

LaRouche calls for exchange controls

Almost daily, Lyndon LaRouche is being covered as *the news* in some part of the world—with the notable exception of the United States—because of the accuracy of his economic forecasts over the past 40 years. In June, he warned of the likelihood of a “Black October” on the financial markets; and on Nov. 15, he forewarned of crisis in Japan and South Korea, which we now see.

For example, *El Mexicano* of Baja California, wrote in November, that today’s global financial breakdown, “confirms the accuracy of the forecast of economist Lyndon H. LaRouche, whose prestige grew enormously after the punctual arrival of the October crash, of which he had warned long in advance.” (*El Mexicano* is a newspaper of the Mexican Labor Federation.)

Interviewed on “EIR Talks” radio program on Dec. 3, LaRouche stressed that we’re facing the “death of the system,” and indicated the kind of emergency actions required.

“We’re talking about a *global* crisis,” he said. “And, the amount of money that would come crashing down, the amount of debt that would come crashing down on the world economy, in case of a chain reaction like this, would be, for starters, at a minimum, over \$100 trillion; current obligations, outstanding this year, of which \$30 trillion outstanding, at minimum, would rebound against the U.S. economy.

“We’re talking about about the death of the system.

“Now, the only way to get out of this, is to kill the system. How do you do that normally? You take a bank which is hopelessly insolvent, but might be reorganized, and you put it into government-supervised bankruptcy reorganization. And that must be done; that must be done, *soon*. Otherwise, you’ll get this collapse where everything disintegrates: chaos. And that’s the worst thing. You must avoid chaos, which means you’ve got to go back *away* from deregulation, *away* from globalization, back to *nationalist-protectionist* programs.

“For example, in the case of Korea, in the case of Japan and other countries, we must immediately reestablish what we established in the postwar period, and continued through 1958: We must return to exchange controls. We must use *capital* controls. We must use other regulatory measures of governments, and cooperation among governments (as the old Bretton Woods system did), to create a system in which this kind of speculation doesn’t go on. The speculator tries to get his money, it’s against the law. He can’t get his money. He cannot. Capital controls prevent money from racing around the globe from one place to the other, on an instant

basis, wrecking one economy after another. Speculators like George Soros couldn’t exist. They’d have to go into retirement. And, that has to be done. . . .

“We’ve come to the point where we have the opportunity to fight a very dangerous battle, against a dangerous opposition; that is, to junk the globalist system, which is killing us. Kill the present system, and reestablish the kind of system which worked for us before, which is the kind of Bretton Woods system we had back in the 1950s. The system that we used to get *out from under* the world economic depression, which, outside the United States, characterized most of the postwar world, the post-World War II world. And we’re going to have to do that again.”

Camdessus fingers South Korea

by William Engdahl

“South Korea stands within ten days of a gigantic financial catastrophe,” International Monetary Fund Managing Director Michel Camdessus announced nine days before the largest country bailout in history was signed in Seoul on Dec. 3. The \$55 billion emergency package for South Korea is intended to prevent a collapse of the world’s 11th-largest industrial economy. Korea owes well over \$130 billion to foreign creditors, much of it coming due in December. Had the deal with the IMF not gone through by Dec. 3, a gigantic debt default, orders of magnitude worse than the threatened 1982 Mexico default, would have taken place. By informed estimates, given the fragility of the current international financial and debt structures, the shock from such a default would likely have been sufficient to detonate a global systemic meltdown.

The Korean agreement, for which Camdessus made an unprecedented personal appearance in Seoul to sign with the Korean government, includes \$21 billion from the International Monetary Fund (IMF), another \$10 billion from the World Bank, and \$4 billion from the Asia Development Bank. To boost “confidence” in the package, Japan will kick in an additional \$10 billion; the United States Treasury’s Exchange Stabilization Fund, \$5 billion; and another \$5 billion combined from Group of Seven (G-7) members U.K., Germany, France, and Canada, plus Australia.

The previous record for an international bailout had been the U.S.-led \$50 billion Mexico rescue package of February 1995. Already this year, however, as the financial crises of former high-growth economies across Asia exploded, Thailand has gotten \$17 billion in an IMF rescue package, Indonesia \$40 billion, and, before the ink has even dried on South Korea’s IMF bailout deal, rumors are flying that Malaysia may

soon be forced to line up for emergency IMF help, along with Russia and possibly the Czech Republic in coming weeks.

