EIR Economics

Financial crisis: Is the second shoe about to drop?

by Chris White

It looks as though George Bush's electoral sweep in the "Super Tuesday" primaries will rapidly prove to have been the biggest debacle since the victory of that Roman general who gave his name to the expression "Pyrrhic victory." International financial circles don't have to much confidence in either the candidate, or the financial institutions represented by the man the British press is calling "the establishment's last wet hope."

The word has gone out, in London, Switzerland, and beyond, that now that "Super Tuesday" so-called, has come and gone, the "meta-stability" which has characterized international currency and stock markets since the beginning of the year, will do the same. Warnings are going out, that the second quarter of 1988 may well turn out to be as turbulent as the fourth quarter of 1987.

On Thursday, March 10, the Dow Jones Index plummeted 48.5 points. It was the biggest such plunge in couple of months. But more to the point, the plunge came about in just one single hour of trading. That plunge jolted the markets. Such volatility, it was said, is only comparable to the kind of pattern that developed in the period leading up to "Black Monday" Oct. 19, 1987.

However, the stock market plunge at the end of the week was merely the confirming signal of the process that had been unleashed politically as "Super Tuesday" came and went. Here it was Britain's Margaret Thatcher, and the Bank of England which set the pace, much to the disquiet of the *Wall Street Journal*.

Thatcher, acting against her Chancellor of the Exchequer, Nigel Lawson, ended Britain's more than two-year-old policy of holding the pound sterling below the 3.00 DM level, and decided to let that currency go where it may. The *Journal*'s disquiet was occasioned by the simple reality that the Bank of England was thereby ending its policy of currency intervention. In 1987 the British central bank was the world's second largest purchaser of dollars after the Japanese. The *Journal* fears that will no longer be the case, and that others will follow suit. Indeed, the next day the French central bank announced that it was letting the franc float freely against the deutschemark too.

The respective decisions by the British and the French signal the end of what was called "the international currency stability policy" adopted by the Group of 7 nations in the weeks before Christmas 1987. The policy commitment was expressed in the then-issued communiqué which declared that further currency instability "could be counterproductive."

Now that agreement is being junked, and the scenery is being set for a new round of currency and dollar crises. Treasury Secretary Baker himself admitted as much in his testimony before the congressional Joint Economic Committee on March 9. Noting that he not been "informed" prior to the move, Baker thought that international stability "would not be affected," and answered Sen. Paul Sarbanes of Maryland's question, by saying it was "unlikely" others would follow in the British footsteps.

Some take this to mean that Thatcher's decision is an indicator of what the U.S. Treasury will now do, too. With Bush now riding high, it is thought, and the way to the Republican nomination clear, Baker, it is supposed, intends to launch a new round of dollar-bashing. This view overestimates the amount of support Bush disposes outside the United States. The Iran-Contra tainted vice president isn't thought to be either electable or supportable.

Then also, the end-of-year currency stability pact was based on a U.S. commitment to reduce the U.S. budget deficit. The election year budget that saw the light of day a month ago, doesn't fit the bill. George Bush's campaign rhetoric—no tax increases, no Social Security cuts, no defense cuts—even if dismissed as campaign rhetoric, still leaves the prospect of another year or more without serious U.S. action on the worsening crises of the bankrupt financial and banking system. A time frame in which U.S. creditors would be expected to cough up at least another $150 billion, and almost certainly, much more than that. It seems that the conclusion is being drawn around the world that the United States will not honor such commitments, and therefore time just ran out on the two-month-old agreement.

Economic policy in the United States, since the October market meltdown, has been characterized by the insanity that replaying the scripts of the Hoover administration, as if the real world were just a movie re-run, and providing credit to keep the lid on erupting crises, would be sufficient to hold the system together, a day and a week at a time, into next year. The insanity assumed that the creditors of the United States could be counted on to play along with the game, for as long as the United States insisted they do do.

The view from Europe, espoused most forcefully by Thatcher's Chancellor of the Exchequer Nigel Lawson, among others, has been a different kind of insanity. That the United States ought to undertake a drastic internal austerity program in which interest rate increases would be combined with budget cuts of approximately twice the magnitude agreed on for the fiscal 1988 and 1989 budgets. Helmut Schmidt and Valéry Giscard d'Estaing, both former heads of state of their respective countries, have spoken for such a view.

The London *Times* put it most bluntly. Decrying the symptoms of inflation in the United States in January, the growth of consumer credit, the growth in auto sales, and the continued supposed growth in service sector employment. The *Times* launched into a violent attack on U.S. consumerism, paid for by credit from abroad, saying that if the U.S. politicians were not prepared to bite the bullet in an election year, then "the markets" might just have to do it for them, in the form of another crash on the stock exchange, and other markets.

Second-quarter crisis

The split between the U.S. crowd, typified by the backers of Bush in the financial community, and the United States's creditors, is the unfolding backdrop to the emerging second-quarter crisis, which was projected by economist Lyndon LaRouche after the October market debacle. At that time, LaRouche who had called the shots on the October crisis, in May of 1987, thought that the monetary system could perhaps be held together into the second quarter of 1988, but not much beyond then. And that the longer it was so held together, under the adopted insanity of prevailing policies, the more surely such a second phase of crisis would come about.

Perhaps, even now, the dropping of the second financial shoe could still be averted by employment of the many tricks available to the financial crowd and their political stooges. But the fracturing of Group of 7 unity on currency stability may doom such tricks, as a crisis within the European Monetary System turns rapidly into a new dollar crisis, more serious than any that have come before.

Of course, the dollar did slide back to the 1.65 DM level in the week that the Bank of England made its shift.

There are probably some who think that the relative stability of the last weeks does actually reflect something about reality. They would be silly to do so. The efforts by especially Baker and Greenspan, since the October crash, have been directed at propping up some $15 trillion worth of financial paper assets, which are in actuality unsalvageable. The means they have employed to do that, creating more such paper assets, while depleting the economic potential which is the collateral for the paper, ensures that their efforts are doomed by their own obsessive insanity.

Baker's congressional testimony included the secretary's thoughts on the question of a tariff on imported oil. He is dead against it. But the renewed plunge in the international price of oil, to below $15 per barrel, is not only one of the most significant changes since October, it has also helped undermine the very fabric of the U.S. banking system.

Anticipated earnings from oil, at higher price levels, are the collateral for loans and real estate ventures. The 1986 collapse wiped out the financial resources of the Southwest; the present one has started the rent that could rip the system apart, starting with First Republic Bank of Dallas. When the Dallas Federal Reserve announced that, at the request of banks in the reserve district, it was no longer putting out weekly reports on the region's banks, eyebrows were raised internationally. It was a sure-fire signal that the whole area's banks have actually gone.

Then the thrifts: Last year's supposed fix for the system, giving the bankrupt Federal Savings and Loans Insurance Corporation the power to borrow on capital markets, didn't fix anything. The system is still bankrupt, and there are renewed calls, out of desperation, for some action by the federal government to alleviate the mess.

The only federal action that could alleviate anything is the kind of financial and economic reorganization policy that LaRouche has put forward. Declare a state of economic emergency to activate the powers of the presidency to reorder the banking and credit system. Provide about $2 trillion per annum of credit, in the form of gold-backed Treasury notes, for investment in basic infrastructure, industry, and agriculture, and forefront areas of scientific research and technological development.

In the absence of this kind of approach, then the fracturing of the basis for international agreement, a Darwinian "survival of the fittest" reflex, will lead sooner or later to the next phase of the collapse, which Baker and company still insist won't happen.