Atlanticists Declare Bankruptcy: Euro-Dollar Market on the Brink

Every policy statement and initiative that came from Atlanticist banking and political circles this week amounted to the same public annoucement: "We are bankrupt." Every attempt to plug the leaks in the international monetary system immediately springs a dozen more. Within the next several weeks, the conjuncture of two developments will produce a general monetary panic: the paralysis of the Atlanticists to maneuver politically, and the rapid worsening of credit conditions on the international markets themselves.

In attempting to prevent immediate and devastating reversals in the Italian and related situations, the Atlanticists have proposed a series of transparent swindles which, at deadline, already seem to have fallen flat.

The keynote for the week came last Monday from the finance ministers of the European Economic Community, who proposed to provide loan guarantees for Italy of $1 billion, and for Ireland of $300 million. (In a related development, the German Bundesbank, which in any case represents the sole backer for such an EEC guarantee, is encouraging German banks to provide several hundreds of millions in loans to insolvent Denmark).

The specific technique of the Italian loan swindle is directly reminiscent of the machinations of Nazi Finance Minister Hjalmar Schacht.

As the leading Italian daily Corriere della Sera wrote caustically, "None of this money will ever reach Italy." Should the Italians accept the loan guarantee, for which the EEC Commission is seeking to extract some form of austerity conditions in return, the entire sum would be transferred immediately to the account of Italy's creditors. Italy at present owes about $5 billion to international banks in short-term external debt. The principal effect of the loan guarantee on the Italian economy would be to raise the debt-load as a whole and the debt-service burden, estimated at $3.3 billion for this year alone.

The bankers themselves are franker than the EEC Commission about the purpose of the proposed loan guarantee. "We don't need draconian austerity in return for the loan," said First National City Bank's Richard Wheeler. "Just some form of austerity." Another Citibank offical added, "We'll sucker the unions into accepting this, and then move in with the real stuff, the Andreatta program."

But there is no sign of willingness on the Italian side to be swindled at deadline. One of the sources whom the EEC had planned to tap for part of the $1 billion, the Saudi Arabian government, put word out quietly that the entire setup seemed too shady. Although several New York banks expressed interest in participating in the loan earlier in the week, all activity towards setting up a banking consortium to provide the cash is at a standstill.

Meanwhile, Italy's foreign exchange reserves, which lost $1.5 billion in the six weeks prior to the closing of foreign exchange markets Jan. 21, remain at too low a level to finance vital imports, including industrial raw materials. Thus the incentive for an Italian debt moratorium has escalated rather than receded.

To the extent that it cooperated in the EEC loan-guarantee plan with Italy's creditors in New York, the Bundesbank has become the butt of this joke. According to one leading banker in New York, "Germany will have to play a continuing role in bailing out the rest of Europe," considering that private funds may no longer be available. Bundesbank vice-president Otmar Emminger is clearly in agreement with First National City Bank on the need for some kind of austerity: Wednesday he told the OECD's Working Party III, "The future of the lira depends on the measures that Italy takes to restore international confidence."

Last week, the Bundesbank refused to condone the proposed series of European currency devaluations which the Atlanticists attempted to enforce as the general prelude to an all-European austerity policy. Instead, the Bundesbank joined with the Banque de France and other central banks in a mutual intervention arrangement for the leading European currencies. On this basis, the central banks prevented the devaluation of the French franc and Danish kroner, which New York had intended to accompany the pre-existing devaluations of the Italian lira by 15 per cent (since Jan. 21) and the 10 per cent devaluation of the Spanish peseta.

But — as Federal Reserve governor Henry Wallich warned a high-level German Atlanticist audience at Eichorn West Germany this week — the currency-intervention policies of the Bundesbank itself, let alone lending and loan-guarantees for Italy, Denmark, etc., will force the deutschemark to take on the role of European reserve and intervention currency, and international buffer for the dollar. This eventuality has always been the ultimate horror for the Bundesbank and its political allies. They have an interesting decision to make within the next two weeks.

Corriere punctuated the question of European refinancing Friday by publishing a "captured" document circulating internally within the EEC Commission, which set out the following sums potentially available to Italy: $2.7 billion in short-term swap lines from the Federal Reserve; $380 million in swaps from the Bundesbank; $250 million in Swiss central bank swaps; a potential $2.3 billion (!) in loan guarantees from the European Economic Community; and $550 million from the International Monetary Fund under the expanded IMF lending agreement worked out at the recent Kingston, Jamaica meeting. According to the document, the Italian problem posed three choices: 1) austerity inside Italy; 2) massive inflation inside Italy, with some external financing to protect the international value of the lira; and 3) total refinancing of the Italian economy and international inflation.

The EEC Commission's report concludes, the third choice seems the most likely. (First National City Bank's economists, meanwhile, hope they can get by with $2.5 billion in financing during the next few months. But there is not a single confirmed loan arrangement out of these proposals during the past week.)

Safety Net

More broadly, the State Department is now circulating a proposal for the general refinancing of Third World debt on an identical, and equally fraudulent premise. Within the State Department's Policy Planning Staff, a brief article by New York Times financial reporter Edwin Dale, Jr. that appeared in the Feb. 16 Times is viewed as the "Bible." Dale reported U.S. officials to be considering a plan under which industrial-country governments would join to discount the short-term loans of international banks to the Third World, and turn these into long-term debt — an operation identical to the failed "Big Mac" scheme for New York City. By rough calculations, the formula could apply to at least $60 billion, or one-third of the overall Third World debt outstanding, — or the equivalent of the Ford Administration's projections for the current fiscal year's Federal budget deficit.

