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EIR Economics

Biggest bailout in history won't save world economy

by Michael Liebig

On Monday, Jan. 12, events had once more come to a crisis-point: Once again, the world financial system was on the brink of meltdown. All over Asia, stock prices fell through the floor. Indonesia, like South Korea just three weeks earlier, was on the brink of insolvency. The bankruptcy of the Peregrine Investments financial house in Hong Kong pulled not only the Hong Kong market into the maelstrom, but the other Chinese financial markets along with it. Most of the Asian currencies were in free-fall. On the previous Friday, the New York Stock Exchange fell 220 points, at which point stock prices collapsed all over Ibero-America. And in Europe on Monday morning, the stock exchanges collapsed across the board. The Frankfurt DAX index lost 150 points; Paris, Zurich, and London registered similar results. Had the New York stock market continued its tailspin on Monday after the markets had closed in Europe, then the collapse of financial markets Tuesday morning in Asia, and then in Europe, would have gone out of control.

That was the situation in which the heads of the central banks of the ten leading economic powers, or their representatives, gathered in Basel, Switzerland, at the Bank for International Settlements (BIS). The majority of the central bankers were in agreement: Absolute priority must be preventing the meltdown of the world financial system. To do this, massive injections of liquidity, surpassing anything and everything which had been done before, and without regard to the inflationary consequences, had to be undertaken. These massive financial injections, so went the agreement, had to be carried out by the government of Japan in order to "stabilize" the Japanese financial system, buried under "bad"—i.e., unrecoverable—credits on an order of magnitude of at least $1.2 trillion. Only on condition that the "front is held" in Japan, thereby buying more time, would there be any chance of bringing the situation in the former "Asian Tiger" countries, and worldwide, back under control.

This position had been discussed some days earlier during the visit of the Japan's Deputy Finance Minister Eisuke Sakakibara in the United States, England, France, and Germany. Before leaving Japan for this trip, Sakakibara had said that Japanese authorities should not have allowed the November 1997 bankruptcies of Hokkaido Takoshuko Bank and Yamaichi Securities, and he insisted that there be "no more defaults" in Japan's financial sector. Around the same time, Jacques Santer, president of the European Union (EU) Commission, EU Commissioner Sir Leon Brittan, and British Prime Minister Tony Blair, the new president of the EU Council, arrived in Tokyo.

No sooner said than done: On Jan. 12, Prime Minister Ryutaro Hashimoto presented a bailout package for "stabilizing" the Japanese financial system, to the tune of about *$500 billion!* This is no typographical mistake: the number is $500 billion. Hashimoto told the Parliament that everything would be done to ensure that Japan would not be the trigger of a "world financial crisis" and a "world recession." The Japanese financial system would be "stabilized," so that there was "no cause for concern." This gigantic bailout package, which will be debated in the Parliament in the coming weeks, has the following components:

• The national deposit insurance fund (DIC) is to be extended with $130 billion (17 trillion yen) of public money in order to meet demands of financial institutions in cases of bankruptcy. Knowledgeable observers fear that much of this vast sum will not be used for legitimate compensation of small depositors, but rather for meeting all sorts of financial obligations of troubled or defaulted banks. It remains unclear how this money and the public funds, listed below, are sup-

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posed to be made available. It is probable that this will occur via issuance of government bonds which have to be purchased by the state-controlled banks, particularly the Postal Bank.

• At the same time, a "Special Budget for Crisis Management in the Financial System" is to be established within the DIC, comprising about $100 billion (13 trillion yen). This money is to be used to purchase the stocks of ailing financial institutions in order to improve their capital base.

Hashimoto also presented new official data on the extent of "bad" credits in the Japanese financial sector: It is now conceded that the volume of various categories of "foul," "distressed," or "endangered" credits amounts to some $550 billion. That would be somewhat more than half of the actual volume, estimated at $650 billion of "bad" credits in the Japanese financial system.

• The government is instructing state-controlled banks, and especially the Postal Bank, to make new credits at a volume of $190 billion (25 trillion yen) available in order to balance out the shrinkage of credit issuance by private financial institutions. Theoretically, these credits could flow into the real economy and have a stimulating effect. It is feared, however, that the lion's share of these credits will flow into the financial sector, because companies will not be making new investments or employing new workers, but will instead strive to reduce their debts to banks.

