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Bankers caught in their own flight-capital game

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Mexican President José López Portillo's warning in his historic Oct. 1 United Nations speech that "flight capital" had run the world monetary system out of control was substantiated in depth by a June report of the Organization for Economic Cooperation and Development. The OECD paper, which underestimates the importance of the $150 billion volume of illicit money flows, is nonetheless the first official recognition by an international organization of the magnitude of the problem.

The OECD paper, noting that $71 billion of world payments deficits *remain uncounted* by the world's governments and international agencies, indicates the existence of a "Fourth Sector of the World Economy," as the OECD calls it. Apart from the industrialized, oil-producing, and developing nations, there is an "offshore" sector with resources now in excess of OPEC's surplus earnings.

Mexico's debt crisis, which forced to world attention the fact that $50 billion dollars of short-term debt accumulation among Ibero-American nations during the past two weeks had turned into American real estate or foreign bank accounts, which funds neither the countries nor their bankers would ever see again. Neither Mexico nor Venezuela nor Argentina, the principal victims of flight-capital operators, had "over-borrowed" in traditional economic terms, i.e. for purposes of covering imports, or even for paying debt services at trebled interest rates: the largest single component of their borrowing was to permit their own nationals to convert easily available local currency into dollars for investment abroad.

Mexico shut down this operation Sept. 1 with the nationalization of its banking system and the imposition of exchange controls; Venezuela must do the same or face a Mexican-style devaluation; and Argentina's former Economics Minister Martínez de Hoz is now on trial for encouraging this process for his and his associates' personal gain.

Yet it was the bankers who, above all, demanded of these countries that they allow removal of capital. The bankers, who must accept massive default, in some form, on Ibero-America's $300 billion foreign debt, dug their own grave. In some cases they made gigantic amounts of short-term credit available to banks of Ibero-American countries, including a $6 billion line to Venezuela's banks alone, to enable these banks to change their customers' local currency into dollar-denominated flight capital.

Neither the countries nor the banks benefit; indeed, the banks may have pushed the situation over the edge of manageability. Who, then, benefits? In a July 21, 1981 feature, *EIR* linked the then-fresh "Propaganda 2" scandal to an international network of flight-capital operators centering on old European, initially Venetian and Genoese, *fondi*, or family trust funds. Of the $300 billion "base" of the $1.9 trillion Eurodollar market (the gross sum represents multiple relending of the same funds), about $120 billion represents such family funds. "The bulk of Eurodollar deposits is not from Arabs or multinational corporations," says former Citibank Vice-Chairman G. A. Costanzo. "It is personal wealth. If we want such money we ask them for it and, if we offer them the right interest rate, they will give it to us."

The emergence of the *fondi* in the form of wealth that might skip the border of the country that produced it and reappear as Houston real estate or Swiss bank accounts begins with the post-1971 "deregulation" of world banking into

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offshore centers out of the supervision of any government. In parallel, what the June OECD study called "The Hidden Economy" within the domestic economies of all major nations grew, serviced by the offshore money outlets.

By September 1980, when the apostles of free trade convened for the annual *Walpurgisnacht* of the Mont Pelerin Society at Stanford University, Count Max von Thurn und Taxis, the Society's permanent secretary, delivered the keynote address on this subject. What Thurn und Taxis, a member of Europe's biggest land-owning family (and the family that created the original Bavarian Nazi Party) told the Mont Pelerinites, whose leaders include Milton Friedman and Friedrich von Hayek, was that the hitherto "underground economy" must force its way to the sunlight. In its own fashion $50 billion of it did in Ibero-America alone during the past two years.

In direct response to President López Portillo, Secretary of State George Shultz told the same United Nations session that the precondition for global prosperity lay in the code-words "open economy" and "free trade," i.e. tolerance by victim-nations of the flight capital phenomenon that the Mexican President had denounced. The Mont Pelerin Society program had, within two years, become the sine qua non of American foreign economic policy.

