H. Armstrong Roberts

Which Capsule Contains The Cyanide?

ECONOMIC TYLENOL

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■ DEPRESSION, Panic, Crash! The very words evoke anxiety and fear in millions of Americans old enough to remember the Great Depression of the 1930s. Shattered men, having lost fortunes in the stock-market collapse, sought escape by diving from the windows of high-rise buildings. Production and profits fell sharply. Huge inventories of repossessed merchandise, marked down well below bargain prices, soon drove new goods off the market. Factories operated only a few days a week or shut down completely.

Widespread joblessness plunged millions into utter despair. Unemployment rose from 3.2 percent in 1929, to 8.7 percent in 1930, to 15.9 percent in 1931, and thereafter escalated into the twenties — topping out at 24.9 percent in 1933.

Many banks and insurance companies foreclosed on mortgages; but, since they could get little or nothing for these properties, they could not pay their depositors. Financial institutions were closed in a national "banking holiday" declared by the federal government. Some thirty-six hundred of these banks never reopened. Business bankruptcies were epidemic and soup kitchens were opened to help relieve the hungry and suffering. America had hit Bad Times.

Today, in the face of an increasingly shaky financial community, international instability, and a mushrooming debt crisis, many concerned observers are beginning to ask ominous and foreboding questions. Can it happen again? Is the American economy emerging from its worst recession since World War II or are we about to experience the worst economic megaclysm in our national history? What might trigger a financial panic which could precipitate a long and deep period of economic grief?

As the Austrian school of economics has demonstrated beyond doubt, widespread financial busts are, at root, caused by government intervention in the economy. Particularly by political manipulations in the fields of money and banking. Best-selling author Douglas R. Casey summarizes this point in *Crisis Investing* ('76 Press, Box 9925, Atlanta 30319) as follows:

"Economic depressions are caused *indirectly* by a government's currency inflation, by its taxation, its borrowing, and its regulations, and *directly* by the misallocation of goods and services that these things, in turn, cause. Since these things make it harder for men to produce and consume, an economic depression may be defined as a period of time during which the distortions they cause in a nation's economy are liquidated. The distortions in the U.S. economy caused by the American government through its economic interventions are pervasive and deep."

Last month we reported the degree to which the banking industry and the international financial institutions have in recent months been increasingly hit with panics and traumas. From the Drysdale Securities scandal and the Penn Square Bank collapse to the near-default of Mexico, financial crises have been popping out like warts on a toad. James U. Blanchard, chairman of the National Committee for Monetary Reform and editor of *Gold Newsletter*, summarizes the situation:

"All you have to do is to pick up the *Wall Street Journal* on a daily basis and see that there is a general *international fear* of a major banking crisis. Almost weekly there's news about another European or American bank in trouble. Although I'm entirely convinced that an international monetary reflation will save the day, . . . the coming months will see *much discussion* of banking and corporate collapses and bankruptcies."

Fearing that this much discussion of the possibility of collapses and bankruptcies could precipitate panics which might aggravate the problem to the point of unmanageability, key spokesmen from high finance are desperately trying to assure the world that the sky is not falling. Walter B. Wriston (C.F.R.) is chairman of Citicorp, the nation's second-largest bank and one of the most financially troubled. He published an article in the *New York Times* in mid-September in which he strongly assured readers that no disaster in Big Finance is about to take place. Concerning the government Debt requirements, Wriston observed:

Despite the frantic efforts of Establishment *Insiders* to paper over the huge cracks in the debt pyramid, the banking structure is on the verge of collapse. At the root of the looming calamity is the enormous Debt accumulated through decades of escalating government deficits and Fed-orchestrated inflation.

"To see why [*a disaster is not inevitable*], it is only necessary to understand the basic facts of government borrowing. The first is that there are few recorded instances in history of government — any government — actually getting out of debt. Certainly in an era of $100 billion deficits, no one lending money to our government by buying a Treasury bill expects that it will be paid at maturity in any way except by our government's selling a new bill of like amount. These obvious facts suggest two corollaries: first, the holder of the bill has justifiable confidence that the government will acknowledge the debt; second, the government will have ready access to a market ready and willing to buy a new piece of paper."

In other words, the huge Debt pyramid built up by the federal government will be financed by borrowing still more money and getting deeper into debt. And, if this "greater fool" system should fail, the government can always pay off its Debt paper with printing-press money. Which can only mean massive inflation.

Wriston euphemizes: "Bankruptcy is a procedure developed in western law to forgive the obligations of a person or a company that owes more than it has. Any country, however badly off, will 'own' more than it 'owes.' The catch is cash flow, and the cure is sound programs and time to let them work."

