

Domestic Credit by Richard Freeman

American banks going down

The flight into Treasuries and other "quality" investments erodes their deposit base as bankruptcies mount.

During the first week of August, four more U.S. commercial banks were liquidated, bringing to 26 the number of banks that have failed in the United States this year.

On an annualized basis, this is the highest level of bankruptcies of financial institutions in more than 30 years.

But there are two other worrisome developments: the increase in bad loans the largest American banks have been forced to report, and the so-called flight to quality, which is eroding the base of the banking system, and therefore will result in a new depth of credit crunch.

On Aug. 11, the Crocker Bank of California, one of America's big 15 banks, reported that the failure of the TOS oil company of Houston will cause non-payment on \$32.7 million worth of its loans from Crocker. The bank added that its loans to TOS, which was 10 percent owned by the chairman of the now defunct Penn Square Bank of Oklahoma, are secured.

However, it is common knowledge that oil loans are "secured" only by oil reserves and drilling rigs which are unsellable in a depression.

As for the "flight to quality," a Wall Street analyst reported Aug. 6 that the newest danger is that investors will not renew their certificates of deposit—amounts of \$100,000 or more placed at commercial banks for at least six months at favorable interest rates—because they are not convinced that the certificates of deposit are as secure

as they ought to be.

This became the problem with Continental Illinois, which is no longer able to sell its CDs at acceptable rates, and the phenomenon is spreading. Certificates of deposit currently represent \$145 billion in funds for commercial banks. "People are moving into quality, like Treasury securities, which are much more secure in the event of a crash," the analyst confirmed.

Once a bank suffers a withdrawal of funds, it must contract its loan extensions. In a banking climate as uncertain as the current one, a lending contraction by large banks could bring down the financial system.

In this environment, the British are preparing to put American banks through the wringer. One of the coordinators of this operation in the United States is Richard Dale, a former senior officer for N. M. Rothschilds of London, who has set up shop at the Brookings Institution in Washington, D.C. There he is working on a two-year Rockefeller Foundation grant for the Group of 30, the official advisory body to the British-run International Monetary Fund.

Dale reported on Aug. 11, "Yes, there is a 'flight to quality' going on in the United States, and I don't see how major problems can be avoided." Dale stated that "years of neglect" by American banks in lending to the Third World, has left American banks hopelessly exposed to Third World debt defaults.

"The American banks have lent recklessly. This has created the mess. I don't see anything that can forestall problems with the repayment of the debt."

Dale noted, "Maybe at an earlier point, had the bankers been willing to listen, we could have set up arrangements to guarantee the borrowers, like Mexico, etcetera, who owe money to the banks, but it's too late for that now."

Dale sees the banking crisis coming to a head within the next few months. Under these conditions, U.S. banks will be forced to abide by conditionalities imposed by the Bank for International Settlements or go under. "Right now, an arrangement in which the central banks and governments put together a \$20 billion fund to bail out banking systems will be essential. The Group of 30 has seen the need for this." Dale predicts that the Federal Reserve will be obliged to spend massively to try to save the American banking system or at least its largest banks: "The Fed will have to create a lot of liquidity, as much as possible without touching off another round of inflation."

It is in this crisis atmosphere that the BIS's Cooke Committee, the group that over recent years has worked up bank supervisory reforms to reorganize the banking system from top to bottom under BIS control, will impose its recommendations.

Dale, who says he has worked with the Cooke Committee since 1975, declared, "A crisis is often necessary for reforms to go through. It can be very helpful. I don't see how one can be avoided."

The prospect of accelerating bank failures makes such a crisis all but inevitable, although poor dumb American bankers have little understanding of what is going on.