

Banking by John Hoefle

Goodbye, Mr. CHIPS

The collapse of the central banking system spells doom for the world of electronic funny-money.

As EIR documented last week, the world financial system has been turned into a giant casino in which the ability of the central banks to control the values of their currencies has been destroyed by the currency-speculation racket spawned by that very same change. As the events of September clearly showed, the central banks no longer have the capability to keep the monster of speculation at bay. Like Dr. Frankenstein, they have been destroyed by their own creation.

The collapse of this giant international casino has the banks and regulators scared to death, as commentators warn that the whole system could come to "a wrenching halt."

Federal Reserve Chairman Alan Greenspan, in an Oct. 14 address to the Federation of Bankers' Associations of Japan in Tokyo, warned of the risks inherent in having trillions of dollars worth of electronic funny-money swirling around the world in bank computer networks.

With the events of September, Greenspan said, "We all became aware that the financial systems were at risk with serious implications for world markets." Global financial transactions may be too fast and too complex for senior bank managers to handle, he warned, calling on central banks and governments to step up their supervision of international banks.

"A number of the old rules of thumb that policymakers used are inoperative" in the current economic situation, Greenspan lamented. "No models can explain the types of patterns we are having.

"We must all guard against a situation in which the designers of financial strategies lack the experience to evaluate attendant risks, and their experienced senior managers are too embarrassed to admit they do not understand the new strategies," Greenspan said.

Greenspan's warnings echo those issued Oct. 6 by Bank of England Governor Robin Leigh-Pemberton, in announcing plans to enable the British Clearing House Automated Payments System (CHAPS) to settle large electronic funds transfers between banks immediately, rather than overnight.

The way CHAPS currently works, wire transfers between banks are processed immediately from the customers' standpoint, but the banks themselves do not settle up until the evening. As long as the banks involved are solvent, and have the money to pay up each night, the system works fine. But, were one or more of the banks involved to be unable to meet their commitments at night—an increasingly likely occurrence—the entire system could be thrown into chaos, sweeping away whole sections of the international financial system at one time.

The danger, in the words of the London *Financial Times*, is "the risk of a domino effect if a bank collapses."

"The vast volumes of business being processed through the payments system" have led, Leigh-Pemberton said, "to huge, unmeasured intra-day exposures for banks, as a result of their willingness to give customers immediate use of incoming funds before being certain that inter-bank

transfers would be settled."

These "intra-day exposures can be massive—sometimes exceeding the capital of the banks concerned," the Bank of England official added.

"I regard this as one of the most important developments in my governorship," Leigh-Pemberton said.

The London *Financial Times* agreed, editorializing: "In a financial system that seems daily to get more fragile, any step to reduce risk is welcome. For the layman, however, it is not always an unalloyed pleasure, since it is often accompanied by a realization for the first time of just how big the risks have become."

A similar worry that the electronic funny-money system "could spin out of control" was expressed by the *New York Times Magazine* on Oct. 18, in an article by Peter Passell on the Clearing House Interbank Payments System (CHIPS—the U.S. equivalent of CHAPS) owned by the big New York-based banks.

CHIPS handles nearly \$1 trillion in U.S. dollar currency transactions—more than the entire U.S. money supply—each day. Together with a network run by the Federal Reserve, the two handle \$1.7 trillion a day, or 80% of the total payments made worldwide in dollars.

"Were the flow to stop unexpectedly," Passell noted, "financial empires would teeter and governments tremble. . . . If something were to go seriously awry . . . in the world of electronic money, the whole system could come to a wrenching halt in the twinkling of a gigabyte."

With the demise of the world's central banking system on Sept. 16, the day that the British pound collapsed, that flow has indeed been cut off, and many trillions of dollars of electronic funny-money has disappeared, never to return. The teetering and trembling has begun.