Volcker tells Reagan: 'Heads I win, tails you lose'

by Richard Freeman and Kathy Burdman

Large British institutional investors, the British press, and the *New York Times,* drove the dollar and the U.S. stock market downward the week of Feb. 20-25. They threatened President Ronald Reagan with worse to come, unless he adheres to the tight-money policy outlined by Federal Reserve Board chairman Paul Volcker last month.

Fed reports published in late February indicate that at the December meeting of the Federal Open Market Committee, which sets Federal Reserve monetary policy, Volcker steered through a vote, with only one dissent, calling for tight credit in 1984. In Senate testimony on Feb. 8, Volcker called for savage (defense-centered) budget cuts on top of tight money, stating that otherwise the budget deficit would push up interest rates. The fact is that Volcker's high interest-rate policy is responsible for 70% of the deficit.

Volcker began threatening dire consequences if the President didn't emasculate the budget and restrict growth through credit restriction: "a pull-back of foreign capital . . . loss in the dollar abroad . . . a shock to inflationary prospects . . . aggravation in the foreign debt" and an inability "of the banking system to handle the flow of funds." Volcker's speech marked a high point in foreign liquidation of stock market portfolios and dollar holdings.

The dollar had fallen from an early-February historic high of 2.85 deutschemarks to the dollar to 2.63 by the end of February, a drop of 7.7%. The stock market has shed 11% of its value in six weeks. A spokesman for Irving Trust bank in New York projects that the dollar would fall below 2.60 marks before any stabilization in early March.

The U.S. markets are being determined almost entirely by electoral politics, in this case, by the desire of not only the British and Swiss banks but of the Soviet Union, to undermine President Reagan. The threat is that unless Reagan kowtows to Volcker, the markets will panic.

Under those conditions, a new round of high interest rates will explode the myth of the U.S. economic recovery, Reagan's favorite selling point, and render the $800 billion in Third World debt unpayable in a way which can no longer be covered up. However, if Volcker gets his way, he will continue to demand budget cuts as the price for holding down interest rates, and his austerity policy will sabotage the economy and Reagan's campaign.

'United States: debtor nation'

The U.S. markets' vulnerability to such manipulation has never been higher. The economy survived through 1983 because foreign investors bailed it out with $160 billion of foreign flight capital, mostly from Europe, as Volcker pointed out in congressional testimony in early February.

The *New York Times* has made front-page news of the dollar's vulnerability. In a Feb. 20 article headlined "U.S. Nears Status of Debtor Nation," the *Times* reports that the United States will soon become a net borrower from the world "for the first time since World War I. Foreigners have been lending and investing more money in the United States than Americans have been investing abroad."

The *Times* pointed out that, according to the Commerce Department's Bureau of Labor Statistics, last year, foreigners invested $49 billion in the United States while investments made abroad by Americans during the same period reached only $28.5 billion. Americans' total overseas holdings on Sept. 30, 1983 were $834.2 billion, versus $711.4 billion held by foreigners in the United States.

First to suffer the consequences of the "dollar scare," which has thus far been more scare than substance, has been the U.S. Treasury market. As Council of Economic Advisers chief Martin Feldstein, a Volcker ally, made clear in the 1984 Economic Report of the President, "a capital inflow from abroad is financing the equivalent of 40% of the budget deficit."

At the end of February, the U.S. Treasury was unable to market $16.25 billion worth of its bonds and bills; the flight from Treasuries was lead by British and other foreign investors. British and Swiss investors, along with the Soviets, who have amassed over $30 billion speculating against European currencies recently, are now positioned to trigger a further dollar drop and stock-market collapse.

The British press has meanwhile hammered on the lying theme that Reagan and his defense budget are destroying the international markets and the West. The Feb. 18 *Financial Times* of London, in a editorial entitled "Fiddling While Rome Burns," accused Reagan of nothing less. "President Reagan has suffered some severe setbacks, and is being manhandled by the media—everlastingly, it seems, on holiday, while his world crumbles. If this disaffection grows into a serious electoral threat, he could have a dollar collapse in good earnest to add to his troubles."

