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Asian crisis shows need for New Bretton Woods

by William Engdahl

After seven months of spreading collapse of currencies and financial markets across almost every country of Asia, from Thailand to Indonesia to South Korea and Japan, the situation shows no signs of abating as the New Year approaches—in fact, the opposite.

In Japan, the internal political battle over whether and how to deal with the country's seven-year-old banking crisis came to a new phase on Dec. 17, when the Liberal Democratic Party of Prime Minister Ryutaro Hashimoto announced a special financial and economic legislative proposal. In a surprise move, Hashimoto offered a package of income tax cuts worth 2 trillion yen ($15.7 billion), in an effort to stimulate the depressed economy.

The government's more urgently awaited proposal deals with an estimated $800-1,200 billion of bank bad loans, the residue of the wild speculative real estate and stock market binge in the late 1980s. Hashimoto proposes to put the equivalent of 10 trillion yen ($78 billion) at the disposal of the government's Deposit Insurance Corporation (DIC), to deal with future failing banks or financial firms, such as Yamaichi Securities, whose collapse in November triggered a panic selloff in world financial markets.

Too little too late?

The Japanese government's proposals are being labelled "too little, too late" by financial market analysts inside and outside of Japan. Under the financial emergency plan, Tokyo will allot 10 trillion yen in newly created Capital Contribution Bonds (CCBs) to the DIC. The bonds will pay zero interest and will be nontransferable, meaning they cannot be sold to the public for cash.

Because of this unusual feature, the placing of the bonds to the now-insolvent DIC will technically not be a net increase of bonds in circulation—an important political argument in Japan, where the idea of spending the taxpayers' money to bail out failing banks is extremely unpopular. Instead, in the event of a new bank crisis in the future, the DIC would be able to take its CCB special bonds and exchange them for ordinary interest-bearing government "construction" bonds. These in turn, could then be sold onto the public debt market internationally, as needed, to raise the cash to deal with a specific future bank crisis, were it to come.

In effect, the complex two-step procedure ensures that the DIC has at hand the potential to deploy up to $78 billion to prevent future bank crises. The hope, obviously, is that the mere existence of such an insurance fund would calm jittery financial markets and prevent panic selling of Japanese stocks by nervous investors. On Nov. 10, the Nikkei Dow index had fallen to 15,082 yen, a level at which the hidden reserves of as many as 11 of Japan's 20 largest banks became negative. Only the promise of radical government action to deal with the long-standing bank crisis, coupled with aggressive pressure from the Ministry of Finance on foreign "hedge funds," such as George Soros's Quantum Fund, managed to temporarily bring the vital stock index again above 17,000 over the past four weeks. On Dec. 18, however, the moment of truth had arrived, and Hashimoto had to act.

Japan is one of the only major OECD countries (South Korea is the other), where bank capital is based so strongly on the value of a bank's holdings of permanent shares in other companies, the so-called *Keiretsu,* or cross-holding system, built up after World War II, to facilitate the reconstruction of war-torn Japan. So long as the Nikkei was rising, the case for most of the period from 1950 until 1990, the system allowed Japanese banks to build huge hidden capital reserves and expand to become the world's largest lenders during the late

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1980s. Unfortunately, when Japan's stock bubble was finally pricked by the worried Bank of Japan in December 1990, the stock prices plunged, and bank hidden reserves with it, leaving a huge residue of bad loans.

On Dec. 18, the day after the government's plan was unveiled, the Nikkei again fell by 2.3% to a worrisome 16,101, and fell another 846 points on Dec. 19 to 15,314, its lowest point since Nov. 10. Bank analysts estimate that a Nikkei level of 20,000 is the minimum necessary to enable the banks to be strong enough to write off large chunks of their bad debt and to reorganize.

"As usual the government is really behind the ball," noted Yasunari Ueno, chief economist at Fuji Securities in Tokyo. "They finally seem to understand the seriousness of the situation, but can't change direction that quickly." As one informed European banker put it, "It's too little, too late, I fear. By trying to get by with the minimum necessary to calm markets, the government risks the crisis erupting in a few weeks or so, with a fury even harder to contain. It is a long way from Dec. 18 until the beginning of debate in Parliament Jan. 19. A lot can happen between now and then, especially in regard to the volatile situation in South Korea. A worsening of the Korea crisis could have severe consequences for the Japanese banks." Japanese banks have lent a total of $57 billion to various South Korean banks and private companies, much of it short term.

