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EIR Economics

London and Zurich debate merits of financial crash

by David Goldman

Just before the spot oil price sank below $12 per barrel, Standard Chartered Bank's chief economist, Jan Toporowski, brought to the surface the subterranean debate concerning the merits of a financial collapse, in a Feb. 19 article published in the London *Financial Times*, under the title, "Why the world economy needs a financial crash." The *Financial Times'* Anatole Kaletsky argued the contrary two days later, speaking for that section of the City whose livelihood depends on trading an ever-expanding, polymorphous variety of dollar-denominated paper instruments.

Toporowski begins by citing the doyen of Marxist capitalist-breakdown theory, the turn-of-the-century economist Rosa Luxemburg, and continues as follows:

> . . .The old solution of ruining the rentiers (in this case the international banks and their creditors) no longer seems to be available. The position of the international banks is reinforced by central banks' implicit, if not explicit, willingness to act as lenders of last resort in order to avoid precisely that financial crash which would resolve the debt problem by devaluing it all. . . .
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> Nevertheless, the decision of debtor countries such as Poland, Nigeria, Peru, and Argentina to limit debt service payments to a minority share of their export earnings testifies to the urgent need of those countries to be released from the grip of rentier claims that are paralyzing their trade and development. . . . Undiminished by devaluation, the acceleration in the growth of these claims must eventually crush either the rentiers, or the countries themselves. . . .
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> Those drawing their main incomes directly from City activities are relatively few. There are many more in Britain who would stand to gain from a revival of trade, investment, and production which are currently suffering progressive paralysis from the burden of rentier claims. The devaluation of those claims is a necessary, if insufficient, condition for the quickening of real economic activity and perhaps even the survival of the capitalist system.

Anatole Kaletsky's reply Feb. 23 was at once less convincing, but far more in consonance with the thinking of the major Western governments. It adopts the usual format of "I never saw that horse before, your Honor, I was only borrowing him, and besides, he was lame anyway."

Default by the major Third-World debtors "would leave the world banking system broadly intact," Kaletsky argues. "Most, if not all of the international banks are now strong enough to withstand substantial losses on their Third World lending," he argues, citing the specific case of Lloyds International, the bank with the most exposure proportionally in Mexico debt, analysing the effect of a theoretical 6% Mexico ceiling on interest, a de facto repudiation of two-thirds of current interest requirements. Kaletsky argues this will mean only a 5% reduction in that bank's annual profits. In any case, he asserts that U.S. banks may have convinced the White House to step in to prevent a full Mexico default crisis by telling the President that the consequences of such a default would be disastrous.

Winners and losers

Mr. Toporowski's sly concluding comment about the small number of people who actually make their living from

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the "City," i.e., the world's premier market in dollar-denominated paper, indicates what is at stake. His argument must be read in the context of the discussion on the European continent concerning what will happen to the dollar, should a financial crash actually take place.

The chief economic spokesman for the Paris bank, Crédit du Nord, predicted March 1: "Before the end of 1986, the entire world monetary system will be reformed." Crédit du Nord is historically associated with the French Rothschild interests. The spokesman, Michel Lutsalla, wrote in the daily *Quotidien de Paris* that the situation in the international monetary system is "extraordinarily delicate." He further rejected the likelihood of a "new Bretton Woods system of fixed exchange rates, or a new expanded European Monetary System" of currency bands. *Quotidien*, in its own commentary, speculated that the new system, "according to rumors circulating in high financial circles" will limit exchange fluctuations and reduce the role of the dollar internationally." The chairman of the Banque Crédit de Nord, Bruno de Maulde, is former French representative to the IMF.

No one in "high financial circles" is silly enough to worry much about the shape of a new monetary system; that is like speculating about the layout of a camp of shipwreck survivors, before the shipwreck. Their present concern is more to ensure that they survive the shipwreck, by pushing fellow-passengers overboard. However, the catch-phrase, "reduce the role of the dollar internationally," refers to something specific: a financial crash would take down with it the mechanisms by which dollar credit is now generated.