• The introduction of a capital reserve requirement of 8% of credits issued for Japanese banks which are active in international business, intended to go into effect on March 31, will be postponed. A 4% capital reserve requirement for institutions which are only active domestically, has likewise been dropped.

• Finally, private households are supposed to be granted tax breaks, totalling up to $45 billion, which is supposed to stimulate domestic demand.

These measures, taken together, represent the *largest financial bailout in world history*. And it is important to keep in mind, that this mega-bailout is being launched with a view toward the entire world financial system; it is not just "national" policy for Japan. Since the Spring of 1995—some two years before the current "Asia crisis"—it has been clear to all informed circles that Japan's financial sector—not its real economy—is the *Achilles' heel of the world financial system*. Following the de facto state bankruptcy of Mexico, the bankruptcy of Barings in the United Kingdom, and the outbreak of the Japanese banking crisis, the world financial system was on the brink of collapse already in Spring of 1995. It was decided at the Group of Seven world economic summit in Halifax, Canada in June 1995, that a looming chain reaction-style collapse of the financial system would have to be prevented by means of an international policy of *liquidity pumping*. Private banks were permitted to cover themselves with easy access to ever more central bank money by means of an internationally agreed-upon policy of low interest rates. And the private banks speculated with this money internationally, wherever they saw the best chance of quick profits. That is the background of the incredible financial-asset price inflation between Summer 1995 and August 1997, when the frenzied surge on the world's stock markets came to a halt.

Japan always took center position in this period of liquidity-pumping. In the Summer of 1995, the Japanese central bank lowered interest rates to 0.5%, which is where they are to this day, and where they will stay. That means that the Japanese private banks obtained money from the central bank, against securities or commercial paper of whatever quality, at almost zero cost! The policy of liquidity-pumping bought the world a two-year "breathing space." Over that period of time, the monetary and financial aggregates, which had already assumed untenable dimensions prior to 1995, further expanded enormously internationally, and especially in Japan. The chasm between the real economy and the accumulated financial titles, including their payment claims, opened ever wider. Time was "won," but the underlying crisis of the Japanese—and global—financial system drastically escalated at the same time.

From August 1997 onward, it turned out that the overstretching of the international financial system, which had been generated by the liquidity-pumping, could no longer be sustained. The speculative attacks by the so-called "hedge funds" à la George Soros, against the currencies and the financial markets of Southeast Asia, were therefore the *trigger,* not the cause, of the rapidly accelerating and escalating financial crisis in Asia which broke out in the second half of 1997. But the so-called Asian financial crisis was, in turn, always merely the most exposed "front" or the "main theater of war" of the *worldwide* financial crisis.

In the late Summer of 1997, the majority of the international financial oligarchy reacted just as it had in the early Summer of 1995: In view of collapsing financial asset prices, which was intensified under the pressures of currency speculation, they concluded that the previous policy of liquidity-pumping had to be upgraded *by orders of magnitude*. Blow by blow, one International Monetary Fund (IMF) bailout package followed another: $20 billion for Thailand, $45 billion for Indonesia, $57 billion for South Korea, and now the Japanese package of some $500 billion.

LaRouche points the way out

At the beginning of November 1997, Lyndon LaRouche presented a package of measures at an *EIR* seminar in Bonn-Bad Godesberg, Germany, for what had to be done in view of the world financial crisis, with its epicenter in Asia:

• As a first emergency measure, capital and currency controls would have to be established in order to stop the destructive activities of speculators and hedge funds. This policy should be oriented to the monetary policy of the 1950s in western Europe, when the principle of "limited convertibility" was in force.

• The principle of "it's only paper," vis-à-vis plunging asset values, must be enforced. The rapid devaluation of speculatively overblown prices for financial paper is not a disaster, but rather is desirable. The elimination of fictitious capital by devaluation should not be prevented. Public money is not to be used under any circumstances to counter the devaluation of fictitious capital which is not anchored in the productive processes of the real economy.

• Under the leadership of the United States, the world financial system must be reorganized and a new "Bretton Woods II" world financial system must be created by the political will and the decisions of governments.

