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Can London hamstring German Eurolending?

INTERNATIONAL CREDIT

In April, the U.S. Federal Reserve put the finishing touches on its plan to impose mandatory reserve requirements on all international banks' Eurocurrency lending operations—a plan *Executive Intelligence Review* was the first to expose. Now that this draconian approach to shutting down the markets has been derailed by opposition, the Fed and the Bank of England are pressing for finer-tuned curbs on Eurolending.

The question is whether key West German, French, and other European banks will be able to continue their current absorption of international—especially OPEC—deposits. They are recycling these deposits in the form of trade and trade-related credits in a quiet first approximation of the European Monetary System's planned control over the bulk of Euroliquidity for global industrial-development financing.

Surveillance and consolidation

The Fed and the Bank of England continue to press for lending cutbacks on the credit extension side; they have won at least nominal agreement by other central banks to prevent banks' "overexposure" in loans outstanding to any one "problematic" borrower. The intent of this surveillance is to give Third World and less-developed OECD economies no recourse but to beg for credit from the International Monetary Fund and the New York and London banks that also insist on IMF "conditionalities."

The Cooke Committee

This month the IMF enforcers have started to openly go after the Europeans' source of funds as well, in a campaign reflected in the London *Economist*, *Financial Times*, and New York *Journal of Commerce*.

The West German Bundesbank, which shares the Anglo-American horror of "overlending, " supported the original Fed reserve-requirement proposal. But the Buba soon backed off in the face of French opposition, plus the German banks' blunt refusal to shut down their Luxembourg Euromarket. (A "Euromarket" is shorthand for any offshore banking center that operates outside national regulations.)

This paved the way for an approach ostensibly more reasonable, spearheaded by the Bank of England: Let us move toward internationally uniform requirements for consolidated balance sheets. This is basically another way of imposing reserve requirements, because a subsidiary's Euroloans would be included in calculating the parent bank's ratio of capital to loans outstanding, as is already the case in the U.S.

This approach is now being revved up by the Cooke Committee of central bankers and bank supervisory authorities from the Group of Ten leading industrial nations. Named after Deputy Bank of England Governor Peter Cooke, the Cooke Committee was established in the wake of the 1974 Herstatt Bank collapse.

Interbank deposits targeted

It was the Cooke Committee that organized the July 5-6 conference of banking supervisors in London, where the U.S. Comptroller of the Currency, John Heimann—a Fed ally from Warburg, Pincus—warned about "interbank lending, which accounts for up to 40 percent of the foreign loans of the U.S. banks."

Heimann exposed the actual reason for his concern: he raised the example of an American bank making an interbank placement with "a quality European bank" "without knowing of that bank's heavy exposure in a place like Iran."

The example is silly on the face of it. What international officer would not about about such things—including Bonn's credit guarantees?

The point is that the consolidated balance sheet/capital ratio approach by itself will not suffice to curb West German lending so long as (a) the banks can beef up their capital as needed and (b) their deposit base continues to grow. The deposit base—heavily reliant on interbank inflows—is consequently under direct fire.

At the same conference Bank of England governor Gordon Richardson cited two further problems: diminishing capital ratios of international banks, and what Richardson described as "skimping" on liquid asset holdings. The Aug. 4 London *Economist* draws out the implications by warning that "International banks have increased their vulnerability by using short-term deposits to make ever-longer-term loans."

This was the warning leveled against French banks in the mid-1970s who lent their petrodollar deposits to cash-strapped Italy, with beneficial results all around. It certainly does not apply to West German banks in 1979: Their capital ratios may be weaker than those in New York, but their key increase in liabilities has been long-term inflows, especially through *Schuldscheine* promissory notes of over four years.