The $2 trillion-plus Eurodollar market is now as pure an example of what Andrew Jackson's contemporaries called "wildcat banking," as has ever existed in financial history. Foreign-exchange transactions now exceed 23 times the volume of merchandise trade. Even more important than the cash foreign-exchange market, however, is the market in futures contracts for foreign exchange, Treasury securities, certificates of deposits, and other financial instruments.

Since the Eurodollar banks have no reserve requirements, they may generate, in theory, an infinite multiplier of banking credit. The entire, vast mechanism of currency, commodities, and financial instruments futures trading depends on this infinite banking multiplier. A financial crash would produce a chain-reaction of defaults, wiping out many market participants and damaging the ability of banks to keep their worried depositors away from the withdrawal window, reducing the dollar's international role in an extremely sudden, brutal fashion.

Exactly such a chain reaction is happening, in slow motion. One of the world's most important commodities markets, the London-based oil futures market, ceased to exist late in February after a series of defaults by leading traders. Previously, the average barrel of North Sea or other oil brought to the "spot" market was bought and sold an average of 100 times, according to industry sources, before its ultimate purchase by a refiner. The collapse of oil prices from $28 per barrel in November to only $12 per barrel has wiped out traders with long positions.

The same process has occurred in the tin and sugar markets, in disarray after falling prices destroyed the resources of joint producer-consumer agreements. Neither has much hope of coming back together in the foreseeable future.

Of course, the banking system's direct losses in the commodities debacle are relatively small. But the entire inventory of dollar-based paper, including the recent fad of bank-backed international commercial paper, will cease trading at the moment that the sanctity of some major names in the market are questioned. Given the impact of collapsing oil prices on developing nations, Texas oil producers, and the oilfield industry internationally, the continued faith shown in some of the largest American banks might have awed the most devout 12th-century Hashishin.

Volcker's fear

That is precisely what Federal Reserve Chairman Paul Volcker warned the House Banking Committee Feb. 20. Banks' wildcat activities, sometimes referred to as "off-balance-sheet liabilities," include potential obligations through financial guarantees and securities repurchase agreements equal to twice their *official* balance sheets. Volcker, whose own policies *caused* the current crisis, warned in testimony that current U.S. banking laws "pose a clear threat not only to the coherence, but also to the safety and soundness" of the banking system, adding, "time is growing short." Volcker, as the London *Financial Times* commented, sought to impress a "new sense of urgency" upon Congress, because of the combined impact of the oil price collapse and agriculture debt defaults, as well as "a series of recent dramatic court rulings" which allow brokerage houses like Merrill, Lynch or E. F. Hutton to take on banking activity "without the protection provided by the federal safety net" of the Federal Deposit Insurance Corporation.

While the fuse burns towards the core of the dollar banking system, the dollar is meanwhile collapsing of its own grotesque weight. It has lost about one-third of its parity against the West German mark during the past year, and stands to lose much more. The global system of wildcat banking, fueled by a $400 billion annual worldwide flow of narcotics and other illegal money, has a wobbly base: America's dependency on foreign suppliers of essential goods. Last year's trade deficit topped $150 billion, and this year's is already running at a more than $200 billion rate, largely because America must pay more devalued dollars for the same essential goods. At a time when the dollar is falling sharply, the United States must pay (and therefore borrow) at an accelerating rate to import essential goods. The ingredients for a true dollar crash are unmistakeable to anyone.

Since 1979, when newly appointed Paul Volcker imposed a credit squeeze on the U.S. banking system, the rest of the world has lived in a chronic dollar shortage, beholden to the largesse of the Fed. Foreign central bankers could not visit the men's room without first checking with the trading desk of the New York Federal Reserve Bank.

