Sobering words from the Basel bankers

by William Engdahl

Normally annual reports of central banks are designed to put readers to sleep. The Bank for International Settlements' (BIS) Annual Report issued June 10 is a notable exception. The report, which is issued each year at the annual Basel, Switzerland meeting of the world's major central bankers, opens on a stark note. Referring to the unusually optimistic situation facing the world 12 months after the political transformation of Eastern Europe, the BIS notes that a rude shock was delivered with the Iraqi invasion of Kuwait and the ensuing Gulf war. "The immediate result was the threat of an external shock of the kind that had severely disrupted the world economy twice in the 1970s."

What concerns the BIS central bankers is the fact that, in the wake of George Bush's Operation Desert Storm, the entire parameters of economic development in Eastern Europe as well as the growth prospects of most of the Western world have dramatically changed for the worse. Calling the Gulf crisis a "sobering reminder of how quickly political upheavals can change the economic scene," the BIS notes that the Gulf events "left policymakers aware that they face an uphill struggle on virtually all fronts." In addition to the new, urgent economic reconstruction needs in the Middle East and the demands that places on world capital, the report cites a conjuncture of "recessions" cutting through the economies of Britain, Canada, parts of Scandinavia, France, and Italy, as well as the fact that the Third World "international debt crisis lingers on and casts a shadow over large parts of the developing world."

But the real alarm put out by the drafters of the document is the situation in the United States.

After detailing the fact that the U.S. economy entered into a "recession" at the end of 1990, they note that "recessionary conditions have also adversely affected the fiscal positions of state and local governments, further exacerbating the general government budgetary position." However, they write, unlike in all previous U.S. postwar recessions, when a general reduction in credit from the Federal Reserve and interest rate rises precipitated most downturns, this time, "the recession in the United States is atypical in not having been initiated by a rise in real interest rates, strong wage pressures or excessive inventories." The Basel bankers' report attributes this unusual phenomenon, where an economic downturn developed despite almost 18 months of looser money and lower interest rates from the Fed, to the careening federal, corporate, and private debt burdens of the U.S. economy, and they particularly draw attention to the "rapid growth in consumer and business debt ratios and high commercial property vacancy rates."

Senior City of London economist Stephen Lewis, referring to the careful choice by the BIS of the term "atypical," pointed out that "in the special language of European central bankers, this is a signal that nasty shocks are about to erupt from the United States and that central bankers elsewhere should heed the warning and 'batten down the hatches.' "

In light of the enormous new demand in Eastern Europe for investment capital, the chronic need in the Third World, and in the war-torn Mideast, the BIS points to a growing "shortfall" in what it terms worldwide savings to meet all these needs. The report documents a cataclysmic fall over 1990 in foreign investment into the United States, dropping from an inflow of $142 billion in 1989 to only $31 billion last year. Moreover, Japan was a net seller of U.S. bonds and stocks last year, and private German savings, the other large source of funds for the U.S. in recent years, largely went to reconstruction needs inside the unified German economy.

Hence, the BIS, again with characteristic understatement, writes, "The buildup of public debt over more than a decade has limited the scope for counter-cyclical fiscal policy action."

U.S. infrastructure catastrophe

But perhaps most notable about the report and its warnings about the disastrous situation in the United States, where the authors clearly don't share the current euphoria about a touted "end of recession," is the mention by the BIS of the deteriorated condition of American public infrastructure. The report states: "A deterioration in infrastructure over the past decade is clearly evident in the United States, where the problem is concentrated in major cities. . . . Government spending priorities must take account of the growth-enhancing aspects of appropriate public investment. Empirical evidence shows a link between investment in core public infrastructure (roads, public transport, airports, water supply, electricity and so on) and economic growth, partly owing to its effects on private sector productivity. A major part of the productivity slump in the United States has been attributed to low public investment."

In his concluding remarks, BIS General Manager Alexandre Lamfalussy warns: "Even the automatic fiscal stabilizers that operate in any recession are being partially offset in the United States by increases in taxes and user fees. The buildup of public debt and the intractability of large structural budget deficits . . . serve as strong deterrents." All told, the BIS gives little grounds for expecting any kind of "recovery" in the near term.