The spreading collapse reminds me of the fable of the small Dutch boy who desperately tried to keep the dyke from bursting and flooding his village, by sticking his finger into a tiny but threatening hole in the dyke. Only this time, the boy is missing most of his fingers, and the dyke is bursting in more than a 100 different locations. In short, the G-7 and IMF authorities are trying to stop a process which already some months ago veered out of the realm of "normal" crisis management.

"The Korea bailout is massive," commented Georg Andersen, a strategist with a large Swiss bank. "It signals simply that the G-7 have decided that not only banks, but also certain countries are 'too big to fail.'" The issue at this juncture, however, is precisely how many countries, how soon?

Ricochet crises

That Korea is now being rescued by the IMF and G-7, is being taken as a signal by financial investors that their global speculation can roar ahead unabated. Traders from Frankfurt to London to New York insist that the unprecedented shocks across world financial markets which erupted on Oct. 27, are "over." Even the anticipation of the Korea IMF deal sent the New York and major European stock markets soaring earlier in the week. In fact, the real crisis is set to begin, even assuming that the new Korean government which results from elections on Dec. 18, observes total compliance with severe IMF conditionalities.

Only 72 hours before the IMF deal was signed in Seoul, senior Japanese Ministry of Finance circles were reported in a state of highest alarm over the political and financial situation in Korea. According to these reports, the internal Korean situation is "out of control." With Korea's won in a state of free-fall since mid-November, when the central bank abandoned futile efforts to hold its value to the U.S. dollar (it is now 35% below its level of five months ago), the Japanese feared that Korean authorities would suspend foreign exchange trading, a possible desperate measure to stop the won collapse. The fall of the won makes the repayment of Korea's dollar debt to date, 35% more costly.

Were Korea to suspend foreign exchange trading, Japanese companies and the government would be hit with "billions of dollars in losses overnight," according to these reports. Informed Japanese government assessment of the scale of the Korean default crisis puts the needed bailout at a level "above \$100 billion," a sum almost double that just agreed.

IMF: Shut down Korea

Among the conditions which made the IMF deal such a bitter pill for Korean politicians to swallow, reportedly are demands that the government close down bankrupt *chaebol*, or industrial groups. The same holds for insolvent Korean banks. Already, the Halla Group, a large shipbuilding concern, has announced that it will cut its workforce in half, to

3,000, by January; Daewoo Group, the fourth-largest *chaebol*, will impose sharp wage cuts and cuts in planned worldwide investment; Samsung Group, the second-largest *chaebol*, will cut investments by 30% for next year.

An economist with Korea's LG Economic Research Institute expects that this will be just the beginning. Under the strict IMF conditions; "*chaebols* will be required to chop off all unprofitable units. I cannot imagine how big *chaebols* will survive with just minor reform. Expect more corporate bankruptcies and massive layoffs," he said. Already, trade unions have begun militant demonstrations against the pending IMF deal. Protests are likely to increase once the now-secret text of the IMF agreement leaks out.

The South Korea crisis is not an isolated event, contrary to the impression Camdessus would like to convey. The reason for the extraordinary size of the bailout and the grudging participation of European countries, the United States, and Japan, is the fact that a blowout in South Korea now would have systemic consequences.

Most immediately, Japan is threatened, as the largest single foreign lender to Korean companies, with anywhere from \$37 billion to \$50 billion at risk. Were a Korean loan default to occur, that shock, on top of the unresolved internal Japanese bank crisis, would likely be the straw to break the camel's back.

Reportedly, European banks as well have large loans outstanding to Korea. In order for the IMF bailout to even temporarily stabilize the Korean currency in coming weeks, it must convince the foreign bank lenders to roll over some \$80 billion worth of loans coming due in the coming 12 months. That will be an extremely tense and difficult job, by all accounts. Should that fail, the cost of any bailout becomes stratospheric.

And the next catastrophe?

Were Korea the end of the problems facing the governments of Asia and the G-7, as financial markets have concluded, that would be one thing. It is only the latest huge drawdown against the rapidly dwindling reserves available to the world's chief emergency bailout agency, the IMF.

Before the Seoul deal, the IMF had little more than \$50 billion available legally for such rescue operations, leaving now \$29 billion. Further, the U.S. Congress in November rejected a Clinton administration request for a \$3.5 billion increment to IMF funds for such emergencies. The U.S. Treasury's Exchange Stabilization Fund, which was used during the Mexico bailout, reportedly has today only \$15 billion in cash and another \$15 billion in foreign currencies, mainly in deutschemarks and yen. All indications are that, given present policies, that sum could fall to zero in a matter of weeks.