Keep your funds to yourself

Therefore, to increase the pressure, the Fed and Bank of England have targeted the lack of regulation that has permitted the Luxembourg subsidiaries of West German banks to draw in, and lend out, funds beyond the grey reach of the Bundesbank. New York and

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London opinion makers are also starting to thump on the alleged political desirability of directing funds into the domestic economy to garner votes for incumbent Chancellor Schmidt in 1980. But it is precisely the West German determination to extend trade credits and thus expand export "demand" based on lending out Luxembourg and other capital inflows that has made the West German economy presently the sturdiest around. "Itis still unclear exactly when the recent OPEC oil price increases will cool the still-vigorous West German economy," complains the Aug. 15 *New York Times*. This export demand is the most reliable vote-getter, as Schmidt, and, grumpily, the Bundesbank, know best.

As for the effort to legislate controls on Luxembourg subsidiaries, it might have no better chance than universal Euro reserve requirements. But the demand is part of a bargaining process involving the proposed divestiture of industrial holdings by the big West German banks, and unless Bonn moves full into Phase II European Monetary Fund implementation, subordinating Luxembourg to a new state-to-state lending offensive, concessions to London on this level cannot be ruled out.

Warnings to France and Italy

Meanwhile pressures are mounting against more vulnerable European Monetary System members, notably France and Italy. The lead *Journal of Commerce* editorial Aug. 14 lauded "the trend toward international regulatory cooperation" as "likely in the long run to have far more significant results than all the wasted effort at controlling the size of the Euromarkets" through reserve requirements. But they complained: "The fact that the three biggest banks in France are owned by the government has limited the enthusiasm of the French regulators for certain international initiatives."

The editorial went on to stress the interbank market, whose "greatest potential abuse," it suggested, "comes from foreign governments pursuing monetary policy that forces their banks into the interbank market for what amounts to balance of payments financing and reserve building." This points to Italy, whose credit ceilings, as the *Financial Times* recently noted, have encouraged banks to borrow internationally. Italian borrowers are welcome in the Euromarkets, given the lira's stability and the 5 percent-plus increase in first-half industrial production from January to June 1978.

If heightened labor unrest is provoked in Italy, or the EMS membership that has clinched the lira's stability is jeopardized by the U.S. State Department's control over its interim governments, both Italy and its creditors could be in trouble, sparking the sort of Euromarket crisis London is threatening as a last resort should its "regulatory" ploys fail.

—Susan Johnson

Aground at Lock 26

Those who are concerned about the growth of America's freight transport network should turn serious attention to the Lock 26 Mississippi River project, where an alliance of railroad companies and environmentalists have banded together to stall one of the most vital waterway construction projects in the United States. Although the consequences of the Lock 26 logjam are less farreaching perhaps, than those of trucking deregulation, they are symptomatic of the difficulties encountered these days in getting underway—to say nothing of completing—major projects whose overall benefits are clear and recognized by everyone.

TRANSPORTATION

Lock 26 is the most strategic point in the river transport network on the Mississippi. Located in Alton, Illinois, where barge traffic from both the Mississippi and Illinois Rivers converge, and constructed in 1938, the lock is designed to handle a maximum of 46 million tons of shipping per year—a volume reached in 1970.

Today, it is servicing 56-60 million tons. Grain volume passing through the lock has jumped from 5.3 million tons in 1960 to 28 million tons in 1977. The combination of structural and capacity obsolescence has resulted in increasing breakdowns and accidents. Delays and back-ups now *average* 21 hours, costing millions of dollars in lost time and missed shipping connections, at the expense of farmers, shipping firms, and U.S. exports.

In 1974, the Army Corps of Engineers announced its intention to construct a new Dam and Lock 26 to service a maximum capacity of 148-175 million tons per year—triple the current tonnage and quadruple the present practical capacity. The project is now expected to take 7 to 10 years to complete at a cost of $500 million.

The corps maintained, correctly, that under the Rivers and Harbors Act it had jurisdiction to begin construction and required no further authorization. In August 1974, 21 Western railroads joined the Sierra Club and Izaac Walton League in filing suit in U.S. District Court in Washington, D.C. to stop the project. The suit charged, among other objections, that the project needed specific congressional authorization and