

Dirty money and the Dow Jones boom

by David Goldman

Three and a half billion dollars of British bids for American companies, most from tarnished sources, preceded the explosion of the New York Stock Exchange averages during the week of Aug. 10. These bids, in turn, were preceded by one of the frankest admissions the U.S. government has ever made concerning the character of capital inflows into the United States, and an even more extraordinary *plaidoyer* from the U.S. Treasury, for such dubious flows to continue.

Such is the administration's anxiety to maintain the illusion of recovery through the 1988 elections, that it has opened the door to dirty money, at precisely the time that other central banks are determined to suppress speculation fed by hot offshore funds. Peru's President Alan García has taken the high ground on this matter, by starting proceedings to nationalize the Peruvian banking system, precisely in order to shut down the dirty money flows. More pragmatic considerations, namely a belated effort to protect national banking systems against a 1929-style bust, have pushed the leading industrial nations to do something comparable. The same week, the British stock market lost 12% of its outstanding value under Bank of England pressure, following an identical development in Tokyo; the Italian stock exchange followed suit on Aug. 10. Wall Street has become the haven for the money the rest of the world doesn't want.

That also raises questions as to why New York's aggressive U.S. Attorney Rudolph Giuliani has virtually abandoned the track of his insider-trading cases, which led into the top levels of Goldman Sachs and other major Wall Street investment houses. Someone may have informed him in strong terms that these gentlemen were financing America's deficits. A similar sequence of events occurred in August 1985, when Attorney General Edwin Meese visited Switzerland, in

hot pursuit of drug money. The Swiss informed him that drug money made up a large proportion of the trust accounts which were financing America's deficits, and Meese returned home, tail between legs.

Who is buying up the United States?

According to Securities and Exchange Commission data, overseas investors bought and sold \$277 billion of U.S. securities during 1986, dwarfing previous foreign-investment levels. That adds up to 11% of total U.S. corporate equity; i.e., more than a tenth of the valuation of the U.S. private sector passed through overseas hands. In fact, the number is undoubtedly much larger, perhaps by a factor of two or three. Treasury data are notoriously inaccurate, and ignore the purchases of any foreign investors who choose to use nominee accounts. For example, in 1980, the Securities Industry Association challenged the Treasury's report that foreign investors' purchases were \$75 billion, a quarter of last year's level, claiming that the actual level approached \$225 billion.

Most analysts believe that the truth lies roughly midway between the two estimates, i.e., that one-fifth of total American corporate equity would have passed through overseas hands last year. Robert D. Arnott of Salomon Brothers believes that the Treasury data "have a strong tendency to underestimate." Salomon's July 10 "Global Equity Investment Strategy Report" refers only to the gross movement of overseas funds in and out of different markets, rather than the so-called net investment (which the SEC puts at only \$18 billion). The gross flows reflect the power of overseas funds in the U.S. market.

Contrary to impressions, the much-publicized Japanese move into U.S. markets contributed a small fraction of the

\$500 billion-plus overseas operations. In fact, the surplus countries as a whole played a minor role. \$168 billion of the \$277 billion in foreign operations in the U.S. market derived from the category the SEC calls "Other," including Hong Kong, Switzerland, the Caribbean offshore islands, as well as OPEC.

That suggests that black and gray money, rather than honestly earned Japanese trade dollars, are buying out the United States. Striking is the extent to which the SEC admitted how dubious they are. "The ability to move capital quickly across national boundaries and to engage in securities transactions through offshore entities provides new mechanisms for the unscrupulous to engage in fraud, and presents new obstacles for law enforcement agencies," it wrote.

Against the reported \$277 billion of foreign in- and outflows through the U.S. market, U.S. investment funds showed a mere \$101 billion of foreign flows. Recognizing that the absolute numbers are dubious, the comparison nonetheless indicates how dependent the American market is upon foreign capital flows.