In Wriston's doubletalk, "sound programs" ultimately mean an inflationary bailout of the big bankers at the expense of the American middle class.

But, says the highly respected *Bank Credit Analyst* of September 1982: "There can never be any certainty that a debt crisis will not spiral out of control. Risks, therefore, must increase until the financial pressure becomes intolerable and the financial authorities move to inject massive amounts of liquidity, reduce interest rates and bail out the large walking bankrupts that are about to collapse."

Despite all the efforts by Establishment authorities to play down and paper over the huge cracks now appearing in the debt colossus, the national and international banking structure is trembling on its fiat-money foundation. Hard-money economist Gary North says he sees light at the end of the tunnel — and insists that it is a locomotive. In his newsletter *Remnant Review* for September 17, 1982, Dr. North observes of the international banking pyramid:

"What we must face is this: the talk of bank failures is everywhere today, as I have never seen or heard in my lifetime. The worries Howard Ruff was writing about five years ago are the worries bank presidents are having today. On August 27, Chase Manhattan Bank — the bank once headed by David Rockefeller — had the wind knocked out of its sails. The Chicago Board of Trade removed it from the select list of banks whose Certificates of Deposit are acceptable in the settling of futures contracts. Chase is owed $1.75 billion by Mexico in short-term debt, with heavy exposure to defaults by Peru and Argentina.

"Am I saying that I think Chase Manhattan will go belly-up? On the contrary, I think the various international lending agencies, and ultimately the Federal Reserve System, will provide the fiat money to keep these dollar-denominated loans at something close to book value. The result, unfortunately, will be higher price inflation and probably the imposition of emergency controls on prices, bank account withdrawals, and possibly even attempted restrictions (which will fail) on the use of cash. The problem here is that buckets of cash are needed to provide the illusion of bank solvency; restrict people's ability to take out their money, and you encourage them to pull the plug the day the windows are open for business again."

And U.S. banks are only part of the problem. They are heavily interconnected with foreign financial institutions. If this international pyramid party is to run its appointed course, the bailout system must include institutions on an international scale. Otherwise, bank failures in Germany, for instance, might start a chain-reaction which could topple banking dominoes in the U.S. The whole megabanking empire might be ruined, and the game would be over. The *Insiders* of international banking need a One World State to maintain a truly effective monopoly over money and banking. Gary North observes:

"The next line I expect is some variant of 'We owe it to ourselves.' When you hear that one, the *One World State* — which is the only legal and metaphysical foundation for such a statement — is part of the overall program. Now, to speak bluntly, if the banking system were in deep trouble, wouldn't you, as a banker, want other bankers to share your risks? Wouldn't you want a final lender of last resort (like the International Monetary Fund or the Federal Reserve System) to be sufficiently powerful to force recalcitrant (solvent) bankers to 'pitch in their fair share' of the reserves? Of course you would. But to make certain that no one else is holding back funds, you would need a regulatory agency to police all members, and a data system to allow the agency to do its work. They haven't got either the agency or the integrated network of electronic bank data, but that's what they need . . . . They need that institutional arrangement to make it stick . . . .

"One of the prime battles of the 1980s will be the attempt by the centralizers to create the international banking system vs. the economic nationalists (and gold-based internationalists) who don't trust the system. The one international money that works — gold — is not what the bankers have in mind. Anyway, not for you and me; for themselves, maybe. They trust gold more than they trust each other. Can you blame them?"

Concern about the worsening world banking crisis is reflected in the lead sentences of Julian Snyder's late August issue of *International Moneyline*: "The collapse of the world's banking system has begun. A major stampede into gold and other tangibles is about to begin. The dollar is poised on the edge of an abyss. When the banking system goes, the dollar will go with it in an incredible explosion of world hyperinflation."

But, as we indicated in the February 1982 AMERICAN OPINION, there has been a running debate among investment advisors, surfacing mainly at the monetary conferences, about whether any such bust would be a classic deflationary depression like the one in the United States during the 1930s, or one characterized by runaway inflation such as occurred in Germany in 1923. Market analysts who predict hyperinflation include Jerome F. Smith, Howard Ruff, Douglas Casey, James Sinclair, Julian Snyder, and economist Murray Rothbard. Prominent prophets of a deflationary scenario include Richard Russell, C. Verne Myers, Thomas J. Holt, James Dines, and Donald Hoppe. Other advisors seem to be hedging their bets fifty-fifty.

This controversy is important to these gentlemen and their clients because of the different investment implications each scenario indicates. During a deflation, it is good to hold cash; but, in a runaway inflation, it is gold, silver, and other tangibles which are to be preferred over rapidly depreciating paper.