The unresolved Korean problem

The perverse interaction between the simultaneous crises in Japan and South Korea is giving the entire Asian crisis a systemic global dimension which has rocked financial markets from Russia to Brazil in recent weeks. On Dec. 18, South Korea held Presidential elections, complicating the government's ability, so far, to deal with the dramatic crisis there.

In South Korea, the private banks and companies of the industrial *chaebol* groups have turned increasingly to foreign banks, especially Japanese and German, to borrow in order to cover losses from a weakening domestic economy. Total foreign debts of the state and all private entities is now some $200 billion, placing South Korea on a par with Brazil as one of the world's most indebted developing nations.

But far more worrisome for Korea, is the fact that $116 billion of that foreign debt is due in the coming 12 months, and a whopping $30 billion by the middle of January. So far, the creditor banks are reportedly refusing to roll over those loans, until they see firm financial guarantee from the International Monetary Fund (IMF) that they will be repaid.

Officially, as of Dec. 12, the Korean Central Bank held no more than a total of $10 billion in dollar reserves, including a $5.6 billion contribution from the IMF. Circles in the City of London the week of Dec. 8 began widely spreading the rumor of an imminent Korean default, something which would have had drastic consequences for the world economy. On Dec. 14, the London *Sunday Telegraph* ran a headline, "Korea on Brink of Default," further fuelling default fears.

To date, there has not come a Korean default, though the election of opposition candidate Kim Dae-Jung could bring fresh financial turmoil. One week earlier, after agreeing with IMF Managing Director Michel Camdessus to abide by the terms of the IMF's harsh conditionalities were he to win, Kim told BBC TV in an interview that, if elected, he indeed would tear up the IMF agreement and renegotiate it. That statement triggered a 30% plunge of the Korean currency, the won, in two days, adding to the credibility of the London default rumors.

"Put simply, South Korea is 'too big to fail,' " insisted George Andersen, a senior banker with a large Wall Street investment firm. "With the unrest in North Korea, the military-strategic stakes are too high for the United States to allow a Korea default. Were they to let it happen, everyone holding U.S. Treasury securities around the world, starting in Japan and Europe, would panic and rush for the exit gate and sell their U.S. Treasuries at any price. This will not be allowed to happen."

However, even if such an outcome is excluded, which is by no means certain at this date, the range of options is grim, to say the least, for Washington, Tokyo, Seoul, and the rest of the world. As Lyndon LaRouche underlined in *EIR* on Dec. 12, the potential exists, for a Weimar-style global hyperinflation, if the world's central banks flood markets around the world with cash, to prop up the present world monetary and debt structures.

"What happened in Weimar?" LaRouche asked, in a Dec. 17 radio interview with "EIR Talks." "In Weimar, they said, 'In order to pay the foreign debt, in this case the war reparations debt, we have to print more money. That is, we have to pour money into bailing out debt. But we're only going to do it this one time, for the short term, to get over this crisis.'. . . Each time they used the bailout method, they made the crisis much worse than before. But they would go back again and say, 'Well, we're just doing it one more time, one more time, one more time.' Each time—'one more time'—actually made the crisis worse. And then one day, within the period of about 18 months, one day, no German money. The printing presses couldn't function any more. They couldn't keep up. And but for a foreign bailout, called the Dawes Plan, Germany would have disintegrated under those conditions."

Today, such money-printing could inflate the way out of the immediate crisis in the short term. But in the longer term, the world economy would soon be driven into a depression, a simultaneous deflation of real wages and prices amid an exploding hyperinflation of financial asset prices, which would make 1930-33 appear like a church picnic in comparison. The present reports of behind-closed-door debate in various international policy circles, over LaRouche's proposal for creation of a New Bretton Woods stable monetary order, coupled with long-term infrastructure investment, will be forced into the open debate, as the crisis escalates into 1998.