The most rapidly deteriorating situation is Russia, where, according to unconfirmed reports from Moscow economists, the central bank has drawn its foreign currency reserves down to the dangerously low level of \$10 billion. To finance state deficits in recent months, the government had opened the sale of short-term, high-interest Russian government certificates,

40% of U.S. Treasuries are held by foreigners

The U.S. government, and the monetary system of the United States, now have a heightened strategic vulnerability: Currently nearly 40% of all marketable U.S. Treasury securities—bills, notes, and bonds—are held by foreign interests, and at a moment of financial tension and crisis, these could be unloaded on the world's markets. The trigger would be the sudden need of foreign holders of U.S. Treasuries, such as foreign central banks and commercial banks, to raise cash through liquidating their Treasury holdings. There are now \$1.279 trillion worth of Treasuries in foreign hands: Were even one-quarter or one-third of these to be unloaded within the span of a few months, the value of U.S. Treasuries, and therefore, of the U.S. dollar, would fall through the floor.

A plummeting dollar would expose U.S. economic and foreign policy, to a significant extent, to London's black-mail. The U.S. Treasury and the Federal Reserve System have worked out an arrangement, in the event of a financial emergency in Japan, to extend collateralized loans to Japan's banks, to avert those banks having to sell their U.S. Treasury securities on the world's market in order to raise cash. But such an arrangement could be pushed beyond the breaking point, if it had to be extended to many countries to prevent wholesale Treasury dumping in the period leading up to and during a financial crash.

According to information provided by the U.S. Treasury's "Foreign Portfolio Investment Survey," in 1993, foreign interests, including foreign governments, foreign corporations (including banks), and foreign nationals, held approximately \$607 billion out of what was then America's \$2.99 trillion in outstanding marketable U.S. Treasury debt, which represented 20.3% of the total. As of Dec. 31, 1995, this percentage had risen to 26.2%, and as of Aug. 31, 1997, foreign interests held 37.6% of all U.S. marketable Treasury securities.

On the one hand, by having foreigners sop up the entirety of U.S. Treasury debt issued during this interval of nearly four years, U.S. internal credit market funds did not have to buy U.S. Treasuries. Some economists would argue that this kept U.S. interest rates down. But this process added to our vulnerability.

Country holdings

Table 1 shows the foreign holdings of U.S. Treasury securities to have more than doubled in absolute size, from

\$607 billion at the end of 1993, to \$1.279 trillion at the end of August of this year.

Table 2 shows the ownership by country. As of Aug. 31 of this year, of all marketable U.S. Treasury securities in the world, Japan held 9.5%. Britain held 7.5%, having more than doubled its holdings during just the past two years.—*Richard Freeman*

TABLE 1
Marketable U.S. Treasury securities outstanding

	Total marketable U.S. Treasury securities (billions \$)	Foreign holdings (billions \$)	Foreign holdings as % of total
December 1993	2,990	607	20.3%
December 1994	3,216	685	21.3
December 1995	3,290	862	26.2
December 1996	3,414	1,147	33.6
August 1997	3,401	1,279	37.6

Source: "U.S. Treasury's Foreign Portfolio Investment Survey."

TABLE 2
Major foreign holders of marketable Treasury securities
(billions \$)

Country	1995	1996	August 1997
Japan	220.0	286.5	321.2
United Kingdom	123.6	190.3	255.1
Germany	53.7	72.2	78.6
OPEC	28.0	44.0	55.6
Spain	19.3	46.4	53.6
Netherlands Antilles	50.9	63.9	48.3
Hongkong	18.8	33.5	46.5
China	34.9	46.6	43.1
Taiwan	24.0	32.0	34.7
Singapore	29.7	38.8	34.1
Belgium	12.7	14.1	28.2
Canada	25.1	27.0	27.0
Switzerland	37.0	31.3	25.4
Mexico	16.4	20.3	17.9
France	9.2	9.6	9.2
Other	158.9	190.8	200.2
Total	862.2	1,147.3	1,278.7

Source: "U.S. Treasury's Foreign Portfolio Investment Survey."

the so-called GKO's, to foreign investors. Once the Asia crisis forced South Korean banks to raise cash to repay loans back in October, the Russian bond market went into a free-fall. Korean banks, eager to get high returns to cover growing losses on their *chaebol* loans, poured money into the world's highest-interest bond markets. They were the same markets which today have collapsed: Thailand, Indonesia, Malaysia, Brazil, and, above all, Russia.