At the root of potential financial calamity, as we have noted, is Big Debt. Or rather the failure to *pay off* the gargantuan debt that has been built up over the years by big government's deficits and the inflationary monetary policies of the Federal Reserve. Historically, it has never been possible to pay back all the Debt built up during a long inflationary spiral. How this Debt is ultimately dealt with will determine whether response to the threatened debacle will be inflationary or deflationary.

In his explosive book, *The Coming Currency Collapse*, Jerome F. Smith says he expects government to try to print money to deal with the crisis. He describes an inflationary depression as follows:

"In real terms, an inflationary depression is indistinguishable from a deflationary depression. In both cases production and incomes decline in real terms; in both cases liquidity problems proliferate; in both cases widespread bankruptcies occur. The distinction between a deflationary and an inflationary depression is this: in a deflationary depression, production, incomes, and living standards generally decline both in real terms and in nominal money terms; in an inflationary depression, production, incomes, and living standards generally also decline in real terms while at the same time all of these show increases in nominal money terms."

A hyperinflationary depression could wipe out almost everyone whose assets are in dollar-dominated bank accounts, pension funds, insurance programs, S.&L.s, and government bonds.

The "deflationists," however, maintain that deflationary forces will outrun inflationary bailout attempts. Deflation, a decrease in the money supply and a consequent increase in the purchasing power of the monetary unit (dollar), would come about as massive bankruptcies liquidate huge amounts of credit money. In a credit-based economy such as ours, each liability of a borrower becomes someone else's asset. When a debtor defaults on a note, the note holder (such as a bank, money-market fund, or an individual) loses an asset. Money is thus wiped out, extinguished, gone.

Among the events which could trigger a financial collapse are a panic in the money-market funds; a real-estate crash; and, a wave of major corporate bankruptcies. This year the number of business failures in the U.S. has gone nearly beyond the record-level collapses that occurred during the Great Depression.

Martin Weiss, author of *The Great Money Panic*, spells out why, in his opinion, any attempt at inflating our way out of the crisis would backfire:

"Those who believe that the Fed can print us out of this whole mess and bring on hyperinflation are dead wrong. The credit markets provide the cash life-blood to everyone. Without credit markets, the government itself goes out of business. And that's almost what happened in February-March of 1980, when even a small lot of $5 million in government securities could not be marketed. The bond traders — at Merrill-Lynch, Salomon Brothers, Goldman-Sachs — called the Treasury Department and said, 'We can't sell your bonds.' The Treasury Department turned to the President and said, 'We cannot raise the money. We must do something to revive the bond markets.' And at that time it meant purposefully to precipitate a sharp decline in the economy. In other words, yes, the government can create cash money — but it cannot create the confidence needed for credit money.

"They are underestimating the importance of credit money which is over ten times larger than cash money. At the end of June we estimated the total debt to be about $4.8 trillion — that includes about $1.5 trillion in mortgage debt, over $1 trillion in government debt, and about $2.5 trillion in corporate debt, consumer debt, and bank debt. If they tried to print us out of this, the more cash money they print, the more credit they lose.

"The Fed buys government securities by printing money! It pumps the money into the bond market. The bond dealers deposit this new money in the banks and at the end of the week it pops up as a major increase in the money supply. Next, the bond owners, creditors, and bankers — hypersensitive to jumps in the money supply — dump their holdings, and we get a net decline in the value of the credit outstanding, which is greater than the increase in the cash money supply. For every new paper dollar they put into circulation, they could lose as much as ten dollars in the value of the credit outstanding."

So deflationists insist that loan demand is too low for an inflationary bailout to work. They believe that it won't do any good for the Fed to create new money if the bankers can't find anybody to borrow the newly created reserves. They claim it would be like "pushing on a string."

James Blanchard, writing in the September 1982 issue of *Gold Newsletter*, responds to this view as follows:

"What these analysts are forgetting is that bankers will not leave newly-created money lying idle even if there's no demand for money from corporations. Remember that banks can create credit at a ratio of seven times new reserves, and if business loan demand is off, banks can simply buy U.S. government or state securities, thus having the same inflationary impact as a large increase in commercial loans. This is a fundamentally important point to remember because it explains one reason the deflationary scenario is invalid.

"But what is just as important is that we believe that the slowdown in the rate of growth in business loans, which was experienced in July and August, has already begun to reverse itself as corporations realize that a new inflationary policy has begun in Washington. In such an environment, business is going to pick up dramatically as corporations stumble over themselves to borrow more money, thus helping the Fed to inflate the economy. In short, recent Fed actions have merely confirmed for all to see that we're in a new *reflationary* environment."

