

Volcker's big debt blowout: It's only the beginning

by Marcia Merry

The weeks since mid-October of intensive testimony to Congress, jawboning of bankers, and daily press conferences on new pyramid plans to handle domestic and international debt, show two things clearly, for those who didn't already know: 1) The dollar debt blow-out is now under way on an avalanche scale; and 2) the "experts" who created it—with Paul Volcker in the forefront—are now proposing plans that would guarantee a final, total crash.

The outbreak of the new phase of crisis had been forecast by leading economist Lyndon LaRouche. Speaking to a nationwide television audience on Labor Day 1984, during the course of his presidential electoral campaign, LaRouche warned that the eruption of renewed chaos in currency markets, attendant on the collapsing U.S. economy, could not be contained beyond the first quarter of 1985. LaRouche forecast then that the dollar could not be maintained at its inflated level against such currencies as the West German mark, and would begin to fall, to a level of perhaps half its then traded valuation. The new phase of crisis has erupted as LaRouche said it would, and as *EIR's* June 1985 Quarterly Economic Report warned it would, under the headline: "The Looming Bankruptcy of the United States," in the following words:

"Thanks to the continued influence of the policies set into motion under James Earl Carter and Paul Volcker in 1979, policies which, despite all talk of a recovery, have remained unchanged to the present date, the United States has been brought to the very edge of national bankruptcy. The crisis foreshadowed in the wave of state and local banking collapses is not the isolable series of special cases the inhabitants of cloud-cuckoo land so wish it were. Under the continuance of the Carter-Volcker policy, the United States republic has

been brought to the edge of the crisis which will determine whether the nation continues to exist, or not."

Fully \$50 billion of the \$213 billion national farm debt is going under, driving farmers off the land and pulling under dozens of banks and millions of suppliers and farm-service industries.

On Oct. 23, the Farm Credit System, which accounts for one-third, or \$80 billion of the farm debt, released its dismal third-quarter report showing a huge pile of non-accruing loans and called for an \$11 billion dollar bail-out from the government.

The same day, a Federal Reserve economist, Emmanuel Melichar, filled out the additional farm-debt collapse picture for a House Banking Subcommittee. Reporting on the scope of the collapse that Volcker's Federal Reserve policies created, Melichar said:

1) The commercial banking sector, accounting for \$50 billion of farm debt, needs a bail-out mechanism to rescue 25% of its debt load that is non-performing;

2) 31% of the \$15 billion debt owed to the government's Farmers Home Administration is going under.

The bad agriculture debt totals close to \$50 billion.

The U.S. home mortgage picture and savings-and-loan debt network is in the same condition. This year marks the highest rate of home mortgage delinquencies in the 32 years since national records were kept. Of the 400 thrift organizations across the country, an estimated 150 to 300 are, in effect, bankrupt.

The director of the Home Loan Bank Board, Edwin Gray, speaking before a House Banking Subcommittee, announced that the potential near-term demand for federal deposit insur-

ance for these savings banks is five times greater than the current usable reserves of \$3.2 billion. Gray proposed a plan for taxing all savings banks by 1% of their assets to raise recapitalization of \$8.5 billion for the Federal Savings and Loan Insurance Corp. (FSLIC). He admitted that the consequence of this surcharge would be that 50 to 100 banks would fail. The alternative would be a federal bail-out.

The scope of the proposed bail-out to manage the international debt crisis has begun to emerge. The New York investment banks want a multi-billion dollar bail-out program from the government, and another \$20 billion bail-out package from smaller banks, coerced to go along with the deal.

The sponsor of this plan is Treasury Secretary James Baker III, who proposed at the interim International Monetary Fund meeting in Seoul, Korea in October, a \$20 billion lending facility to come from the private banks, as well as an additional \$20-25 billion in funding to come from the World Bank. It was not well received, but since then Baker has been shopping it around as the best thing going. His line is that it will use the World Bank as a vehicle, and downplay the Don Regan approach of case-by-case, austerity measures, enforced by the International Monetary Fund.

Baker's pitch to Congress is that debt should be handled through "development," and that, if there are "major economic reforms" by debtor nations and U.S. commercial banks are going to cough up another \$20 billion, then Congress should allocate more money to the World Bank.

Some Wall Street investment banks, which would be temporarily bailed out by Baker, are all for his plan. The Oct. 24 *Journal of Commerce* editorial, "Mr. Baker's Plan" . . . indicates that the United States is finally willing to show some leadership in the debt arena. For that reason alone, it is a worthy plan."

However, Baker simply echos a proposal already advanced at the end of July by Fed chairman Paul Volcker, testifying before the Senate Banking Committee. At that time, Volcker described Third World debtor-nations as now "in recovery," which should be sustained by development aid through the World Bank.

Volcker repeated this message before the American Bankers Association meeting recently in New Orleans, but clearly blew the cover of the operation when he emphatically rejected any flexibility in the terms to be applied to Third World debt.

In other words, Baker's and Volcker's "recovery" policy is the same vicious austerity policy of the International Monetary Fund, maybe with, maybe without, the IMF, but the same.

Some in Congress, even the blow-dry economics know-nothings, are suddenly beginning to get worried under the pressure for bail-outs coming from all directions at once.

When Baker addressed the House Banking Committee Oct. 22 and called for more money for the World Bank, Committee chairman Fernand St Germain (D-R.I.) said, "I

assure you that the Committee will never allow domestic programs to take a back seat in the budget process." However, Congress is on a balance-the-budget austerity binge. The House has just passed a \$78 billion budget reconciliation bill, and a House-Senate Conference is meeting to conclude work on the so-called Gramm-Rudman-Hollings budget balancing amendment that would mandate cuts over the next five years of several hundreds of billions in federal spending.

Paul Volcker himself has been sucking his cigar and jawboning the bankers to try to get them in line. On Oct. 22, during his address to the American Bankers Association convention in New Orleans on the need for the \$20 billion loan package to Third World nations proposed by Baker, some booing started from the local banks represented. So, Volcker conducted a closed-door session to explain the "details" of his plan. ABA President James Cairns diplomatically said, "A number of bankers were concerned with how the plan would work."

However, not all bankers are as stupid as the top management of the Big Five. Some do not see the wisdom of lending more money that will never be repaid, nor do they wish to

Some in Congress, even the blow-dry economics know-nothings, are suddenly beginning to get worried under the pressure for bail-outs coming from all directions at once.

see new loans suddenly declared non-performing liabilities on their balance sheets. Nor do they wish to set aside more contingency funds against bad loans.

Volcker has proposed yet another institution—a "super bank" to channel new lending as a solution to these legitimate fears. At the ABA meeting, Volcker asserted that "cooperating bankers" would be increasing their foreign-debt exposure by only 2½-3% a year . . . but everybody will be better off. . ."

Foreign bankers are also squeamish about these proposals, so Volcker is convening yet another meeting to try to arm-twist the credit community to participate in his bail-out plans. On Oct. 28 in Washington, D.C., bankers are gathering on the debt crisis at the Institute for International Finance meeting. Baker and Volcker aim to get a consensus for their schemes, but there are counterschemes by smaller U.S. banks to get concessions in the form of relaxation of the reserve regulations on shaky loans for Third World debtor nations.

Two things seem certain. First, as one observer said, "The last three years of debt policy have been a total failure." Second, "You ain't seen nothing yet."