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The Federal Reserve girds for a banking crash

by Chris White

Officials at the Federal Reserve, and at the nation's other banking regulatory agencies, are now girding for a collapse of the banking system. Their proposals were set before Congress in hearings before the Senate Committee on Banking, Housing and Urban Affairs on March 11.

On that occasion, officials from the Federal Reserve Board, lead by Preston Martin, Volcker's number-two, were joined by William Seidman, chairman of the Federal Deposit Insurance Corporation, Edwin J. Gray, chairman of the Federal Home Loan Bank Board, and Robert L. Clarke, comptroller of the currency. The officials presented a united front on the dangers facing the banking system, during what they called "this transitional period."

But it was the chairman of the Federal Deposit Insurance Corporation whose testimony revealed what the nation's banking regulators now expect to come to pass.

Seidman recommended "that a Federal depositor preference statute be enacted." This, he said, would prefer depositors to other bank creditors, including those creditors who might establish claims in connection with letters of credit, other guaranties, law suits, etc. It would apply to all FDIC-insured banks.

Seidman's proposals confirm what was suspected when Paul Volcker and the central banks of Germany and Japan acted abruptly to lower interest rates recently. That move was not made because of the strength of the so-called United States recovery, but simply because the United States banking system, stretched by the impact of collapsing dollar and oil prices, is on the verge of collapse and needs infusions of credit. Indeed, Volcker himself had implied as much in his semi-annual report to the United States Congress, in which he counterposed the benefits of the oil price fall, with what he called "the stresses and strains" accumulating in the U.S. banking system.

What the Seidman proposals mean is that bank regulators have now figured out that the explosive bankruptcy crisis of the dollar monetary system, and the United States, have reached the point where the accumulation of unsupportable speculative paper has, even in their minds, become insupportable. That conclusion won't exactly be news to regular readers of *Executive Intelligence Review*.

Admission of bankruptcy

If boiled down to essentials, two alternate sets of proposals were presented to the Senate that day. The proposals differ in regard to the timing to be expected for the crash, though neither set of protagonists said as much openly.

Seidman's call for legislative action on the question of depositor preference is an admission that a collapse can no longer be delayed. Other officials advocated the opposite, seeking to buy more time for the doomed banking system, by such means as accounting tricks, restructuring loans without forcing banks to take write-offs, and promoting the usual panacea of interstate banking, with which Seidman agreed.

The two alternate sets of proposals conform to the political line-up that has prevailed since the beginning of the year, between the politicians in the administration, typified by James Baker's Treasury Department, still committed to the psychotic illusions of the continuing great recovery, and the technicians at the Federal Reserve. Thus far, the technicians have fought the politicians on the question of "junk bond"-financed mergers, and on the question of the dollar, and their

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views seem to have prevailed on both accounts.

Junk bond mergers, the purchase of perfectly good companies with rotten promissory notes of some third party, were stopped by order of Volcker, despite the opposition of the Treasury and White House. Measures were taken to stem the system-endangering slide of the dollar—despite the insistence of the administration that it should be allowed to fall yet further. Measures typified by the recent lowering of interest rates are part of the same picture.

Now, the issues involved are beginning to come out. The FDIC chairman's core proposals signify that the key controllers of the nation's banking system have determined that time-buying measures, of the sort pursued so obsessively since the Bretton Woods system first began to unravel back in the monetary chaos of 1967, will no longer work.

Those who argue on behalf of the latter approach still insist on the existence of any number of separate crises, a farm sector crisis, an energy patch crisis, a real estate crisis, a Third World debt crisis. They obsessively maintain that each such crisis can be handled separately, by stretch-out measures for the associated banks, without regard to the economic plight of the productive economy the afflicted banks have lent to.

The combined collapse of the dollar and the international price of oil, over the last two months, seems at least to have disabused some officials of that kind of idiocy.

But the kind of crisis those officials now expect cannot be dealt with by the kind of measures they propose. Depositor preference, favoring depositors, employment, and employment-related services, is necessary in any banking reorganization, as declared presidential candidate Lyndon H. LaRouche proposed last year at the time of the Maryland and Ohio savings bank crises. Such measures would separate out those parts of a bank's money flow and operations which are related to economic reality, from those which are totally the creation of the speculative fictions of usurious speculations, or worse forms of criminality such as the drug trade. The claims of depositors, that is, wage earners, family households, pensioners, would be given priority over letters of credit and other such instruments.

Under present circumstances such measures would simply hand over the remaining healthy functions of the economy to looting by essentially bankrupt institutions like the major money-center banks, Chase Manhattan or Citibank. Or, to that group of institutions known to the regulators, as "nonbank banks," or "phantom banks," the Searses and Merrill Lynches, a creation of the regulators' permitting the laws to be undermined or changed to preserve the expanding bubble.

Meanwhile, the lowering of interest rates, with its impact on the mortgage and related markets, is functioning as a kind of bridge to such envisioned reorganizations, as debt instruments are shifted through refinancing agreements from higher interest cost to lower interest cost. The scramble to suck much financing into such new low-interest packages, expected by mortgage associations to leap more than $50 billion this year, is part of the effort.

None of this will work. The dollar won't be stabilized. Interest rates will not stay down. Perhaps within the next three to six months the question will be called.

What is needed, in addition to measures to protect depositors, is simple recognition of the broader reality that the entire monetary and banking system is bankrupt. Depositors whose money and earnings are hostage to a bankrupt banking and credit system can never be given the protection that is in equity their due. The usurious monetary system which the bankrupt banking system serves must be swept away, and replaced with a return to a U.S. Treasury-backed gold reserve standard. The issuance of Treasury notes, gold-backed, into the banking sector to provide backing for issuance of credit for productive purposes in agriculture, industry, utilities, infrastructure, would ensure the protection of depositors, banks, and economy alike, while permitting the revival of production and trade internationally.

If such measures are not taken, then the Federal Reserve and the banking regulators are simply organizing the biggest deflation of paper values, i.e., the biggest and bloodiest depression collapse, in human history. In Texas and parts of California, it is widely considered that that is exactly what is going on. It was evident in Ohio and Maryland last year. Action by regulators helped to bring about collapse, while setting up the victims and their depositors for takeover by out-of-state, drug-money dependent interests.

The oil collapse

This reality is underscored by the emerging direct and indirect consequences of the collapse in the oil price, on top of the unraveling of the monetary system. Over the last year, the number of active wells in the United States was reduced by almost 40%. Now, fields are being shut down and wells capped in every major oil producing region of the country. The estimates of those knowledgeable of the industry range from a low estimate of a further 15% of U.S. oil production to be shut down at $15 per barrel, to 30%. Exxon and Mobil are leading the majors in making cuts of 25% and up in their operating budgets for the next year.

Already, the question has been called on Third World oil-dependent debtors like Mexico, Venezuela, Nigeria, and Indonesia. Now, it is the advanced sector's turn, not only in the United States, but also Canada and Britain.

The reality that has been set into motion over the last two months makes a mockery of those who argue that time can still be bought for the decaying remnants of the Bretton Woods system. Such advocates no longer have anything left to buy time with.

The technicians are themselves equally incompetent. Committed to the defense of the indefensible, the maintenance of a bankrupt monetary and financial system, their proposals won't work either.