The BIS makes a 1981 power grab

by David Goldman

It is misleading to draw historical analogies for the sort of world turning-point that 1981 promises, but it is almost impossible to avoid referring back a half-century to 1931, the year of the collapse of the pound sterling, the financial ruin of Germany, and the Standstill Committee of Germany's creditors—which, as French economist Jacques Rueff insisted, erected the Nazi economic structure before Hitler took power. As then, both the monetary authorities and governments of the major industrial countries, as well as corporations and individuals, are so preoccupied with which direction the financial system will tumble from its razor's-edge position that they are completely blind to the real dynamic of events: how their fears and perceptions are employed to push them toward making decisions which they otherwise abhor.

That is the case with the West German Bundesbank's announcement in the last week of 1980 that it would freeze further issuance of German mark-denominated credits to foreign borrowers (see International Credit). Unreported in the American financial press, the decision severs one of the few bonds that have held the world financial system together since the 1974 oil crisis.

It also explains a great deal about the current state of the markets: the lowering of interest rates, as the *Times* of London signaled in a Dec. 23 editorial, is part of a package deal worked out between the Federal Reserve, the German Bundesbank, and the Bank of Japan through the mediation of the Bank for International Settlements in Basel. In return for cutting off the last *independent* source of major financing for the developing countries, the Bundesbank has been offered a lowering of dollar interest rates sufficient to remove pressure from the mark and the German domestic economy.

The questions ahead

This does *not* mean that dollar interest rates have peaked. In early September we predicted an "interest-rate disaster" based on fundamental economic considerations. No predictions can be made now. Will the average price of OPEC oil follow the radicals' price up to $41 per barrel? Will the Federal Reserve demand that banks cut back on lending no matter what the domestic American demand? How will the fall in commodity prices affect loan demand on the Eurodollar market on the part of countries whose export income depends on these prices? What will Ronald Reagan do about a federal budget deficit that could exceed $60 billion this year? Plug in different sets of assumptions, and you come out virtually anywhere between Bear, Stearns view that rates will start rising again shortly, and Harris Trust's prediction that the prime will fall to 12 percent by the end of this year.

The list of uncertainty factors indicates what is at stake this year, namely control over the world monetary system. The German capitulation is of incalculable significance. Between 1976 and the present, Germany's foreign lending, directly and through support of France and other European Community members, held big chunks of the world economy together. The German-dominated Luxembourg lending market financed a

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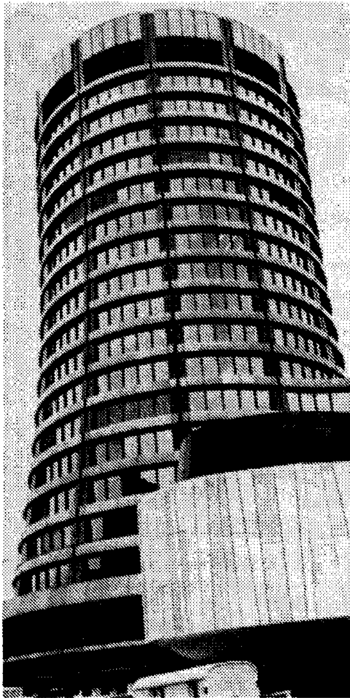

The Bank for International Settlements headquarters.

margin of world trade expansion that was rejected by the New York and London market and by the International Monetary Fund.

Luxembourg became moribund as a financial center when the July 1979 rise in oil prices finally broke the back of the West German payment surplus. Between then and the present, Germany financed its foreign lending either by borrowing from OPEC countries—making its currency system the intermediary for relending oil money to oil-deficit countries—or by printing money. Hence the weakness of the West German mark. The mark has gradually been forced into a position comparable to that of the U.S. dollar, extended internationally to cover for an insupportable international debt structure.

As we report elsewhere in this section, the question was finally put to the Bundesbank at a private gathering of the Hamburg Conference on Oct. 24, then worked out operationally, according to Federal Reserve Governor Henry C. Wallich, at the Bank for International Settlements: yield the international financial arena to the supranational control over the BIS in return for a momentary respite on interest rates. At this time, the *Wall Street Journal* ran an otherwise incongruous lead article under Richard Jannsen's byline mooting the growing power of the Bank for International Settlements at the expense of even the floundering International Monetary Fund.

Once before, the BIS emerged as the dominant arbiter in world financial affairs, following the 1931 blowout. At the point that the pound sterling could no longer function as the world's major lending currency and the dollar could not replace it—because the Federal Reserve had directed dollar international lending to support the weakened pound during the previous decade—the world credit system ceased to function. The German and Austrian financial crises, marked by the Kreditanstalt bankruptcy, toppled the structure of short-term borrowing on which Germany had depended since 1924. The Bank for International Settlements, created in 1928 to administer Young Plan funds, became the mediator after international payments broke down, supervising the German payments moratorium through the central banks' Standstill Committee.

