Click here for Full Issue of EIR Volume 7, Number 35, September 9, 1980

A new stage in Carter's 'controlled disintegration'

by David Goldman

In background discussions over the past week, New York-based investment and commercial bankers, and Washington officials responsible for international monetary matters, stated that a banking consensus had been reached:

1) That Persian Gulf oil production had to be cut back to ensure a stable and rising oil price—contrary to Saudi Arabian efforts to lower the world price of oil, reported last week in *EIR*;

2) That the Saudi regime itself would undergo a destabilization similar to the Iran pattern, either through an actual internal destabilization or through a "preemptive" American occupation;

3) That developing-sector debtor nations would be cut out of the reduced flows of international capital and energy resources, with a major international financial crisis as the result.

Within a period bounded by October and January, senior officials of several of the top institutions in New York predicted, the industrial world would enter a new phase of "controlled disintegration," to use the phrase coined by British economist Fred Hirsch in one of a series of documents entitled *Agenda 1980s*, published last year by the New York Council on Foreign Relations.*

Battling against cheaper oil

Secretary of State Edmund Muskie officially launched the destabilization of Saudi Arabia in a bitter attack against the oil-producing countries Aug. 25 at the United Nations, before a Special Session of the U.N. General Assembly in New York.

"The hidden agenda item at the U.N.," a member of the American delegation told *EIR*, "is energy. The point of Muskie's speech is to convince the developing countries who don't produce oil that they should line up with the industrial countries against OPEC." In reality, breaking the erstwhile support the OPEC countries have had from the developing countries' Group of 77 would isolate the Saudis and clear the way for destabilization of the Saudi regime by Iranian, Libyan, and other "radical" elements within the Arab world—on the pattern of the overthrow of the Shah.

Although Muskie challenged the oil producers to stabilize oil prices, the U.S. administration and most leading U.S. commercial banks are in fact trying to prevent the Saudis from bringing down the price of oil.

By continuing high production levels despite the dropoff in oil demand this year, the Saudis have brought the spot market price of oil to less than $30 per barrel. If the trend continues, the elaborate structure of energy autarky investments sponsored by the Carter administration and the large oil companies will crumble—since it depends on continuously rising oil prices. The beneficiaries of the Saudi action would be Western Europe, which is committed to a cheap-energy posture based on nuclear power.

We reported last week that a number of institutions, including the World Bank and the Chase Manhattan Bank in the private sector, had programmed into their internal operations and forecasts a drastic cutback in oil supplies, from 17 million barrels per day to only 9 million barrels per day from the four major Persian

© 1980 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Gulf producers, notably from Saudi Arabia.

The implications of such a reduction in supplies are devastating, but they have been fully appreciated by the institutions who propose to implement such a reduction. What the "consensus scenario" in New York and Washington promises is the final realization of the "energy shock" proposed for the industrial countries in March 1979, at a meeting held at former New York Governor Averell Harriman's Arden House estate.

In response to the question, "What are the risks of an interruption in Persian Gulf oil supply?" an internationally known economist at a top New York commercial bank had this to say:

> Let's turn that around. The risk is that there will be no interruption of oil supplies. The spot market oil price has fallen [to less than $30 per barrel—dg] to less than the contract price, demand is weak, and this is happening without evidence of a quick agreement among OPEC members to cut production. The Saudis are in the middle of this.
>
> There has to be a reduction in oil supplies to avoid a convulsion in, or a breakdown of, the OPEC cartel. Now, there are some in this bank who would prefer a drop in oil prices. There are as many vested interests in this bank as there are customers. However, any deviation in the basic trend in oil prices would upset those concerned with world money markets.

The banker continued:

> To sustain the contract price of oil demands substantial production cutbacks. The game is really over the Saudis' long-run price aim. For the next two years, they have dominance over world financial markets.
>
> If they want to continue an uptrend in the real price of oil, they will have to jack up their price and eliminate the two-tiered price system [which has prevailed for the past year–DG] and make sure the other OPEC members [who have higher prices than the Saudis–DG]do not. The ability of the other OPEC members to do anything with the price of oil is nil. Therefore, it is a political question for Saudi Arabia.

"What should be done?" the banker was asked.

> The corollary is that we should move into Saudi Arabia fairly early—do what we used to call in the old nuclear warplanning days a "preemptive strike." It's better to go in now before the trouble gets out of hand.

At a private briefing for senior staff of the leading New York investment bank Goldman Sachs, former Secretary of State Henry Kissinger predicted that Ronald Reagan will, if elected, launch an invasion of the Persian Gulf within two months of taking office.

The ostensible purpose of the invasion, Kissinger said, would be to retrieve American hostages in Iran. "Carter should have done this within two weeks after the hostages were taken," Kissinger told the bank, which retains him as a foreign affairs adviser. "The Soviets respect American conservative governments more than liberal governments which they have to psychoanalyze."

The same predictions are not merely current, but integrated into policy planning, and oil and financial projections, at Citibank, Chase Manhattan, Morgan Guaranty Trust, and other New York banks, and at the World Bank in Washington.

The repercussions of a shutoff of oil supplies would be devastating for the world financial situation, bankers add. A senior partner at one of New York's leading investment banks says: "This is a time to be liquid and short. There is a fundamental tension in the Mideast situation. The international banks are stretched to the limits. Major problems are hitting the LDCs [less developed countries]. Any interruption of oil supplies would create a major problem for some of the big LDCs, and lead to an international financial crisis, due to the overextendedness of Eurodollar loans."