All that changed during the first week in March, when all world markets waited breathless to see whether the German central bank would reduce its discount rate, supposedly permitting the Fed to also reduce rates without crashing the dollar further. (The German central bank did reduce its rate, for whatever that is worth.)

The dollar does stand to lose its international role, with terrible consequences for the United States; for if the dollar is no longer the ruling international currency, why should foreigners accumulate $200 billion a year of additional dollar paper, in return for the goods they sell us in excess of their purchases?

What is most remarkable—and the source of grim concern in the London dollar markets—is the fact that the U.S. Treasury is so fixated on the supposed benefits of a falling dollar (to increase exports the United States can't even produce), that it is riding the dollar down—in fair imitation of Slim Pickens astride the H-bomb in *Dr. Strangelove*. Even Paul Volcker's cautionary voice concerning the dangers of devaluation mania has been lost, the British note with worry. It is of special interest that the Treasury official now in control of international policy, Assistant Secretary for International Affairs David C. Mulford, has extremely close personal ties to the Swiss: he was part of the team which sold the old-line investment bank White Weld to Crédit Suisse in 1978. A cynic might suggest that Mulfold is a Swiss agent, promoting the interests of continental European financiers at the expense of the Anglo-Americans.

1934 all over again?

In a very broad sense, the debate over the merits of a financial crash replicates the division of the world at the disastrous London International Monetary Conference of 1934, when President Roosevelt devalued the dollar by 40% against gold. The British, who lost the benefit of their 1931 competitive devaluation of sterling as a result, were livid, to the point that the Queen Mother cut dead the American ambassador at Buckingham Palace garden parties. (Only John Maynard Keynes supported Roosevelt, on the crackpot assumption that a devalued dollar would automatically reverse the 50% deflation of world trade prices. No such thing happened.)

But what was then called the "gold bloc," i.e., France, Switzerland, and Italy, took advantage of the simultaneously cheap dollar and cheap U.S. share prices to buy up a big chunk of the American market at pennies on the dollar. Those who call for a reduction in the dollar's international role today have something similar in mind.

What should be done about a financial crash?

In a nationally televised address to the American people on Feb. 4, 1984, and in a series of other broadcasts prior to the Nov. 6 presidential elections, *EIR* founder Lyndon LaRouche explained exactly how a financial crash could be averted and the current world depression in production and trade brought to an end—by an American President not particularly concerned with preserving the power of London, Zurich, or their cousins in usury in New York and Boston.

The United States has the idle plants to produce, and the unemployed or misemployed workforce to man them. Where is the "demand" to come from? The real demand is already there: the nation needs highways, bridges, waterways, railroads, industrial plant, agricultural machinery and equipment, vehicles, ships—and exports to meet the enormous needs of Third World nations.

But how do you pay for it. *The answer is credit*. Low-interest, long-term credit issued by the U.S. Treasury to agriculture and industry. LaRouche prescribed the following emergency steps:

1) "Federalize" the Federal Reserve Board, so that it no longer controls the credit of the nation and cannot set interest rates. The Federal Reserve as it now exists is a violation of Article I, Sections 8 and 9 of the U.S. Constitution.

2) Issue $500 billion in gold-reserve backed, 2-4% interest Treasury notes through a regulated private banking system to specified productive categories of manufacture, agriculture, transportation, and infrastructure, to put 5 million people back to work quickly.

3) Convene an emergency summit of, at minimum, the heads of Western Hemispheric governments and other allies to reorganize the international monetary system with 2-4% refinancing to allow Third World nations to import again—allowing the United States to export again. Establish gold-based parities between currencies, and work out a framework of credit and "foreign aid" based on "great projects" to industrialize the underdeveloped world.

This implies that the British doctrine of "free enterprise," "free trade," "free market," as re-popularized in the 19th century by Karl Marx, be once again thrown out the window to rebuild the nation and industrialize the world, just as America's Founding Fathers threw such "free market" dogmas out the window to originally build the American Republic out of colonialism.