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European bankers blame U.S. defense budget for the financial crisis

by Kathy Burdman and David Goldman

President Reagan will be told by Europeans at the London economic summit June 7-8 that the U.S. budget deficit, especially the U.S. defense budget, is the cause of the U.S. banking crisis, because "the markets" react to the deficit with high interest rates and lack of confidence in U.S. banks.

As British Foreign Secretary Sir Geoffrey Howe stated in a London speech May 29, "Lower interest rates, smaller budget deficits, and more predictable exchange rates are essential if the non-industrial nations are to share in the recovery. . . . Without these, many countries will have great difficulty servicing their debts."

The precise opposite of what the British minister says is the case: the Anglo-Swiss banking cartel which has become America's principal foreign creditor is responsible for the budget deficit, and now seeks to use the capsizing of the American banking system as a blunt weapon against American defenses. Indeed, the banking cartel chose to bring to the surface the longstanding weakness of the American banks at the moment when this would do the most damage to the American defense budget.

A band of latter-day Neville Chamberlains in Europe, led by Sir Geoffrey's collaborator, NATO Secretary General Lord Peter Carrington, Swiss National Bank President Fritz Leutwiler, and West German Bundesbank President Karl-Otto Pöhl, encouraged a run on U.S. bank deposits, "in order to make a point concerning the American budget deficit," as a British merchant banker from a centuries-old family put it.

How the Euromarket created the deficit

When Federal Reserve chairman Paul Volcker flew home from the October 1979 Belgrade International Monetary Fund (IMF) annual meeting in the midst of a crisis that had reduced the dollar's parity to DM 1.78, 40% lower than today's, he "saved" the dollar by imposing a regime that made America a net debtor for the first time since the First World War: first by sucking up flight capital from the developing sector, then by drawing portfolio investment from Europe and Japan, and finally by borrowing from the Eurodollar Market at what appears to be an annual rate approaching $150 billion during 1984.

These measures were dictated to the United States, and accepted by an eager Paul Volcker, by the same crew that intends to bludgeon President Reagan into accepting massive defense-budget cuts at the upcoming London summit of world leaders. The dollar had collapsed because the City of London had blown the supply of overseas dollars into a $1.6 trillion monster (by 1980), employing a runaway banking multiplier in the offshore markets. London and Zürich then demanded that the dollar deposits which they had generated through this multiplier be secured by higher rates of return on dollar deposits! Volcker obliged by doubling American interest rates.

Between 1979 and 1983, these higher interest rates wiped out federal revenues and increased Federal interest expenses to push the Federal budget deficit of the United States from $40 billion (including "off-budget" expenditures) to the $184 billion mark, or closer to $300 billion when the off-budget subsidy to the housing industry is tacked on.

The "Economic Report of the President," transmitted to Congress in February 1984, contains the following startling admissions concerning the dependency of the United States on capital inflows:

> The U.S. current account deficit in 1983 was nearly three times the previous record, which was set in 1978. The immediate connotation of the current account deficit, as of the trade deficit, is lost production in import-competing and export industries. But there is another way to look at it. The current account deficit is financed by a capital inflow from abroad. Foreigners have been investing in the United States, for example, participating in the rising stock market and buying Treasury bills.
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> In 1984 the U.S. current account deficit is forecasted to be roughly 40 percent the size of the Federal Government budget deficit. *This means that a capital inflow from abroad is financing the equivalent of 40 percent of the budget deficit*, and the crowding out of other sectors of domestic demand is reduced correspondingly.

In short, once the United States threw itself into massive official deficit by meeting the demands of European dollar-holders, the latter proceeded to finance the deficit. They demanded increasing interest rates as the penalty for doing so, on the grounds that the "risk" of a future dollar crash

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compelled them to shun dollar paper unless the risk were met with a correspondingly high reward.

Now they are insisting that the high interest rates they have demanded, and obtained, upon their dollar holdings be secured by the elimination of the American defense budget!

In effect, they have demanded cuts in the defense portion of the Federal budget to pay the interest item on the expense accounts:

Net interest on the federal debt rose from only $42 billion in 1979 to an estimated $135 billion in the current fiscal year. Defense expenditures, the object of rage among the European banking cartel, rose only slightly more, by $154 billion to a projected $272 billion in the current fiscal year. Cuts already instituted will lower that figure.