The reasons for the circulation of this proposal are strictly political, because in the words of a State Department economist, "The Third World is using sophisticated new tactics on the debt question, and they've outflanked us." Should governments print (or absorb bad assets to the extent of $60 billion, the U.S. monetary authorities will owe apologies to the long-forgotten central bank governor of the Confederate States of America.

In addition, the Treasury is reported by the Journal of Commerce to have begun an intensive lobbying effort for rapid passage of the $23 billion "safety net" plan for the OECD countries originally proposed by Secretary of State Kissinger. The plan was presented to Congress one year ago. Treasury officials confirm that the decision to lobby for the plan at this point represents a policy shift.

The White House is directly involved with these various refinancing efforts, now under discussion between State, Treasury and the Federal Reserve.

As in the case of the proposed Italian swindle, the banking community is considerably more frank than government spokesmen on the intentions of these refinancing schemes. The probable reason for this frankness is that financiers must admit to being swindlers in order to maintain a reputation for competence. "It won't ever come to" the mere printing of $60 billion, the chief of international operations at a leading New York bank said this week. "These countries are going to have to cut back. India, Pakistan, and others will have to return to subsistence agriculture."

Once noted, the efficacy of these plans cannot be overrated. In context, the circulation of refinancing plans underscores the complete lack of real policy on the part of the Atlanticists generally. What remains of their apparatus has no capacity to enforce the cutbacks which they propose, and promises of refinancing will not delude the intended victims of these plans.

This fact came to light at a Feb.19 closed Senate briefing with high State Department officials and associated thinktankers, to discuss policy for the Third World. Present were Undersecretary of State for Economic Affairs Charles Robinson, Deputy Assistant Secretaries of State Paul Boeker and Julius Katz, and Brookings Institution economist C. Fred Bergsten. To the astonishment of Foreign Relations Committee staffers, the State Department crew refused to depart from the narrowest approach ever adopted at State, refusing to budge an inch on the debt question, stabilization of Third World commodity prices, or other schemes freely touted on Wall Street. Katz and Bergsten staged an acrimonious debate on the commodity-price issue, which is subsumed by general refinancing questions, in which Katz ignored Bergsten's urgent promptings to the effect that something must be done fast if the entire debt structure is to survive.

The reasoning behind the State Department's refusal to brief Congress on the contingency plans it is now pushing is simple: if the Administration publicly acknowledges its willingness to negotiate with the Third World from the standpoint of weakness, it will merely encourage the Third World to undertake pre-emptive debt moratoria in anticipation of such negotiations.

Finally, the Treasury has dealt with the safety-net scheme so timidly that even the minority counsel of the relevant Congressional committees, presumably Secretary Simons Republican co-thinkers, have been kept in the dark as to the Treasury's intentions. Out of the 16 national parliaments that must approve the safety net scheme, which Kissinger and Treasury Secretary William Simon proposed in November 1974, only four have approved it to date.

The Eurodollar Market On The Brink

An appropriate measure of the international community's confidence in the Atlanticists' capacity to hold the line is the current state of the international lending markets. According to authoritative Swiss and New York banking sources, large international banks with major Eurodollar subsidiaries and American headquarters are quietly transferring the worst of their Eurodollar assets to their parent branches. According to bankers, this will enable the parent bank to discount this bad paper with the Federal Reserve, something not directly possible for an unregulated foreign subsidiary. The fact that the Eurodollar banks are sending their dirty laundry home to parent branches who are themselves the target of exposure campaigns is astonishing. But the procedure has been under discussion among Wall Street money-men since at least December as a "worst-scenario" contingency plan.

The particular explosiveness of the Eurodollar sector is that fully one-third of banks' liabilities represent loans from other banks. Liquidity has been fluffed up at every point of difficulty through a rise in interbank lending, which, since there are no reserve ratios enforced in this market, enables the banks to increase funds available indefinitely. Traders monitored a significant rise in interbank lending during the first weeks of this year. But reports suddenly began circulating at the beginning of last week — and found their way into the leading financial press — that confidence in interbank lending had dropped precipitously. After the June 1974 bankruptcy of West Germany's Herstatt Bank, a collapse of interbank confidence threatened to bring down the entire market.

This problem is partially attributed to the failure last week of a billion-dollar Southern bank holding company, Hamilton Bancshares. Hamilton's demise puts about $100 million of correspondent loans to Manufacturers Hanover and other New York banks in jeopardy. But the more pressing worry is that the Southern banks, among whom Hamilton was only the first casualty, are notoriously large participants in the Eurocurrency interbank market.

Storm warnings came from London as well this week. After the most recent collapse of a secondary bank at the outset of this month (First National Finance Corporation, the Bank of England and clearing banks' "lifeboat operation" had to expand to the point where, according to press accounts, fully 10 per cent of the clearing banks' assets are tied up in the bailout. New York bank analysts have rated the internal British situation as among the most dangerous for the banking system as a whole for several months. Chancellor of the Exchequer Denis Healey's new budget, although it entails the type of austerity that the banks demand for Italy, has done nothing to ward off panic.

On the contrary, London Times economics editor Peter Jay claimed Feb. 20 that Healey's budget reveals "The Classic Profile of National Bankruptcy." The budget increases debt repayment by £3 billion, and cuts £620 million from education, £500 million from roads, £440 million from food subsidies. The debt-service rise "more than cancels out all the painful savings." Mr. Jay writes.

"The political consequences of a world in which the people pay taxes principally in order to meet the cost of interest on the national debt while the standard and quality of public services and national defense are eroded further and further, defy imagination. This indeed is the classic profile of national bankruptcy. It is the slippery slope which leads ineluctably to repudiation of debt and political collapse."