The problems the SEC refers to involve the narrower issue of insider trading from offshore banking centers, laundering of narcotics money through U.S. markets, and so forth. A bigger problem concerns the so-called errors and omissions in the U.S. balance-of-payments accounts, which have amounted to scores of billions of dollars in each of the last several years. A further problem involves the funding of nominally legitimate offshore takeovers.

Bring on the big bucks, the administration says. Don't ask where they come from. Despite its admissions concerning the "challenge to law enforcement" presented by the offshore tide, the SEC wants *less* regulation, since U.S. disclosure laws "may discourage some foreign investors and move trading offshore, adversely impacting the ability of U.S. markets to compete with others." Strictly speaking, that is not true, since the Japanese and British, the two largest stock markets next to America's, have done everything possible to drive offshore money out.

After the SEC reported the above to the House Subcommittee on Energy and Commerce, Assistant Treasury Secretary Michael Darby urged the deregulation of everything. He said, "We should recognize the important role that the United States has played in the increased integration of the world's financial markets over the past decade and a half and ensure that misplaced attempts to regulate U.S. markets do not jeopardize the international competitiveness of U.S. financial institutions." This should "underscore the need to reevaluate restrictions on financial institutions in the United States . . . and promote the dismantling of encumbering regulation worldwide."

It is probably no coincidence that \$3.5 billion of British takeover bids followed the Treasury's invitation. Hanson Industries, the U.S. arm of Hanson Trust of the U.K., agreed to acquire Kidde, Inc., a diversified U.S. manufac-

turer, for \$1.8 billion. Hanson is a regulators' nightmare, the sort of corporate dirty-pool player SEC investigators dream of bagging. Apparently, Hanson felt the atmosphere was congenial this time around; in January, Hanson bought Kaiser Cement, for \$250 million.

National Westminster Bank's purchase of First New Jersey National Corp. for \$820 million, is more interesting. Of the big London clearing banks, NatWest has the closest historical tie to the Hongkong and Shanghai Bank, Hongkong's private central bank, and also historically the central bank for the opium traffic.

Borrowed time

The longevity of this fling received a sardonic evaluation Aug. 6 by the editors of the London *Financial Times*, who wrote of America's efforts to "sell off the family silver." "So far this week British companies have laid claim to more than \$3.5 billion worth of the U.S. corporate sector. . . . Yet they scarcely amount to much in relation to last year's U.S. trade deficit of \$148 billion. The comparison is relevant because the acquisitive instincts of these British companies ultimately contribute to the financing of the trade deficit. To put it crudely, the inability of the U.S. in the recent past to sell enough of its goods and services to the rest of the world means that it must now sell off its assets instead. . . . In the wake of the dollar's precipitous decline in 1985-1986, dollar assets look cheap in terms of most of the developed world's main currencies, much as European assets look cheap to Americans in the 1960s. Few people are more conscious of this than the cohorts of the fee-hungry American investment banking fraternity, who are now travelling the world in an attempt to sell off as much of the country as possible. The world's commercial bankers, meanwhile, are responding to a shortage of good borrowers in the present slow-growth economic cycle by financing large bids by small entrepreneurial companies with any remote claim to good management and sometimes very little claim at all."

However, the *Financial Times* suggested, "An enlightened American would welcome these takeovers—not least because the American managers will probably buy back many of the assets at knock down prices when acquisitions are seen to have failed."

Wall Street has its own good reasons to crash, but the actions of foreign monetary authorities may have an impact all their own. For example, Japan's stock market decline could spill over into U.S. markets, as Japanese companies find themselves short of funds, and pull funds out of the United States, Wall Street analysts warn. Japanese industrial companies are using working capital to speculate in financial markets, and the squeeze on industrial companies engineered by the Bank of Japan could trigger a general liquidity squeeze. Since Japanese companies invest almost twice their \$60 billion trade surplus with the United States abroad, the effects on American markets could be dramatic.