Howard Ruff, another well-known forecaster of more inflation, denies that a bond market collapse and massive bankruptcies would plunge the nation into a deep inflation. He comments, "That happened in Germany in the early stages of their runaway inflation. It was not deflationary. All it did was create a tremendous demand for paper to supplant credit. We have a credit economy. There is a process by which you go from a credit economy to a printing-press economy. In my opinion, the government won't let a deflation happen. I think they will freeze everything until they can print enough money and rush it to the rescue. They'll have legislation to stop bankruptcies. They will do what's necessary until they can rush that money out there, because they have got to inflate or die!"

Investment advisor Larry Abraham told us in a recent telephone interview that he is another who doesn't believe the big financial institutions, which are the main bondholders, would panic out of the bond market as Martin Weiss suggests. Mr. Abraham observes: "One of the problems I see with Martin Weiss's contention is that most of these bonds are being held by the very same people who would be part of the bailout — and I don't think they would rush to destroy their own position. They would be slicing their own throats . . . . Those who have pushed, and who continue to push, a massive deflation scenario are going to have faces looking like Egg McMuffins."

Yet many top market watchers remain on the other side of this doomsday debate. The highly respected financial expert James Dines has gone so far as to stake his reputation on the notion that we are heading into a devastating deflation that cannot be bailed out. Nicknamed the Original Gold Bug, Mr. Dines believes the triggering of a rapid slide into a full-scale deflationary depression could come as a surprise which would catch the economy off guard, that the Federal Reserve could not crank up the money supply quickly enough, and even if it did it would not be enough to bail out all the cash-hungry debtors.

"Some big banking failures could come along by surprise, and a spark could start a wave of bankruptcies. After all, when banks are going bankrupt, the first thing they're going to do is go through their loans and say, 'You — We're not going to renew your loan.' Or, 'You — We want our money back right away.' Where are you going to get cash? There will be this scramble for liquidity."

Mr. James Sibbet, editor and publisher of *Let's Talk Silver & Gold*, is on the side of those expecting runaway inflation in the 1980s. He points out that the last seven recessions have been inflationary, not deflationary, and that both interest rates and the Consumer Price Index have steadily increased over the last twenty years. He states: "There has been no deflation in any of them [*the last seven recessions*]. Why should this one be different? It will be different in that in this one, inflation will run away, because the Fed will have to monetize the whole national debt and much private debt as well to prevent financial collapse. This will create a money lenders' panic. The die is cast. The last inflation has started."

It must be said that the "inflationists" seem to be winning the argument. Today, the monetary authorities have more sophisticated ways of increasing the money supply. Modern computers permit an increase of credit units in the form of electronic impulses. We must also not forget that the Monetary Control Act of 1980 gives tremendous new inflationary powers to the government and the Federal Reserve — powers which they did not have in the 1930s. The government has already established a pattern of bailing out problem debtors: New York City, Penn Central, Chrysler, Poland, and Mexico. All this sets up a precedent which other debt-heavy firms and foreign governments can point to when they request a "rescheduling" of their debts.

Moreover, our own government's deficit-spending is stupefying — building up a total Debt which is larger than the combined Debts of all the nations of the world. Federal Budget deficits of $200 billion or more per year are beyond the capital generating ability of the American economy, held down as it is by inumerable political controls, regulations, and taxes. This means that huge chunks of these deficits will have to be funded by having the Federal Reserve "purchase" Debt securities from the Treasury by creating new phony money. The greater the Debt, the greater the potential for runaway inflation.

None of this means, however, that a deflation is necessarily out of the question. It is possible that in response to continuing crises the economy could go through a temporary deflationary interlude before the inflationary bailout of the Magic Money Makers takes hold and drives the nation into hyperinflation. Only a fool or a gypsy with a crystal ball fails to hedge his bets.

Those foreseeing a long-term, gradual slide into an increasingly severe economic debacle tend to believe that the government, the monetary authorities, and the international bankers have the power and will to cope with the various Debt crises as they arise — patching up and staving off with stop-gap measures until an orderly but inflationary bailout can be effected. On the other hand, those like James Dines who predict a massive deflation are also, generally speaking, those who believe that any crash will come as a sudden, lightning-bolt event — a precipitous fall triggered by something comparable to the Stock Market Crash of 1929.