Whether the *de jure* bankruptcy of the American dollar, the inability of developing nations to close a more than $100 billion 1981 payments deficit, and the inability of other Western economies to function with $35 per barrel oil will produce a similar payments breakdown is not the most important question. No such events are inevitable. In 1931, the payments breakdown occurred because the Warburg-led consortium of Germany's short-term creditors decided to provoke it. The BIS gang employed the *threat* of such a payments breakdown to force all participants to negotiate on their terms.

To outgoing BIS President Jelle Zjylstra, the former Dutch central banker, or Gustav Schleiminger, the new chief executive of the institution, whether a crisis actually occurs or not is immaterial. If all national governments accept the principle (proposed by Federal Reserve Governor Wallich) that all currency-market interventions must be treated by the same monetarist criteria as provision of credit to domestic economies, the "central bank for central banks" will have carried off a coup coup d'état over world financial affairs. If the type of shock therapy that Paul Warburg's International Discount Bank and Schroeders Bank of London administered to Germany in 1931 appears necessary to achieve the same result, prepare for real storms on the currency and credit markets.

At bottom, the BIS represents the residual power of the old Venetian, Genoese, and later Dutch and British financiers who ran world finance in their own name three centuries ago. These are families who believe that industrial republics and their governments come and go, but that their power remains eternal. The summer home of the BIS staff is at the Villa Santa Colomba of the Siena-based Monte dei Paschi Bank, where an annual economics conference prepares documents that used to be considered obscure; the brains of the BIS operations, including Alexandre de Lamfalussy, the BIS staff director, and central bankers like Giovanni Magnifico and Rinaldo Ossola of the Banca d'Italia and Jelle Zjylstra of the Bank of the Netherlands have been

publishing the scenario described above for some years.

These men now feel confident that they have suppressed what the *London Economist* called "insurgent European nationalism," that is, the international development perspective centered on the European Monetary System and the projected European Monetary Fund. Should the German departure from international lending remain in force, the world trade expansion perspective embodied in the EMF will be in the gravest jeopardy. Short of the most astute possible actions from what is now a confused and heterogeneous American administration, the world would fall back into the pit of 1931.

Henry Wallich: central banks aren't monetarist enough

From a Dec. 30 interview with Federal Reserve Governor Henry Wallich, provided to EIR. *The Hamburg Conference, as elaborated in our International Credit column, is a group of 60 international economists that met Oct. 24.*

Q: Did the Hamburg Conference discuss the pending German capital controls declaration?
A: The conference theme was "In Search of Stability and Development in an Unbalanced World," and in that regard we discussed the need on a world scale to control the excess creation of credit, and to cut back reserve growth in the Eurocurrency markets. There has been a tremendous amount of excess expansion of world credit, both domestically in the industrial nations and internationally in the Euromarkets, and the central banks must get control over the process and scale it back; the U.S. and all Western countries need to pull back sharply on international lending.

Q: Do you see any early implementation of your proposal for placing reserve requirements on the Euromarkets?
A: No, that is very much on the back burner, but the central banks do agree on the basic principles of monetarism—that we must cut excess reserve growth internationally. We noted that Germany's problem is deutschemarks being created abroad by German and other banks, outside the control of the central bank, which has led to a long-term account deficit. The Bundesbank wants to get a hand in every syndication done by any bank, German or not, involving marks, and has announced it wants all DM bond issues and loan syndications to have German participants for this reason.

But this has not stopped an extensive capital outflow on the long-term lending account; they have had a tremendous borrowing out of German banks by Nordic, Third World, and other countries. . . . But recently. . . due to rising oil prices, they began having to finance both a long-term and a short-term capital outflow. They then had two choices: they could continue to finance both deficits by borrowing from OPEC, as they had been doing extensively, or they would have to restrict capital outflows. The Saudis and the other OPEC countries, however, did not provide enough funding to keep the deutschemark from growing very weak, as far as the foreign exchange markets went. So the option was taken to restrict capital outflows.

Q: This was a surprising step, wasn't it? Who at the Bundesbank was responsible?
A: The man responsible for this indeed radical new departure was one of our Hamburg [Conference] members, Bundesbank Deputy Governor Helmut Schlesinger. Of course, we have several members from the Bundesbank, which funds our conference, who were also involved—Herr Gleske, for example.

Q: What about your proposal that central banks limit foreign-exchange intervention to fixed growth rates, just as monetarism limits central-bank credit creation?
A: Yes, we discussed this at length; the idea is to get central banks—governments—out of the foreign capital markets. Whenever governments intervene, they are in effect creating new reserves, which leads to inflationary expansion of credit and distorts the markets. The idea is to fix an intervention quota and then intervene no more, no matter what the exchange rates do. This is akin to ignoring interest rates and focusing on monetary aggregate targets. In fact, Steve Morris, the OECD chief economist, who is also a member of our Hamburg group, is studying an identical proposal very carefully; he thinks the entire OECD should implement it jointly.

But you know that this Hamburg Conference is all really very professorial. . . . The real center for these policy discussions and for policy implementation is at Basel, at the Bank for International Settlements.