Having drawn the United States into arranging its own national bankruptcy through the Volcker policy since 1979, the old European families have now called in their chits in order to force their debtor to sacrifice national defense, much as they previously forced the major Third World debtors to sacrifice development efforts, with the cooperation of the United States.

Next victim: the MX missile

On **May 16,** the European creditors succeeded in forcing the slashing of the U.S. defense budget, by demonstrating the collapse of foreign confidence in the U.S. banking system. "We wish to make a point concerning the U.S. defense budget," as one British banker said.

That day, the United States lost the MX missile, when liberal Congressman Les Aspin (D-Wisc.) rammed through an amendment reducing the number of MX missiles approved for construction this year to 15, with no money to be spent at all unless the Soviets have still not returned to the arms-control talks in six months. A vote on the House floor on an amendment by Rep. Mavroules (D-Mass.) to kill *all* funding for *all* MX production lost by just 212-218.

By **May 23,** the House of Representatives passed the Brown-Coughlin amendment to the FY 1985 Defense Authorization Bill by a 238-181 margin, declaring a one-year moratorium on U.S. Anti-Satellite (ASAT) technology. This bill was submitted by Reps. George Brown (D-Calif.) and Larry Coughlin (R-Pa.) and had been drafted by the same team of operatives that worked with the Soviet embassy in Washington to draft a bill introduced by Rep. Joe Moakley (D-Mass.) against the U.S. Strategic Defense Initiative program for antiballistic-missile defenses. Dr. Carol Rosin of the Institute for Cooperation and Security in Outer Space had worked with Soviet officials to draft the exact formulations of the Brown-Coughlin bill.

On May 23, the London *Financial Times* published an article by New York money manager George Soros who said that the only way to avert a crisis was for the United States to drastically cut military spending. Entitled "International debt—the danger of Reagan's imperial circle," the article explained that "the Reagan administration has developed a new form of economic imperialism which allows it to finance a high budget deficit at the expense of the debtor nations.

"I shall call this benign circle the 'Imperial Circle,'" wrote Soros. It is a "vice that sucks dry the debtors," but "the Imperial Circle is liable to be broken. . . . It is only a question of time before the same thing that happened to developing countries happens to the U.S. budget deficit. . . . 1985 may turn out to be a year of economic crisis."

To end the crisis, "It is essential to reduce military expenditures," he concluded. "Military spending can be reduced only if there is a relaxation of political tensions. Anti-communism as it is professed by the Reagan administration runs a great risk. . . . [Let us] depend less on our military might [in order to] tackle the international debt problem."

Pulling the plug on Conti

The pressure on the Congress was prepared by the banking crisis which began on **May 10-11** (the anniversary of the 1931 bankruptcy of the Vienna Kreditanstalt bank), when Edmond Safra's banking group in Switzerland, a group of German banks lead by Deutsche Bank under the guidance of the Bundesbank, and British bankers under advice of the Lazard Frères group in London pulled some $5 billion in deposits out of Continental Illinois, the eighth largest bank in the United States with assets of $49 billion.

Since then, this same group has orchestrated the pull-out of over $50 billion deposits aggregate from U.S. banks in the European offshore markets during May. Just as Mexico's foreign creditors removed $40 billion from Mexican banks during 1982 to enforce their desire for a 100% devaluation of the peso, so now our foreign creditors are pulling the credit reins on the United States to tell us how much defense we can afford.

The run on foreign deposits was initially (and falsely) attributed to Japanese banks; in fact, the Japanese followed Zürich and London.

The operation was clearly timed with precision. A full month earlier, Continental Illinois had taken a hefty 6% profit drop in the first quarter on bad oil loans from the bankrupt Penn Square bank. But it was not until the week of May 11 that Conti experienced a "walk" by depositors, led by London eurodollar investors. The bank was forced to pay 100-150 basis points more than other banks for large certificates of deposit.

During the 48 hours following May 9, London eurodollar six-month interest rates jumped more than 2% to almost 13%, "the largest jump in history," according to one banker.

