Carter Administration Plans Bailout Of Endangered New York Banks

BANKING

Expecting the near-term outbreak of financial trouble at several large New York City-based international banks, the Carter Administration has taken emergency measures to bail them out. These measures, whose implementation is far from guaranteed, include the proposed creation of an International Monetary Fund facility to tide over heavy international debtors, and a program for top-down centralization of the banking regulatory agencies in the United States.

Wary of Congressional opposition, the Administration is "seeding" these plans into the press, Congress, and international organizations furtively, rather than taking a direct public stand. A key signal was the appearance this week of a series of articles on offshore banking by *The New York Times'* Ann Crittenden, summarizing the least embarrassing information in circulation on the New York banks' operations in the Bahamas and the Cayman Islands (see EIR Vol. IV no. 8). Crittenden's articles included statements by House Banking and Currency Committee chairman Henry Reuss (D-Wisc) on the negative effect of banking offshore operations on U.S. interest rates and investment, and a complaint by Rep. Fernand St. Germain (D-RI) that insufficient information is available on the banks' foreign activities. Additionally, the *Times* series quotes New York state and city officials' complaints that the offshore operations of Citibank cost them $10.8 million annually in taxes that would have been collected if the banking business had been done at its New York headquarters.

Not coincidentally, an exchange of letters had already taken place proposing hearings on banks' offshore operations between the offices of Rep. August Hawkins (D-Cal.), the co-author of the Humphrey-Hawkins bill, and Parren Mitchell (D-Md.), chairman of the House's Subcommittee on Domestic Monetary Policy. A spokesman for Rep. Hawkins described the Hawkins-Mitchell hearings as a pepper operation for other legislation on "banking reform," put forward by Reuss, Sen. William Proxmire, the chairman of the Senate Banking Committee, and Rep. Benjamin Rosenthal (D-N.Y.), chairman of the House Oversight Committee.

In Paris, meanwhile, Carter's chief economic advisor Charles Schultze, the Chairman of the Council of Economic Advisors, proposed to a 20-nation meeting of the Organization for Economic Cooperation and Development the formation of a $20 billion international facility through the Group of 10 leading industrial countries and the International Monetary Fund, with major participation by Saudi Arabia.

Back in Washington, Rep. Rosenthal concluded hearings on HR 2167, his bill to give Congress' General Accounting Office extraordinatry subpeona and oversight powers over the bank regulatory agencies, while Sen. Proxmire prepared for hearings to begin March 10 on the general condition of the banking system.

This little conspiracy is motivated by fairly general recognition that the international banks' precarious position is about to become critical. "There are only two possibilities. If everyone remains cool, calm, and collected, and no-one panics, then there is a chance — a slim chance — that we can get by this situation and muddle through once again. But that's a lot to hope for. The other possibility is that everything will blow sky-high," a leading Wall Street bank analyst said.

At present between $50 and $100 billion in uncollectable and non-accruing loans to lesser-developed countries (LDCs) and other international borrowers are being rolled over, mainly by a handful of international banks. The per-bank total of such loans is not known, since the banks are not compelled to report loans issued by non-consolidated subsidiaries, such as Chase Manhattan's part-owned Orion Bank and other London-based consortia. Typically, the parent banks channel funds to their Bahamas or Cayman Islands outlets, which are "multiplied" through deposits and re-deposits on the interbank market by a factor of twenty times the original input. This artifical liquidity is then used to "lend" the equivalent of principal and interest due from borrowers like Brazil, Mexico, Zaire, Egypt, and Turkey. On paper, these $50 to $100 billion of defaulted loans continue to accrue interest — as *The Ne*
without mentioning how the trick is done.

A number of factors have combined to intensify the problems in this operation, which has been running since commodity prices broke and destroyed the CLDs export earnings in early 1974.

1) The "bunching of maturities" on principal repayment from Third World lenders, estimated at $17 billion in 1977 for the LDCs as a group by Swiss Bank Corporation.

2) A new ratchet-decline in world trade, further eroding Third World countries' earnings.

3) The likelihood of a sharp rise in U.S. dollar short-term interest rates, already anticipated in the expanding yield-curve spread, due to the danger that the $85 billion Federal government and agency borrowing requirement this calendar year may have to be financed on the short-term side of the market.

4) The possibility that the Europeans and Third World

countries may agree to some form of a debt moratorium at the next round of the "North-South" negotiations in Paris, over the objections of the United States.

