The Volcker albatross can sink the ship

by David Goldman

Paul Volcker's reappointment to the chairmanship of the Federal Reserve, sold to President Reagan as a means of defending fragile monetary stability and the Potemkin Village economic recovery, prepares the United States for a monetary disaster. Like the supposedly impregnable Maginot Line smashed by the Nazi *Blitzkrieg* in the first weeks of the 1940 offensive, Volcker's well-elaborated contingency plans for the defense of the liquidity of the American banking system guarantee the destruction of American finances in the event of major debtor country defaults over the summer.

Volcker's confirmation will be bitterly fought by political groups including the National Democratic Policy Committee, which is advised by *EIR* founder Lyndon H. LaRouche, Jr. "I strongly oppose the re-appointment of Paul Adolph Volcker as chairman of the Federal Reserve System," LaRouche stated June 22. "For practical reasons, I cast humility aside, to cite the evidence that I am the world's most accurate economic forecaster, and state that anyone who considers Mr. Volcker to have performed on behalf of the interests of the people of the United States does not know that the world and the United States are presently sliding downward in a general economic depression, and teetering on the edge of the worst international financial collapse in modern history."

Although International Monetary Fund officials and Fed staff specialists still speak hopefully of an eleventh-hour deal with Brazil before a crucial June 30 payments deadline, there is probably no way to avoid some form of Brazilian debt moratorium, followed by similar action by other debtor countries, except to break the rules of the game as Paul Volcker invented them.

According to well-placed administration sources, Volcker's reappointment emphasizes the already crumbling status quo in international monetary relations, that is, International Monetary Fund "adjustment" programs in return for debt relief. President Reagan was ill-advised to confirm this policy at the precise moment that the Brazilian government chose to ignore the impossible and unworkable demands of the IMF. If Brazil does not receive the $411 million loan tranche already withheld by the IMF in retaliation for Brazil's noncompliance, the Brazilians, already more than $2 billion in arrears, will default against a $430 million payment due June 30 to the Bank for International Settlements.

In this case, American banks, the largest of which have between two and three times their total shareholder's capital tied up in Brazilian exposure, will not merely be technically insolvent; they and their offshore subsidiaries will become subject to the deposit runs that nearly brought down the banking system in the wake of the Mexican crisis last August.

Federal Reserve officials, as well as their opposite numbers among the German-speaking central banks, are well aware of this danger. Paul Volcker is, however, not merely a man openly committed to the evil program he once described as "controlled disintegration of the world monetary system"; he is a stupid man profoundly committed to his own stupidity. The result of IMF "adjustment programs" to date has been a 37 percent reduction in American exports to Ibero-America as a whole, with most of that decline concentrated in Mexico, which has had the longest-duration IMF program in place. By destroying this section of world trade, ruining the currencies of the major debtor countries, and subjecting the latters' economies to auto-cannibalization, Volcker and his friends in the administration have set up the worst debt crisis in modern history.

What may shape the next several weeks' events in a way that Volcker is not capable of understanding, however, is the order of battle of the Swiss and other German-speaking central and private banks. Since the Mexican crisis exploded on Aug. 20, Bank for International Settlements Chairman Fritz Leutwiler and the Swiss generally have been the most fanatical proponents of economic attrition as a putative solution to the debt crisis. As reported by this service (see Special Report), the Swiss perspective, despite its apparent overlap with Paul Volcker's more thuggish instincts, is skewed in two basic directions. First, the Swiss establishment consists of the compact remnants of the Third Reich now in full collaboration with the Soviet Union in a project to produce a credible version of the "final collapse of capitalism." This extraordinary assertion is well documented elsewhere in this week's Special Report. Second, from a banking standpoint, the Swiss believe correctly that the last player to leave the table collects all the chips.

Were this drama and not journalism, the prologue would have represented the early June meeting of central bankers at the Swiss-based Bank for International Settlements, where Volcker committed the United States to a document known as the "Basel Concordat." Although not a treaty, the Basel Concordat pertains to matters delegated to the Federal Reserve by Congress, and represents an equivalent American committment as long as Volcker is able and willing to honor it.

Released to the public June 9, the Basel Concordat simply reports the agreement of central banks to stand surety for the foreign operations of commercial banks headquartered in their countries; this committment is half-implied and half-stated in the actual text. As the chief Swiss bank regulator, Dr. Baltensperger, said in an interview published in *EIR* June 14, the Swiss reading of the document is that Volcker must bail out foreign branches of American banks that wind up in trouble.

Federal Reserve and administration officials warn that this is Paul Volcker's reading of the document as well. That is, the Fed chairman intends to bull through the universal revolt of debtor countries against the International Monetary Fund, employing selective bribes and intimidation, to prevent the formation of a unified front of debtors. It is unlikely that he will succeed during the next three months; if he does, he will have merely added an additional weight of short-term refinancing to the inverted pyramid of Third World debt, producing an even worse situation at year end.

The Federal Reserve backup plans, should this fail, are limited to a defensive perimeter around the liquidity of the American banking system. That is, the Federal Reserve will provide a virtually unlimited amount of discount-window money to commercial banks which will hemorrhage deposits after a Brazilian or Venezuelan default blasts a hole in their balance sheets.