The same newspaper two days later reported that "jitters" at the recent fall of the dollar, "brought moves by several [British investment funds] to reduce their exposure to a sustained drop in the U.S. currency's value." The paper reported that Prudential Assurance, Courtland's textile group, and one large unnamed pension fund were among those selling the dollar.

Clash in the Oval Office

Volcker and the President met several times during February, in what became a series of head-on clashes over monetary policy. According to a Feb. 17 Evans and Novak syndicated column, the President urged Volcker to let up on the credit spigot and Volcker declined. Through the narrow prism of his re-election chances, the President has begun to realize that Volcker is a danger.

Twice before the White House has been blackmailed on behalf of Volcker. Last summer, when Volcker's term expired, the British and Wall Street banks raised a hue and cry that if Volcker were not reappointed, the "recovery" would fall apart. The Federal Reserve's faked industrial production increase statistics were paraded about, and Reagan reappointed Volcker. He had contemplated firing Volcker as early as 1981, according to several press accounts, but the British and Wall Street prevailed against the President's better judgment.

Meanwhile the multibillion-dollar Mexican and Brazilian loan packages have begun to unravel, according to bankers across the United States involved in the negotiations.

At this point any crisis in the Ibero-American or other foreign debt markets would be blamed on the President—who has had almost nothing to do with it—rather than on Volcker, who has created and managed the entire bubble. The *New York Times* editorial of Feb. 21, "America in Hock to the World," put out the line. Unless the President keeps Volcker in office and slashes defense spending, they write, U.S. farm exports would be smashed, American manufacturers would not be able to export, and the Third World debt situation will fall out of control.

Even the $3.5 billion Mexico package for this year, which has been sold as a "sure bet" because of Mexico's vast IMF-dictated import cuts to free dollars to pay interest, is falling apart, insiders say. An official at a leading Philadelphia bank in charge of collecting loan commitments for Citibank and the Mexico consortium chairman in the entire Southeast quarter of the United States, said on Feb. 24 that "nobody wants to give any money to Mexico because they're convinced the economic miracle can't last." Regional bankers are beginning to realize that precisely because Mexico has cut imports so much, its economy will have to fall apart soon. "I've spent the entire Washington Birthday weekend trying to come up with a package and I'm getting turned down all over the place," he complained. "Not even $3 billion," he said, "of the total $3.5 billion package has been raised."

The banker also reported that he has been asked to report the names of regional banks who won't chip in to Citibank in New York, and that Citibank's debt overseer, senior vice-president William Rhodes, is phoning the names to Volcker and Comptroller Todd Connover. "Volcker and Connover are getting on the phone personally at a very high level with the recalcitrant banks and armtwisting them, to be very, very polite," he said. "The threats are tremendous. These regulators have the power to close down some of these banks."

On Brazil, bankers are openly telling reporters that the much-balleyhooed $6.5 billion Brazil loan agreement of last fall, yet to be disbursed, is now falling apart because the IMF is getting ready to declare Brazil to be out of compliance with its IMF program, specifically the IMF's inflation target.

The British banks in particular are refusing to go in because the U.K. government has stalled their share in the companion $5 billion OECD export-import bank loan program for Brazil.

"Brazil is well over 120 days in arrears now, and even if the IMF gave their blessing tomorrow—which is almost impossible—there is no way that funds could be dispersed to them until the end of March," one Florida banker involved explained. "By the end of March, Brazil will be 150 days" or five months, in arrears, he said.

The total arrearages of Latin America could be mounting toward the $10 billion mark by the end of the first quarter, *EIR* calculates. Argentina could be another $1-$2 billion in arrears at least, Argentine negotiators told creditors on Feb. 22. If Mexico and Venezuela accumulate arrearages, which they will do if their current loan packages—for purposes of interest payment—fall apart, the totals could zoom.

Most of these arrearages are actually being paid—not in U.S. dollars, of course, but in soft currencies, Brazilian cruzeiros, Mexican pesos, and so on, as *EIR* reported last week, into blocked accounts at the debtors' central banks (see Banking).