5) Persistent reports that U.S. regional and European banks may quarantine Chase Manhattan and other New York institutions on the $200 billion interbank lending market, partly due to solvency fears, and partly as a jab against the Carter Administration (see EIR Vol. IV no. 6).

State Department, Treasury Department, Council of Economic Advisors and Federal Reserve Board officials are in a state of confusion over the $20 billion bailout proposal made at the OECD, although several officials corroborated the contents of a March 4 Wall Street Journal dispatch from Paris describing the plan. This confusion indicates hurry and bypassing of normal channels by the White House. According to the Journal, the U.S. delegation to the OECD gathering in Paris asked for doubling of the current $6 billion Group of 10 emergency fund, the General Arrangement to Borrow of the International Monetary Fund; soliciting a further $8 billion from Saudi Arabia; and bringing Saudi Arabia into the Group of 10. U.S. officials, whose demand that the West Germans and Japanese reflate in tandem with the United States met with a solid rebuff, gave no indication of what they thought the prospects for this plan were. Private bankers are skeptical. "The International Monetary Fund will get zero, zilch new money this year," says Bank of America's Senior Vice-President for Research Carlos di Origunaga.

This plan follows similar proposals made by Chase Manhattan's David Rockefeller, Morgan Guaranty's monthly World Financial Markets, and Fed Chairman Arthur Burns, during the past two weeks. Leading U.S. bankers outside New York City are furious over these plans. One leading banker, who asked not to be quoted by name, said, "David Rockefeller is an idiot for saying that the banks can't handle LDC loans. Some banks may have been mismanaged, but not all of them."

The supporting battery of legislation in Congress breaks down as follows:

Rep. Rosenthal's legislation would give the Democratic-controlled GAO Watergating powers, in effect, over the three regulatory agencies responsible for the national banks. Reportedly, Rosenthal, who is in close touch with a group of New York investment houses, is upset at a recent move by the Treasury's Controller of the Currency to obtain more detailed information on the international loan status of U.S. banks.

Sen. Proxmire's legislation would create a National Bank Commission, and collapse the regulatory powers of the Federal Reserve Board, the Controller of the Currency, and the Federal Deposit Insurance Corporation into a single super-agency. Proxmire's bill is motivated by a recent GAO report, leaked to the press several weeks in advance of its publication, warning that public confidence in the banking system had waned to a low not seen since the 1930s.

Sen. Adlai Stevenson (D-Ill), a prominent member of Proxmire's Senate Banking Committee, has fielded a "Tweedledum" version of the Proxmire bill, which would create a "coordinating council" among the three regulatory agencies while retaining their nominal independence. Fed Chairman Burns supports the Stevenson bill, a Federal Reserve aide says, because — unlike the Proxmire bill — it would give the Fed a "mediating" role among the three agencies.

In the murkier background, Rep. Parren Mitchell is designing hearings for purposes of atmosphere, to create pressure in support of the Reuss-Proxmire-Stevenson-Rosenthal operation. Rep. Mitchell is both Chairman of the House Subcommittee on Monetary Policy and head of the Congressional Black Caucus. "With a black face running the show, there's no way that Reuss and Proxmire could keep the lid on it," a Congressional staffer involved with the projected hearings predicted.

Proxmire's and Reuss' broader objective is to bring back Reuss' Financial Institutions legislation of 1975, the so-called FINE bill, which died in committee 18 months ago. the FINE proposal would place trade-unionists of the Leonard Woodcock variety and "consumer advocates" like Ralph Nader on the Federal Reserve Board and on the boards of the 12 regional Federal Reserve Banks. FINE would give Congress powers to direct the nation's banking system top-down on behalf of the Carter deindustrialization program.

Although Proxmire and Reuss, leery of the opposition that faced their legislation last time round, have not put a comprehensive legislative package on the table, Proxmire has kept an "Urban Development Bank" proposal on the back burner. Treasury Secretary Michael Blumenthal indicated in a talk with reporters Wednesday that he favored such a program. The Urban Development Bank concept was first proposed by Lazard Freres' Felix Rohatyn, the director of New York's Municipal Assistance Corporation, as a means of issuing Federally-backed short-term securities to fund labor-intensive public works schemes in localities. The proposal mimics Hjalmar Schacht's Mefo-Institute of the 1930s, which issued short-term bills to finance the Nazi armaments industry. This legislation interfaces with more short-term plans to provide Congressional backing for a bailout of some of the leading New York commercial banks.