No defensive strategy is less likely to work than the one Volcker is following. It is the monetary equivalent of the Fall of France. This is true not merely because it is incompetent in monetary terms, but because it is disastrously blind in the political realm. From Volcker's personal standpoint, his problem is that his own intentions are just evil enough to blind him to the much more evil intentions of his erstwhile Swiss partners. Most of the East Coast banking establishment of the United States, including Volcker's old employer David Rockefeller, cheerfully endorsed the Kissingerian arms control and deterrence policies of the 1960s and 1970s which have produced the preconditions for an American strategic debacle in the 1980s. But the idea that the worst rogue element in world politics, the old adherents of *Mittleuropa*, would draw the appropriate conclusions and wreak mischief upon their old adversaries in the West, is beyond the comprehension of Volcker and his circle. Part of the problem may be that Volcker relies for information regarding the German-speaking banking community on Federal Reserve governor Henry Wallich, the scion of an old and nasty Swiss-German banking family.

The major Swiss banks are already de-capitalizing their subsidiaries in offshore markets—an event which Federal Reserve foreign department officials have noted with growing alarm—in preparation for a collapse of the "inter-bank" market. About half of the $2 trillion Eurocurrency market consists of 1- to 30-day transactions by which commercial banks take in each others' laundry, lending and re-lending the same deposits at slight interest rate differentials. The failure of the Herstatt Bank in 1974 and of the Banco Ambrosiano last spring nearly produced a chain reaction of deposit withdrawals in these markets. Since American banks, the primary originators of dollar deposits, stand to lose the most in such a chain reaction—foreign banks may, if necessary, walk away from their foreign subsidiaries—the potential liability of the Federal Reserve in any effort to bail out this mess is "mind boggling," remarks one senior administration economist.

In effect, the Federal Reserve would be compelled to substitute central bank money, i.e., the official obligations of the United States, for interbank deposits multiplied through the creative accounting mechanisms prevailing in the Eurodollar market, many times in excess of the Federal Reserve's present balance sheet. The Swiss refrain uttered by Fritz Leutwiler before the American Bankers Association Brussels conference May 18, and by many of his colleagues since, that the United States must pay, is a prescription for the bankruptcy of the United States government. This is what Paul Volcker cheerfully accepted both in the negotiations leading to the publication of the Basel Concordat, and in the actual contingency planning of the Federal Reserve in Washington.

Dealing with this crisis would be, under the best of circumstances, the most difficult task President Reagan had ever faced; he has made the job inestimably more difficult by keeping Volcker in office.

Yugoslav spokesmen address the urgency of the world debt crisis

At a mid-June meeting with foreign journalists in Belgrade, Deputy Mayor Radomir Stefanovic said that wages in Yugoslavia have had to be reduced by 20 percent over the last four years, while national and local budgets were reduced by 5-10 percent annually since 1978.

Dr. Anton Vratuša, the head of the Yugoslav delegation at UNCTAD VI, which is meeting in Belgrade's Sava Centar until June 30, gave some figures in his speech which explain where the money "saved" by wage and budget reductions went: "Because of increased interest payments on the earlier contracted credits alone, Yugoslavia had to give away about $2.5 billion from its accumulation in the three-year period 1979-1982"—thanks to Paul Adolph Volcker, you might add. "Nevertheless," Vratuša continued, "Yugoslavia has managed to meet all its obligations on time, but with great sacrifice on the part of its population, and stagnation of production."

While some politicians like Stefanovic pretend—at least in public—that Yugoslavs have a unlimited capacity for belt-tightening and have lived "beyond their means" for too long, others have begun to think that it is primarily external economic and financial conditions which must be changed.

On April 11, the Yugoslav daily with the widest circulation, *Politika Ekspres*, carried an article on Club of Life founder Helga Zepp-LaRouche and the proposal that indebted developing countries form a "debtors cartel" to force the creditors to the negotiating table, "but on the conditions of the developing countries." Entitled "Debt Bomb," that article caused shock waves. A Yugoslav journalist in Paris said that until he saw that article, he would have never believed that such a thing could appear in a Yugoslav newspaper!

At UNCTAD VI, the Yugoslav delegation is actively lobbying for the Non-Aligned proposal of calling a new international conference on money and finance "with universal participation," i.e. outside the IMF. As Janez Stanovnik, a senior member of the delegation, told *EIR*, one key issue to be discussed at such a conference would be a "common approach" of all debtor countries vis-à-vis their creditors.

Interview: Janez Stanovnik

'A cartel for common action by debtors is realistic'

The following interview with Mr. Janez Stanovnik, former cabinet member of the Yugoslav government, was conducted at the UNCTAD VI conference in Belgrade. Mr. Stanovnik served as executive secretary of the U.N. Economic Commission for Europe for 15 years. Now retired, he is a senior adviser to the Yugoslav government on matters of foreign economic policy. Mr. Stanovnik was interviewed by EIR *correspondents Edith Vitali and Hartmut Cramer on June 14.*

EIR: The head of your delegation, Dr. Anton Vratuša, called for new proposals to deal with the debt situation on June 13. Recently there has been a lot of explicit discussion of the idea that the Ibero-American countries should unite for a joint renegotiation of their foreign debt. Some even speak about creating a debtors' cartel in order to challenge the already existing creditors' cartel [the Ditchley Group of international bankers]. It is argued that such a joint action should be done to force negotiations for a new just monetary system.

Would your country support these moves? Has there been some discussion of this idea at this conference?

Stanovnik: Not at this conference, to the best of my knowledge. But from the New Delhi [Non-Aligned summit] document, you could very well see that there was action in this respect. In my view, the New Delhi recommendations for consultations for a more systematic study of the problem is a very sound one. I think that this is the right kind of approach. As you suggested yourself, we are today faced with the creditors' cartel, the new commercial banks' institute in New York.

In addition, the links between the commercial banks and the International Monetary Fund, which had not existed before, have evidently created a new situation. If you examine [IMF head Jacques] de Larosière's speech in Florida, you