In view of the events of recent days, the crucial importance of LaRouche's second point has become quite evident. Everything points unmistakably to the fact that Hashimoto's program for "stabilizing" the Japanese financial system with $500 billion signifies a further escalation of the world financial crisis in the direction of *hyperinflation*. Public money and the savings deposits of the "little people" are being used to an enormous extent in order to balance out the losses of private financial institutions. The "bad" credits of the private banks—fictitious capital—are not being *surgically disposed of*. There is no thorough "value adjustment" to the cost of private financial interests. Instead, the "bad" credits are being "parked" longer term, that is, they carried into the future with the view to retire them over some unspecified, but lengthy period of time.

The total mass of financial aggregates is being extended even further by means of the continued policy of pumping liquidity via the 0% interest rates of the central banks and the "injection" of immense volumes of public money, which will necessarily have hyperinflationary consequences. And the funds made available by the cental banks and the governments are not flowing into an stimulation of the real economy, for national or transnational projects to increase productivity. Instead, they are seeping away into the bottomless pit of the objectively bankrupt financial system.

The Hashimoto program is one of a line of similar, but smaller, public mega-bailouts. At the beginning of the 1980s, the American savings and loan institutions were "deregulated," i.e., the restrictive regulations for the investment and credit-issuance practices of the S&Ls were nullified. By the end of the decade, the ensuing speculation in real estate and financial paper had ruined the S&L system. President George Bush saw to it that an estimated $200 billion was spent on the bankrupt S&Ls. The lion's share of public money did not flow into protection of the deposits of the "smaller savers," but into paying off *private claims,* in the aftermath of the speculation.

The bankruptcy of Crédit Lyonnais, the largest bank in Europe at the beginning of the 1990s, was similar, although in smaller dimensions. Credit Lyonnais suffered losses estimated at $50 billion in real estate, bond, and derivatives speculation, together with bad debts. Instead of carrying out a surgical valuation adjustment, the losses and the bad credits were taken over by the state, i.e., by the French taxpayer.

But the crises of Crédit Lyonnais and the American S&Ls seem small and harmless in comparison with the current banking crisis in Japan.

Hashimoto stricken by Anglomania

Immediately following a five-day Jan. 9-13 high-profile visit to Japan of British Prime Minister Tony Blair, Japanese Prime Minister Ryutaro Hashimoto took the extraordinary initiative of writing a signed commentary for the widely read, Rupert Murdoch-owned British tabloid, *The Sun*. Under the headline, "Britain and Japan Must Go Forward Together," Hashimoto fawns that "I cannot recall a time when Japan's relations with Britain were so good. Tony Blair and I are both determined to achieve a more compassionate yet efficient society and to take the tough decisions required.

"He is a new star on the world stage, and whether addressing our top businessmen or meeting the people of Tokyo, he has made a huge impression, which can only benefit our relations further."

Hashimoto lists a number of Britons of the past, including that ideologue of British imperialism, Charles Darwin, as among "my childhood heroes," and goes on: "I always wondered what it was about Britain that gave birth to so much talent. I was also inspired by the Boy Scout movement. When I was young, I became a Scout, and impressed by the ideals of the founder, Lord Baden-Powell, I later made a special visit to Scout headquarters." (Hashimoto was evidently not informed, before writing this article, that Baden-Powell was recently exposed on a British television program, as an active homosexual.)

After issuing an apology for the "tremendous damage and suffering" caused by Japanese treatment of British prisoners of war during World War II, Hashimoto writes that "I look forward to two visits to Britain later this year—first, for the Asia-Europe Summit in London, then to the G-7 Summit in Birmingham. . . . *We are working together in a number of areas, and these regular contacts can only help*" (emphasis in original).

"But the highlight for us of the Anglo-Japanese relationship will be the state visit to the U.K. of Japan's emperor and empress in May. They are looking forward to seeing the new Britain. I welcomed Tony's statement that they would be warmly welcomed by the British people."

Other, somewhat rational voices

The majority of the international financial oligarchy currently stands firmly behind Hashimoto's program of pumping liquidity and bailouts with public money. It is also becoming apparent, however, that some in the European and American financial and political elites are coming to understand that ever more comprehensive bailout packages are an untenable policy. The continuous injections of fresh liquidity into the financial system, supposedly in order to gain time, necessarily lead to galloping inflation. This faction emphasizes that one should not "socialize" the *private risk* of private financial institutions, and that *private* losses have to remain a central feature of a market economy.