Today, debt pyramids abound. Among the events which might conceivably act as triggers of an overnight tragedy are: a sudden surge of major corporate bankruptcies; a money-market fund panic; a bond-market collapse; a real-estate crash; a Middle East crisis resulting in the

The staggering level of Third World Debt could bring the international bankers to their knees. Mexico owes Western banks more than $81 billion; Romania owes over $10.2 billion; Hungary owes $7.8 billion. Poland alone could topple the financial system by forcing a default on $17 billion owed to the Western banks.

Saudis pulling their funds out of the major banks; a grass-roots run on the banks and S.&L.s; or a concerted Third World or East Bloc debt default.

Major Corporate Failures

Since the end of World War II a tremendous quantity of credit has been extended by our fractional-reserve banking system to corporate borrowers. Simultaneously, the financial soundness of these debtors has steadily deteriorated. On average, corporate liquidity has been declining, while corporate debt has mushroomed to mammoth levels. And these debts are coming due at increasingly shorter periods of time. During a liquidity crunch, the cash just isn't there to meet such debts. For instance, Ford Motor Company has only fifteen cents in cash for every dollar of its short-term debt coming due. Sears has less than six cents. Virginia Electric Power has less than half a cent in cash and equivalents for each dollar of its short-term debts. When interest rates peak again, you can count on astounding numbers of bankruptcies.

Already this year the number of business failures has nearly gone beyond the record-level collapses that occurred in the Great Depression year of 1933. According to Dun & Bradstreet, an estimated 657 commercial and industrial firms closed down or sought court protection under the federal Bankruptcy Code during the second week of September. This pushed up the total business failures for the year to 17,502, which was already the highest since 1933 when 19,859 business collapses were recorded. Which means that, to mid-September of this year, business failures averaged a whopping 473 per week, the highest weekly average in fifty years!

Despite temporarily lower rates of interest, many large business enterprises are dangerously over-extended and face severe liquidity problems now and in the coming months. The economic system is healthy as long as there is real liquidity — as long as lenders have enough capital in the form of saved wealth to lend, and as long as borrowers have the ability to repay those loans. The problem is, as more individuals, corporations, and governments borrow more than they take in as revenues, there is less capital for further lending and to repay previous loans. At the same time, saving (capital accumulation) is choked by inflation, taxes, and regulations.

As our capital is used up, the liquidity squeeze could well produce widespread bankruptcies in numbers never seen before in history. That would cause a banking panic as businesses defaulted on their bank loans. Of course the Fed and the government would try to bail out the situation by injecting artificial liquidity into the system in one way or another, and this could keep the banks from crumbling; but America's standard of living would assuredly decline.

We expect the failure rate among American companies to increase in the coming months, but the current drop in short-term rates of interest should eliminate a wholesale collapse during this phase of the business cycle. It is when interest rates peak again, as they inevitably will, that the crisis will come.

Money-Market-Fund Panic

Money-market funds are mutual funds which pool investors' cash and place it in large-denomination, short-term, highly liquid money-market instruments such as the federal government's Treasury bills (T-bills), large Certificates of Deposit (C.D.s) from banks, and the I.O.U.s of major corporations. When you put your money into an M.M.F., you are really purchasing shares of the fund, which in turn invests in the short-term securities. Money-market funds developed as a result of high interest rates during the 1970s and because of a little horror called Regulation Q, a politically imposed ceiling on the interest rates that banks and S.&L.s could legally offer their customers.

As your correspondent pointed out in the June 1980 issue of this journal, Regulation Q was instigated at the behest of the powerful banking lobby to eliminate Free Market competition within the industry and to keep lending costs low at the expense of savers. The banks were "allowed" to pay up to five percent and the other thrifts were "permitted" to offer up to 5.25 percent — levels well below market interest rates. The banks and thrifts loved this arrangement. They were borrowing from their savers at five percent and lending at ten or twelve percent — raking in the difference. The development of money-market funds, which are not subject to Regulation Q, represented the Free Market's end-run around this banker scheme.

Money-market funds have come to the rescue of small savers who could not afford to buy Federal T-bills (sold in the minimum denominations of $10,000) that carry market rates of interest. By pooling his money with others in an M.M.F., a small saver can earn a return nearly as high as someone with millions of dollars to invest. And he doesn't have to tie up his money for any great period of time to do so.

