Caracas and Miami) of funds derived from the Colombian and other narcotics traffic, as the principal way-station for illicit funds leaving the continent. American intelligence specialists attribute both the Uruguayan and Venezuelan problems to a change in the pattern of flight capital; as everywhere, they believe, funds are departing the offshore centers, unprotected as they are with respect to central-bank safety nets, for safer havens, principally the U.S. itself.

This is not merely true in the Mideast, East Asia, and

Latin America. Last week the Stuttgarter Landesbank closed its Luxembourg office, the first substantial West German bank to do so, although the Germans had done very little business through Luxembourg since the failure of the Ambrosiano branch there last May.

Narcotics and offshore banking

On Oct. 31, 1978, *EIR* described what was then a $200 billion annual retail business in narcotics of all types; EIR's story ultimately became part of the 1978 bestseller, *Dope, Inc*. Conservatively estimated, total narcotics revenues today flowing back into the offshore markets exceed $150 billion; to this figure must be added about $100 billion of annual flight capital (evasion of tax and currency laws), as well as perhaps $30 billion in illicit arms traffic, and various other categories of contraband-related funds. The cash flow of the subterranean economy via the offshore markets is in the order of $400 billion per year; how much of this remains in the market's deposit base, and how much pauses briefly before finding its way back to "laundered" investments inside various national economies, is difficult to estimate.

Nonetheless, a very large portion of this multi-hundred-billion dollar flow must remain in the market's deposit base, because the simplest means of disguising illegal funds is also the most commonly used: offshore banks will accept secret deposits from individuals who wish to evade tax or other laws, and "lend" the same funds back to the depositors. Most of the hotels on the Mediterranean were built in this fashion, for example. This procedure requires that funds earned or sequestered illegally be kept on deposit in the offshore centers. The late Banco Ambrosiano specialized in such "loans," on behalf of the Italian Mafia.

Major shifts in the flow of illicit funds will, therefore, have a major impact on the liquidity of the off-shore centers. It appears impossible to understand the present events in Hong Kong without taking into account the *glut of opium and heroin* that began with the Spring opium harvest in the "Golden Triangle" of Burma, Thailand, and Laos. According to the Feb. 26, 1982, *Neue Zürcher Zeitung*, the 600 to 700 ton harvest of raw opium brought prices for a kilogram of raw opium down from $400 in 1980 (when the Golden Triangle harvest was only 200 tons) to only $80. As the authoritative Swiss newspaper pointed out, the February price for refined heroin in New York did not yet reflect the price drop at the base; however, it appears that a substantial price drop occurred in Western Europe over the summer, which has since affected the entire advanced sector.

To attribute the liquidity problems of the Hong Kong property market, however, to the global reduction in heroin revenues, would be too simple, even though Hong Kong is (as Hong Kong authorities admitted brazenly last month to visiting Attorney General William French Smith) the principal laundromat for narcotics funds. Said the London *Economist* Nov. 13, "Singapore and Hongkong are . . . not merely convenient staging posts in a 24-hour market. They also launder money from the opium growers and the pirates who have prospered in the region for centuries."

The China connection

The property market bust began formally when Mrs. Thatcher, the British prime minister, failed during her late-September visit to China to win any assurance that China would renew Britain's lease on Hong Kong when it expires in 1997. A symbolic, but important indication of China's tough attitude towards Britain was the fact that HongShang's deputy chairman, shipowner Sir Y. K. Pao, appeared in Peking, not as a member of the British delegation, as expected, but as a member of the Chinese welcoming party. In effect, the Chinese decided to shake out the property market; British sources grumble that they are prepared to buy out whatever property comes onto the market at a reduced price.

Since the volume of opium production each year is well-planned in anticipation of the succeeding year's demand, it may be assumed that the Chao Chou Chinese expatriates who control the Triangle opium fields arranged the glut in the first place. They must have done so in full knowledge that the relatively newer source of Western opium, the "Golden Crescent" of Pakistan, Afghanistan and Iran, was already producing sufficient dope to meet the entire industrial world demand. As *Dope, Inc.* showed, the Chinese turn over to the Hongkong and Shanghai Bank and other British entities perhaps 60 percent of the profit potential of opium production—at least as of about 1980—in return for access to Western markets. But the new generation of expatriate Chinese businesses, the 50 leading families with assets of $500 million to $1 billion each, no longer need the British tie, and are pressing hard for the senior partnership. Under conditions of world financial crisis, they are better situated to withstand a price war than their erstwhile British partners.

In summary, this is the Chinese bid for power, as it has been reconstructed—in part—by their British competition. But the deeper significance of these developments is shown better in the ongoing Italian mass arrests (see International), which effectively ended the ring which controlled heroin from the Golden Crescent coming to the West. Both the financial crisis, and the new "war on drugs" of the Reagan administration and several European governments, have shattered the old structure of what *EIR* called "Dope, Inc." in 1978.

There is a "crisis within the crisis": internecine warfare among the networks which, over the postwar period, collaborated to turn the offshore financial markets into the center for an illegal money traffic that challenges the banking systems of all major countries. Hard times mean less honor among thieves: witness the reported 700 murders on the European masonic circuit in the past year, including the grisly death of Banco Ambrosiano Chairman Robert Calvi under Blackfriars Bridge. The old snake must change its skin, along with its changing habitats. And the most propitious moment to kill it is while it is moulting.