Russia, today, in many respects is like Mexico in late 1994 before the peso crisis hit. It is wholly dependent for government daily finances, on foreign "hot money" investment in short-term bonds. With the flight of those funds, Russia's ruble is again collapsing, hyperinflation is exploding, and untold political and economic instability will result.

As well, eastern Europe is teetering on the brink of disaster. The Czech Republic has just been plunged into chaos with the abrupt resignation of Prime Minister Vaclav Klaus, the architect of the country's post-1990 economic reforms. The country was already reeling from a devastating series of summer floods and a run on its currency, the koruna. The political uncertainty threatens flight of foreign investment, which could make that country the next candidate for IMF funds, if Malaysia or Brazil doesn't get there first.

The 'mother of all meltdowns'

None of this takes into account what one trader terms "the mother of all meltdowns," namely, the potential for the Japanese financial crisis to explode. The present calm there is illusory. On Dec. 10, the Hashimoto government will present plans to the Parliament to deal with the crisis in the Japanese financial sector. Bad debt still held by Japanese banks from the 1980's "bubble era" speculation in real estate and stocks, is estimated to be anywhere between \$900 billion and \$1.1 trillion. Unless the government is able to break a deep internal political deadlock and decisively act to clean up the banking mess, by no later than Dec. 11 we will be talking of the spill-over of the "Japan crisis" into global markets.

It is not surprising that, privately, and, increasingly, publicly, the proposals of American economist Lyndon LaRouche for the creation of a new, just world economic order, a new Bretton Woods system, are being seriously studied.

Fight against currency speculation spreads

by Gail G. Billington

As the financial contagion that hit Southeast Asia in the spring and summer spreads, engulfing Russia, eastern European countries, Brazil and Argentina, and now the economic pow-

erhouses of Asia—Japan and South Korea—Malaysian Prime Minister Datuk Seri Dr. Mahathir bin Mohamad continues as the leading head of state calling for reining in speculation against national currencies. Since his ringing indictment of megaspeculator George Soros at the September International Monetary Fund (IMF) Annual Meeting in Hongkong, Dr. Mahathir's remarks have been picked up from Moscow, to Budapest, to Lima, to Shanghai. *EIR* last week reported on his role in putting this issue on the table at the heads-of-state meeting at the Asia-Pacific Economic Cooperation (APEC) conference in Vancouver on Nov. 24-25.

Immediately following that meeting, certain circles in Japan decided to "play the Mahathir card," inviting the Malaysian prime minister to expand on this subject in a televised interview and in the country's leading financial press, during his stopover in Tokyo on Nov. 28-30. Upon returning to Kuala Lumpur, Dr. Mahathir addressed the Association of Southeast Asian Nations finance ministers' meeting on Dec. 1-2, in what proved to be a squaring off with IMF Managing Director Michel Camdessus. Dr. Mahathir made clear that he will pursue these themes at the Dec. 12 World Trade Organization meeting in Geneva, and the annual informal summit of ASEAN heads of state in Kuala Lumpur on Dec. 14-16, which will mark the association's 30th anniversary. A Dec. 1 press conference in Beijing by Chinese Foreign Ministry spokesman Tang Guoqiang, on the importance of the ASEAN summit, underscores that Dr. Mahathir speaks for a broad consensus. Tang said: "We should emphasize regional and global financial cooperation to safeguard the normal financial order and jointly prevent being attacked by the excessive speculation of international floating capital."

We include below excerpts of Dr. Mahathir's statements to APEC business leaders in Vancouver on Nov. 25, on Japanese TV on Nov. 28, and at the ASEAN finance ministers' meeting in Kuala Lumpur on Dec. 1-2.

Documentation

From Dr. Mahathir's address to CEOs of APEC countries on currency trading (from The Star Online, Kuala Lumpur, Nov. 25):

"We really don't know who is trading, how much money is being traded, where the funds are coming from, what is going to come next and where they trade. . . . Surely you cannot allow people who make billions of dollars to get away without paying tax. Our country has been deprived of some U.S. \$30 billion . . . but we don't get a single cent in tax. We can't tax people we cannot see. So they should be made visible. They should also be limited to maybe raising up to 100% more than what they put in by way of capital. . . ."