Not only do M.M.F.s have the advantage of much greater liquidity and higher yields when short-term rates are high, but some are safer (and more private) than banks and S.&L.s. If a large-scale banking panic occurred, accounts of depositors might be frozen by the government. The safest M.M.F.s — and the only ones recommended by Doug Casey, Gary North, and most other hard-money advocates — are those which invest *only* in federal government debt instruments (Treasury securities and obligations of government agencies) and *not* those investing in bank C.D.s or commercial paper.* Casey explains that "shares in a money-market fund invested solely

*According to Casey, "About 36 percent of money-market funds' assets are currently in commercial paper, 37 percent in CDs, and 10 percent in ICDs (International Certificates of Deposit). The fund you invest in should have 0 percent in any of them."

in U.S. government paper are in effect backed by the folks who actually print the money. There's no better assurance that when you ask for a dollar you'll get a dollar. There's no assurance what the dollar will be worth, of course, but that's the point of getting high interest rates in the first place — which brings us full circle. For practically every safety reason, you're better off with properly selected money-market funds."

But what about those M.M.F.s — the vast majority of them — which invest in the riskier debt papers of banks and cash-starved corporations? Douglas Casey and other analysts (such as Julian Snyder, Richard Russell, and Harry Schultz) see potential peril in this group of funds. In his August eleventh issue of *Dow Theory Letters*, Richard Russell predicts that problems in the banking community will ultimately "panic the public and the result will be a frightening run on the money-market funds."

Part of the fear of a potential money-market fund panic comes from the observed spectacular growth in M.M.F.s — from only $4 billion in early 1978 to a staggering $200 billion today! In his new book, *Strategic Investing* Doug Casey summarizes his concern over the situation as follows:

"The money funds have grown like Topsy over four years. Their growth can't continue at its present frantic pace, for within a few more years the entire net worth of the U.S. would be tied up in short-term obligations. It's going to end. The only question is whether it will be with a whimper or a bang. My guess is the latter.

"It will be interesting to see what happens when a few funds (actually it's likely to be more than a few when it happens, since most hold the same type of paper) experience some defaults. After some assets are wiped out, the public will start redeeming en masse, which will have unpleasant consequences for the banks and corporations that have been counting on this pool of funny money to keep rolling over their paper. The default of a few borrowers could cause a credit crunch of unbelievable proportions as other corporations looking to the funds for cash find there's none available. And that would bring on more defaults, which would bring on even more, and so on, ad bankruptian . . . .

"There's also no way of telling what shareholders would do with money they salvaged from troubled funds under those circumstances, but it's unlikely they'll put it back into the banks; more likely they'll try to cash their redemption checks for Federal Reserve notes at the teller window, which will further compound the crisis, since banks don't keep a lot of cash on hand. If the Fed responds by printing up enough currency to meet demand, what started out as a 1929-style deflation could end up as a 1923-style hyperinflation. Either way, shareholders of the wrong funds will become bagholders."

Although the money funds have attracted billions of dollars that might otherwise have gone into bank deposits and savings accounts, a significant portion of this money has been recycled into the Big Banks by investing in their large certificates of deposit. According to William Donoghue's *Money Fund Report*, the ten largest M.M.F.s — out of a current total of 255 — hold $24.7 billion in bank C.D.s. Banking officials are jittery over the possibility that the funds will suddenly withdraw from these major C.D.s and cause a financial panic that would smash the banks.

Indeed, some of this kind of action has already occurred. This summer, following the collapse of Oklahoma City's Penn Square Bank, several money-market funds pulled hundreds of millions of dollars out of Chase Manhattan Bank and Continental Illinois National Bank and Trust Company of Chicago, and have refused to renew deposits after maturity. Chase, the nation's third-largest bank, and Continental, the nation's sixth largest bank, then had to pay much more than other banks for their deposits.

This contributed to the growing problems of foreign loan losses already sustained by these banks, and was partially responsible for both of these megabanks reporting a second-quarter after-tax operating loss this year. That was a dramatic revelation in financial circles because it was the first time in recent years that any of the top ten banks had reported a quarterly loss. Moreover, the Chicago Board of Trade, the world's largest commodities exchange, removed Chase Manhattan from its list of banks whose C.D.s are deliverable against domestic futures contracts.

The system was not overturned by all this, but many are worried about what could happen when interest rates run up again. The banks are running scared, especially the large banks which depend on M.M.F.s as an important source of deposit money.

It is true that money-market funds have enjoyed incredible growth at rates which cannot be expected to continue. It is also true that shaky banks or corporate failures could result in significant defaults on the debt paper held by most M.M.F.s. It should be pointed out, however, that unlike the stock market of 1929 the money-market funds are not leveraged pyramids. Howard Ruff, writing in the October 9, 1981, issue of *The Ruff Times*, explains: "The stock market of 1929 was leveraged. A decline of 5 percent would wipe out the entire investment of all those who had bought stocks on margin (which was just about everybody), triggering margin calls and forced liquidations. It was the prospect of forced liquidations of inflated securities that caused the huge run. The money-market-fund situation is simply not parallel. No one is margined. The securities in the funds' portfolios are 100 percent owned by the investor. Investors could not be forced to sell by any market decline. The only people forced to sell would be those who have a need for the funds for reasons unrelated to the investment itself. There is no chance of a domino margin-call collapse as we experienced in 1929."