The Latin American case

Official accounts place flight capital outflow from Mexico in the 1981-82 period at $20 billion; from Argentina, $8.25 billion (only 1981) and from Venezuela, $22 billion. In these cases, around 40 percent of this outflow was intentionally financed by short-term direct international bank loans, to force the rest of the 60 percent to piggyback its way out with the loaned-out funds.

Mexico: Until 1982, Mexico's economy was growing at an 8 percent annual rate; this year, it is expected to grind to a zero growth rate. Until 1979, Mexico's debt was growing at a fixed rate of $3 billion annually and the ratio of private-sector debt to debt incurred by government agencies was firmly fixed. High interest rates alone were not sufficient to stall Mexico's economy. What drove Mexico into its payments bind was the "dollarization" of the Mexican economy, which undermined the value of the peso. Rising interest rates provoked an increased need for dollars by Mexican entities. In the same post-1979 period, however, the Mexican government was duped by a team of Wall Street banks, working in cahoots with the World Bank, into believing that U.S. investors had a great desire to invest in Mexican capital markets.

The ensuing upgrading of the Mexican capital markets paved the way for the 1981 outflow of flight capital.

In this game, every dollar of private investment capital admitted into the country provoked a $100 outflow. In 1981, for the first time, the fixed ratio between private and public sector borrowing broke down. $4 billion in funds were acquired by privately held Mexican institutions to facilitate capital outflow for foreign real-estate purchase and private banking accounts held in the United States. In such a climate, financial institutions had little difficulty in circulating rumors that the peso would be devalued. In the first months of 1982, when the devaluation finally hit, there was an unprecedented, panicky rush for $16 billion in new foreign loans.

Only the nationalization of the Mexican banks and imposition of exchange controls Sept. 1 put a halt to this chain-letter depletion of deposits.

Argentina: For decades, every time Argentina has aimed to "monetize" domestic money supply to coincide with its international reserves, it has provoked hyperinflation. The core problem is the result of an absence of tough foreign exchange controls.

Under the influence of monetarist ideology, Argentina has attempted to face this problem through exchange-rate manipulation instead. The actual result is that for every dollar in short-term borrowing incurred by the private sector, $2 in flight capital is sent out for speculative investment abroad. Under conditions of chronic undervaluation of the national currency against the dollar, manufacturers and agricultural exporters can only make ends meet by subjugating themselves to speculators who run up the national debt to make gains on currency differentials.

The absence of exchange controls—reinforced by Argentina's bank creditors—is exclusively what has sucked Argentina's ability to finance its debt.

Venezuela: In recent years, international banks financed a $14 billion outflow of banking deposits from Venezuelan private companies and citizens in a bid to gain control over Venezuela's approximately $10 billion in accumulated cash reserves, earned from oil sales and a continuous 1970s trade surplus. Venezuela is refusing to hand over its oil wealth.

The fight in recent weeks between Venezuela and its creditors over $8.5 billion in short-term debt due this year has been ludicrous. Venezuela has more deposits currently in the Western banking system than it owes—and again, a large portion of those deposits were financed by the creditors themselves. As in the case of Argentina, it has been possible to calculate through this chain-letter process that for every $1 in short-term funds lent to Venezuela, $2 has re-entered the Western banking system in interest-earning deposits. The whole free-exchange-rate game—enforced by the banks themselves—has made it impossible to develop Venezuelan industry.

Who, ultimately, has benefited? The Martínez de Hoz trial in Argentina, by pointing to the financial powers that underlie the Propaganda-2 lodge (such as the two largest Venetian insurance companies and the Inter-Alpha group of commercial banks) could shed considerable light on this. But it also raises questions concerning commercial bank management in the United States, which has insisted upon a doctrine that has ruined the portfolios of the banks themselves. Are the American oligarchical families who still dominate the nation's commercial banks—the Rockefellers, Stillmans, Pages, Houghtons, Goelets, Harrimans, Cabots, Mellons, and so forth—"skimming" their own institutions at their depositors and stockholders' expense?