In the opening days of the new year, several central bankers in Europe raised public accusations against the IMF's policy of ever more and ever grander bailout packages. The head of the German Bundesbank, Hans Tietmeyer, was cited in the Frankfurt financial publication, *Börsenzeitung,* at the turn of the year: "In my opinion, the IMF policy ought to be fundamentally reviewed," and he said he wanted to counter the impression that international organizations, such as the IMF, or other countries would always be standing by with big credits wherever a financial crisis breaks out. U.S. Treasury Secretary Robert Rubin expressed the point more sharply on Dec. 24, when he said that he would not make "a single nickel" available for private banks to compensate private creditors of South Korea for their losses incurred there. After all, the IMF money for bailout packages come from public funds that national governments are supposed to provide the IMF.

In a background discussion, a spokesman for the Bundesbank said that Tietmeyer's statements were intended to "deliver the message" that, while the IMF was not being "put into question," it was moving into "dangerous terrain" by continuously packaging new bailouts. It had to be emphasized, said the spokesman, that "private creditors" had taken a "private risk," and they could not count on being saved with public money. There is "complete agreement" between Rubin and Tietmeyer in this regard. On Jan. 7, in a commentary for the Copenhagen daily *Politiken,* the former governor of the Danish National Bank, Erik Hoffmeyer, criticized the conditionalities of the IMF for the $57 billion bailout for South Korea because of the "immense" negative economic and political consequences. Hoffmeyer then asked: "There is a very great risk that the money which flows to South Korea will only be used to pay the loans of the most nervous [private] creditors [from Japan, Europe, or the United States]. Now, does that make sense?" But these views of Rubin's or Tietmeyer's, also now shared in the Swiss National Bank, do not currently determine policy. These views are also miles away from LaRouche's proposals for a "radical reform" of the world financial system.

For the moment, the agony of the world financial system will probably continue, but the worldwide and systemic nature of the crisis is becoming more obvious as each day passes. It can be assumed that there will be an extraordinary combination of three trends in the first quarter of 1998: 1) a continuation of the inflationary policy of liquidity-pumping and public bailouts; 2) a drop in stock values of up to 40% on the European and U.S. financial markets; 3) the shrinking financial values will go hand in hand with a shrinkage of the real economy in the U.S.A. and Europe. These three factors make an explosive mixture, and not only in monetary-financial respects, but also in social respects, and especially in political-strategic respects.

Blair makes an offer Japan must refuse

by Our Special Correspondent

British Prime Minister Tony Blair could not have chosen a more opportune moment for his official visit to Japan on Jan. 9-13. The wild gyrations of the Tokyo currency and stock markets, the overall weakened Japanese financial situation, and the unwillingness of Japan to break from longstanding plans to deregulate its markets, left Japan particularly susceptible to Blair's pitch for a new Anglo-Japanese alliance, based on a series of financial and economic deals between Japan and Europe.

In Tokyo, Blair held a series of meetings with Prime Minister Ryutaro Hashimoto, Finance Minister Hiroshi Mitsuzuka, and Emperor Akihito, and appeared almost daily on Japanese national television. As one Japanese observer told *EIR,* "It was Blair-mania" all over Japan.

Concretely, what Blair's trip was aimed at achieving was a full integration of Japan into Britain's global financial orbit. The day before Blair left for the Far East, he had met, in London, with 20 members of the European Commission. He told them that he would secure a commitment from Japan for full cooperation with the European Monetary Union (EMU). Given that Britain has already announced that it will not be among the first countries adopting the single currency, the euro, in January 1999, Blair's Japan gambit was aimed at giving Britain greater leverage on the euro arrangements than it would otherwise have.

In Tokyo, Blair pushed hard for Japan to move forward with the scheduled April 1998 "Big Bang" opening of its financial services sector—despite the fact that the Japanese Ministry of Finance had just released data showing that Japanese banks are carrying over $575 billion in bad loans—more than double the previously acknowledged figure.

This deregulation push would open Japan's $7 trillion in personal savings, for investment into the global markets—i.e., for unchecked looting. Those savings deposits, and the fact that Japan still has a large, high-tech industrial base, are the country's chief defenses against the looming assault by