But even though M.M.F.s are not inflation-driven leveraged pyramids like the 1929 stock market was, most of them are potentially vulnerable to defaults on the assets they hold from the riskier classes of issuers (banks and corporations). Defaults on debt instruments held by money-market funds could result in panics and runs which might be traumatic enough to destabilize the entire financial structure in the nation.

The Real-Estate Crash

Unlike the money-market fund phenomenon, the real-estate boom of past years *does* resemble the stock-market boom of the 1920s. In fact, real-estate buying has been even more leveraged than the stock-market of half a century ago. Stock buyers, moreover, generally bought stock with cash in order to hold for the long term and receive dividends. Today, and especially during the 1970s, real

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property is not purchased for cash but bought on margin through mortgages. It has been possible to buy land for less money down than it would take for a commodities future contract of the same value. Buying grain futures on ten percent margin is generally considered speculative, while buying land on even less margin has been considered a "sound investment." This was based on the assumption that the value of real estate must necessarily continue to rise.

More fortunes have been made in real estate since World War II than by any other method. It has been touted as a tax shelter, an investment, and an inflation hedge. But the surge in real-estate prices was bid up by a veritable orgy of speculative buying. This was made possible by tremendous amounts of borrowed money churned out by our inflationary banking structure. Just as the Federal Reserve pumped up the stock market to dizzying levels in the 1920s with its easy credit policies, injections of funny money into the S.&L.s and banks inflated the expanded real-estate balloon.

That balloon couldn't continue to expand forever. In several areas of the country a mad scramble has already begun to get out of the housing market as values sag. Unfortunately for many owners, selling has become much more difficult as fewer and fewer people can afford to buy at the high mortgage rates we have seen. The party could be winding down.

According to the *U.S. News & World Report* for September 13, 1982, mortgage foreclosures have soared 65.6 percent over last year's figures. Twenty percent of all mortgage payments in the U.S. are at least thirty days overdue. Thomas Harter, chief economist for the Mortgage Bankers Association, estimated that 100,000 to 140,000 homes were taken over by lenders in the first quarter of 1982 alone. And, despite somewhat lower mortgage rates, the situation could well get worse in the early years of this decade. A crash of most real-estate prices — especially in the big cities — might even take place over the next few years, perhaps bottoming in the mid-1980s.* There will be great bargains for those who can take advantage of them. But the decline could be awesome!

Like other debt-related pyramids, any real-estate collapse will threaten to bring down the banks and S.&L.s. But, since the government will fight any deflationary spiral, an inflationary bailout is likely in one form or another. Douglas Casey writes that the signal for the bottom of the real-estate market — and the beginning of a new boom — will be the creation of new government mortgages to make housing "more affordable" for families and to save the S.&L.s loaded down with nonperforming mortgage loans on their books. Pointing out that it is foolhardy to underestimate government's ingenuity when the support of the voters is at stake, Casey forecasts the following possibilities:

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*The hardest-hit areas of the country will be those where the biggest speculative booms occurred. *Barron's*, viewing the collapse of farm prices and flattened-out California real estate, comments that, "Creative financing of four years ago has turned into creative bankruptcy, as record numbers of Californians default on mortgages." Harry Schultz quotes mortgage banker William Heath as stating: "Californian real estate is a catastrophe waiting to happen. California is where the New York Stock Exchange was in 1929 — homes bought on margin. It's the 1930s, only this time Californians will be heading for Oklahoma." Schultz predicts that Texas real estate is next in line for bubble-busting. Especially office buildings.

"The VA and FHA might get a mandate to make more and larger mortgages available to bull the market up. Or, perhaps, the Fed or the Treasury will offer some kind of cash aid or tax benefits to banks and thrifts to enable them to grant mortgages on 'affordable' terms. They'll need aid desperately to keep from failing anyway."

Third World Or Red Defaults

Two-thirds of all private loans made to nations that are not exporting oil are concentrated in the hands of only five major banks. Among these institutions, the paper profits made on loans to Less Developed Countries (L.D.C.s) often account for over half of each bank's net income for the year. A series of L.D.C. defaults could lead to a tidal wave of banking collapses. Citibank has loaned out to Third World governments over two hundred percent more than its assets, or enough to wipe out its entire shareholders' equity twice over. The other major banks are in a similar situation.