The pressure from the Conti crisis was immediately turned against the U.S. government itself. Friday, May 11 became known as "black Friday" in sophisticated financial circles, because of the collapse of the entire U.S. Treasury debt market. Led by Conti, banks throughout the system internationally began dumping their Treasury security portfolios to gain liquidity to pay depositors' withdrawals.

By **May 14,** it had been announced that a $4.5 billion

standby credit had to be pumped into Continental by a syndicate of 16 U.S. banks, lead by New York's Morgan Guaranty. The bank had lost over $5 billion in deposits.

The capitulation of the U.S. Congress to the budget-cutters only whetted the appetite of the European banking sharks, who continued to pull up to another $6 billion in deposits that week out of Continental Illinois. On **May 17,** Conti was bleeding funds so badly that the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) had to put together a $6 billion financial assistance package for the bank.

On **May 18** the extent to which the Leutwiler-led European central banks were coordinating the run was shown when the West German Bundesbank was forced to deny it had pulled funds out of Conti. The Dow Jones wire commented that it was probably the private Deutsche Bank instead of the Deutsche Bundesbank that was to blame.

A source at the Bundesbank commented dryly, "We are on the other side of the Iron Curtain with respect to this question."

Said a source at the Swiss National Bank, "This will teach the Americans to stop throwing money at problems," such as national defense.

White House held hostage

A well-placed Geneva banker reported on **May 23** that Reagan was finished as a result of the Continental Illinois crisis. "Volcker is preparing President Reagan's non-reelection. Ronald Reagan and this idiot Don Regan are totally unaware of what's going on. They're going to move on until they get badly bashed over the head. The European recovery is already vanishing; it's something of the past. Projections for economic growth are already beginning to be revised downwards. And the pressure of the Latin American heads of state won't work—the White House is the hostage of the banks.

"So, the game is going to blow. The Democrats are protecting Volcker: He's doing their job, after all, destroying Reagan's recovery. And this poor Reagan does not see the danger."

NSIPS/Stuart Lewis

On May 31, the Manufacturers Hanover crisis took its toll on the defense budget. The House prohibited MX missile production outright.

The next day, **May 24,** the wires reported rumors of a run on New York's $65 billion Manufacturers Hanover Bank, the fourth largest bank in the United States. By midday, major bank stocks had collapsed in New York on a "rumor that Manufacturers Hanover had encountered difficulty," as the Dow Jones wire put it.

One source told the wires that Manufacturers Hanover had had to sell off a large position in British government bonds or "gilts" to raise cash to pay fleeing depositors, thus raising more suspicion in the bank deposit market.

Manufacturers Hanover stock fell ⅝ to 28⅜, Chase Manhattan Corp. fell 3⅛ to 38⅝ and Irving Bank Corp. fell 2⅝ to 54.

Although a bank spokesman said that the bank "has absolutely no funding problems," this was clearly not the case. "A 5% contraction of the Eurodollar Market might well be underway as a result of the Conti Illinois crisis, and with an interbank market of $1 trillion on the Eurodollar Market, that means well over $50 billion that evaporated in ten days," a London broker stated today.

"European banks are cutting their internally fixed lending limits to American banks, they are cutting down on the credit lines and other exposure to American banks—especially the smaller ones, since the Fed will bail out the huge ones—and U.S. banks cannot even get a rating in London, they could not sell a toothbrush with their name on it," a Frankfurt banker said.

On **May 31,** the Manufacturers Hanover crisis took its toll on the defense budget. The House, on three separate votes, all in the range of 199 to 196, overturned the MX "compromise" of three weeks before, and prohibited MX missile production outright.

The U.S. chairman of the KGB-linked Parliamentarians for World Order, Rep. Tom Downey (D-Moscow) gloated, "Never have we beaten a sitting administration that worked this hard."

The defense debacle does not end there. Still before the House is a Les Aspin amendment which will cap funding for the Strategic Defense Initiative (SDI) at a rate of 5% real growth per year—a devastating cutback from the administration requests. The House Armed Services Committee has already cut the $1.8 billion budget back by $480 million. The Senate Armed Services Committee has proposed a cut of $120 million and Senate sources expect that Senators Larry Pressler (R-S.D.) or Paul Tsongas (D-Mass.) will successfully push further Senate cuts on the floor.