Click here for Full Issue of EIR Volume 8, Number 45, November 17, 1981

Herring of the University of Pennsylvania argued that no matter what the Fed does with interest rates, the banking system as a whole is now "crisis-proof." "The development of deposit insurance has eliminated the possibility of runs at most financial institutions," they write, "and converted potential runs into 'walks' at others," they begin. "Deposit insurance aims at preventing runs altogether, by making the soundness of banks irrelevant to depositors."

What can now be accomplished, they conclude, is the orderly shutdown ("absorbable shock") and merger of "discrete" institutions. "This [the deposit insurance system] has largely transformed the bankruptcy decision from a market-driven process to a deliberate, administrative process," so that Volcker may proceed with his policy in full confidence.

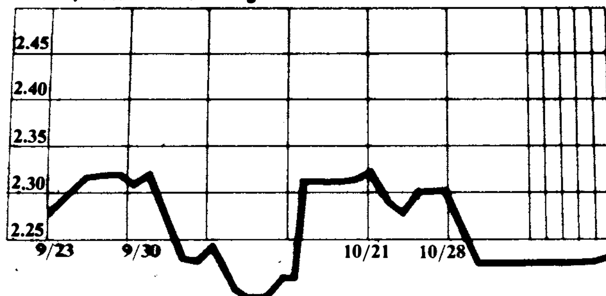
Guttentag and Herring's only reservation is to call for the U.S. Treasury to make explicit its now implicit but "ambiguous" commitment to back up the federal insurance agencies should the insurance funds themselves be exhausted. "Complete credibility" is not possible without this, they write. "We believe that the federal government should explicitly assume full liability for deposit insurance commitments," adding that the failure to do so "would be morally, and perhaps legally, indefensible."

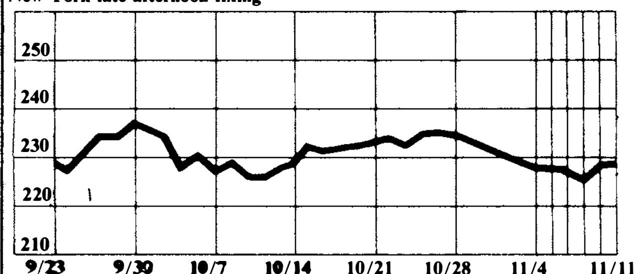
From there, the discussion went further downhill. Professor Wachtel objected to a paper by NYU Professors Thomas Ho and Ronald Singer in support of the government's loan-guarantee program for the Chrysler Corporation. "The U.S. economy can easily survive the shock of a Chrysler bankruptcy," he said, "and it would be healthy. The economy is telling us we are producing too many autos. We must allow the structural shrinkage of the auto industry to take place."

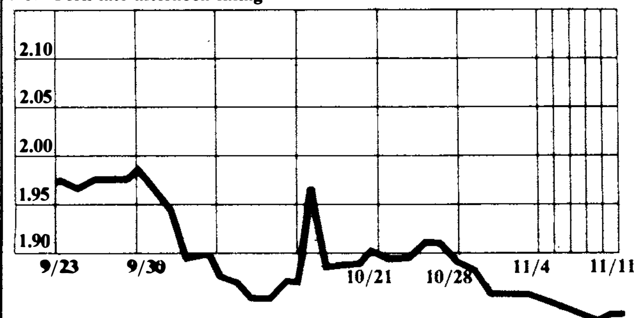
Two other papers then suggested the world economy and banking system can nicely survive 1) a Third World debt collapse and 2) the loss of all Persian Gulf oil production. In "LDC Debt in the 1980s: Risk and Reform," Jeffrey Sachs of Harvard argued that cooperation with the International Monetary Fund has made the risk of massed LDC defaults unlikely. Sachs proposed allowing a series of "orderly" defaults by negotiating default clauses, at appropriately high interest charges to cover lenders' risks, into LDC debt contracts.

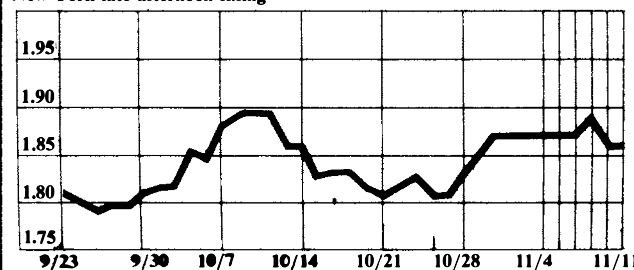
Professor Knut Mork of the University of Arizona, in "What If We Lose the Persian Gulf?" examined the U.S. economy before, and after, a projected total shutdown of Gulf oil supplies. He concluded that while U.S. GNP might drop by 15.5 percent in "Year 1" and 8 percent in "Year 2" after the "shock," consumption of energy would also decline, and the economy would stabilize! "After the shock, life is predicted to go on, although with not quite the same level of productive capacity," Professor Mork concludes.

Currency Rates









© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.