Mexico is in the deepest debt — over $81 billion. At least $22 billion of that total is owed to fifty-five U.S. banks, with $12 billion of this owed to the Big Six banks of New York: Chase Manhattan, Citibank, Manufacturers Hanover, Morgan Guaranty Trust, Chemical Bank, and Bankers Trust. When, in August, Mexico was on the verge of formal default, representatives of one hundred bankers held an emergency meeting at the Federal Reserve building in New York. They decided to "reschedule" Mexico's payments which amount to some $10 billion that was due this year. In addition, the central banks of the world and the International Monetary Fund are sending billions to the People's Republic of Mexico for a temporary bailout. All of this, however, will not be enough to keep Mexico afloat.

The Mexican mess was only the proverbial tip of the iceberg. If you add together the debts of Poland, Mexico, Brazil, and Argentina, you have something like $220 billion in unrecoverable debt. Keep in mind that this is for only four countries; it does not include the other L.D.C. or East Bloc debtors.

Romania is in debt to the tune of over $10.2 billion, and is now demanding that its 1980-1981 past-due debt payments be stretched out for another 6½ years, with no payments for the next three years. Hungary owes $7.8 billion and is also asking for a massive rescheduling. Yugoslavia can't or won't pay its debt of some $4.2 billion and is demanding even more loans. Poland, acting alone or in concert with other Soviet satellites, could topple Western banking by forcing a default on its debt of some $17 billion owed to more than five hundred Western banks.

It is inconceivable that the bankers didn't know what they were doing when they made these risky loans. They evidently felt confident that they could get the U.S. Government and the Fed to underwrite their bad decisions. They surely know which nations are in trouble and can see the crises coming. But the central banks should be able to implement some sort of patchwork to hold it all together until a somewhat orderly inflationary bailout can be instigated. This will mean a gradual slump into an inflationary depression if it works. But if the paper printers can't juggle these debt time bombs, and make a slip, the situation will get totally out of control.

So What Happens Now?

Any of the above crises could cause a run on America's financial institutions. Banking is connected to all of them through the debt markets. We could have a surge in major corporate bankruptcies; a money-market-fund panic; a real-estate crash; or a chain of foreign-debt defaults. No one of these potential crises can occur without setting off a banking debacle. No one really knows what the next crisis will be. A large bank failure in Germany, for instance, could start a chain reaction which would have such far-reaching ramifications that it could topple the U.S. banking system. Central banking and global debt pyramids have made the world a far more complex and dangerous place.

Readers of AMERICAN OPINION know that many of the major decisions in the world are made by elitists of the Aristocracy of Pull. But it's a big world out there. In these complex times there are more strings than any single group of men could possibly control. While it is probably true that our Establishment *Insiders* have in the past created wars and depressions for their own benefit, these things happened in the days when such trauma could be somewhat localized. Given today's "interdependent" global economy, it is no longer easy to keep a major crisis localized. Everything affects everything else.

It's one thing for an arsonist to burn down a building with a gallon of gasoline. But if there are hundreds of thousands of gallons of gas lying around in open pools, whoever lights a match can burn down a whole city — with him in it. Which is why we believe the *Insiders* probably do not now wish to try to facilitate a major financial crisis. The probability of backfire is just too great. They want to prevent *any kind* of widespread panic or collapse. Even they must have sweaty palms.

What is now likely is that, without a major turnaround in the collectivists' control of our government, and a freeing of the marketplace, our economy and standard of living will continue to erode with periodic rallies within the on-going trend of more inflation. The monetary authorities will bail out the debt crises as they become more and more frequent and scary.

Nevertheless, there is always the X-Factor: some unforeseen watershed event or panic which can neither be planned for nor controlled. If the crises come one at a time, the situation can probably be handled without having an overnight plunge into economic oblivion. But this will be at the cost of loading the economy with more and more inflation. In addition, psychology plays an important part in this. While the American people are still in a narcoticized state of ignorance and trustfulness, any of the above-discussed financial panics and earthquakes could throw millions of people into emotional hysteria. What might happen then is anybody's guess.

In the meantime Americanists who love our country must work as never before to replace the Federal Reserve System with a gold standard, stop the underwriting by our government of new bad loans to the bankrupt L.D.C.s and the Reds, eliminate the capital gains tax to encourage a heavy move into market investments, and free our great economy to *produce* its way out of economic disaster beyond the experience of any living American. ■ ■

CRACKER BARREL

■ Ted Kennedy has based his entire political career, explains John Brennan, on the principle that the average voter cannot remember a thing that happened before yesterday noon.