Very suddenly, some who have been warning of the collapse of developing-sector credit in the past have raised their voices shrilly again. Sen. Jacob Javits, who campaigned in 1978 for major backstopping for the $300 billion of developing-sector debt through the international institutions, is telling Senate colleagues that he may have been premature in predicting the worst for Third World debt, but he was not wrong. Javits drives home his point by citing recent private discussions with Chase Manhattan Bank chairman David Rockefeller and Citibank chairman Walter Wriston, who reportedly told him that the refinancing of the Third World "can't hold."

In an editorial Aug. 25, the London *Financial Times* proposed one scenario for the breakdown of Third World debt payments:

> The gloomy forecasts for the 1980s produced by the World Bank last week underline the importance of recycling the capital surpluses of OPEC countries and of ensuring adequate flows of funds to the developing world. . . . For these countries to service their bank debts over $250 billion, it is crucial for them to be able to sell in the markets of the North. . . . But the danger remains that, preoccupied with internal problems, Western countries will increase protectionism or react like Britain in

cutting aid or like the U.S. Congress in long resisting fresh appropriations for international development agencies.

The point for the developing sector, however, is that a crisis is programmedinto the next six months—given trends in the world financial system—whether or not the intervention of adverse events such as an oil shutoff or protectionist trade barriers starts a crisis.

The only reason that countries such as Brazil, the Philippines, and others did not run into an impossible payments bind during mid-1980 is that dollar interest rates fell by half between April and June, from almost 20 percent at the peak to under 10 percent. That is the difference between $50 billion and $25 billion in annual interest charges on Third World bank debt.

However, the rise in interest rates—continuing through the next several months—will create insufferable conditions by the year's end (see Banking).

There are, indeed, major indications that Euromarket institutions are girding for a liquidity crunch and a crisis.

During the past month, banking sources say, commercial banks have suddenly increased their issue volume of certificates of deposit, short-term money market paper that banks use to raise funds. To a great extent, the issue volume of such paper is responsible for the rise in the interest rate on CDs by more than two percent during the past two weeks.

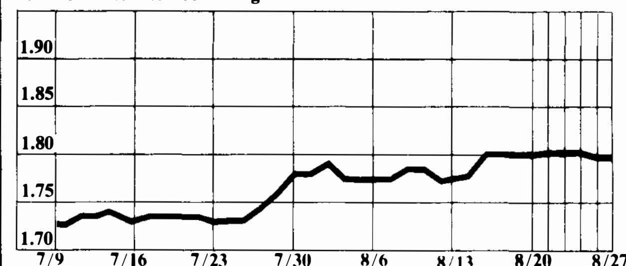
"There has been some pickup in lending," a commercial bank economist explained, "but the banks are rushing to the money markets for the same reason that corporations are rushing to the credit markets—they are afraid that it will be much more expensive to get not very long from now. It may well be that the rush to get liquidity is related to the international strategic situation."

On the international markets, gold has been the beneficiary of the unstable Polish and Mideast situations, and is likely to continue to be. At *EIR*'s deadline on Aug. 27, it stood at about $635 in all the leading markets. West German bankers, who believe the dollar's underlying value is less than the current market price of DM 1.80, worry that both gold and the dollar will rise together for the moment—because an interruption of Mideast oil supplies would devastate the Western European economies.

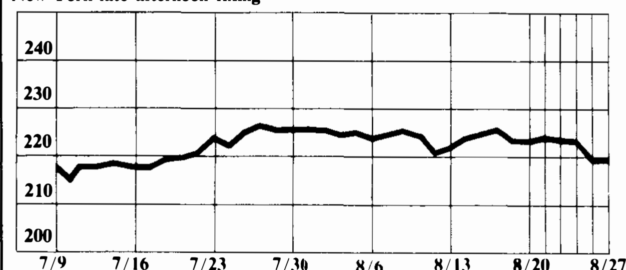
*"A degree of *controlled disintegration* in the world economy is a legitimate objective for the 1980s and may be the most realistic one for a moderate international economic order. A central normative problem for the international economic order in the years ahead is how to ensure that the disintegration indeed occurs in a controlled way and does not rather spiral into damaging restrictionism," wrote Fred Hirsch, Michael W. Doyle, and current State Department official Edward L. Morse in *Alternatives to Monetary Disorder*, published by McGraw-Hill in 1979. The "controlled disintegration" vantage point was endorsed by Federal Reserve Chairman Paul Volcker in a series of speeches starting with a commencement address at Warwick University in January 1979.

Currency Rates

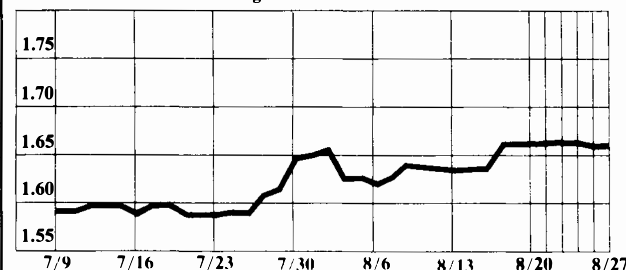
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing