The off-balance-sheet bubble

Federal regulators are issuing dire warnings, but the U.S. banking system is addicted to dirty-money flows, they admit.

Several pages of the International Monetary Fund's *Survey* of July 14 summarize dire warnings delivered by Federal Reserve officials and private economists, that "the wave of innovation that has swept over financial markets in recent years has increased risks and problems for the world monetary system."

The innovations referred to center on "off-balance-sheet operations" of the major commercial banks, who have managed to expand their liabilities to about 2.5 times their assets.

The banks have, in effect, taken fees up front in return for loan guarantees that remain on their books indefinitely, to the extent of $1.25 trillion for the 15 top U.S. banks, and untold trillions for the banking system as a whole.

The present world monetary system is dominated by $500 billion per annum in illegal narcotics flows, which represent an "investible surplus" at least four times greater than the petrodollar surplus at its height. Financial "innovation" has permitted the commercial banks to take a cut in the circulation of anonymous, unregistered securities preferred by dope traffickers. Occasionally, U.S. authorities have forced Swiss or Caribbean banks to cough up narcotics money on deposit with them. No one has ever seized unregistered securities sitting in a Swiss safe-deposit box.

National monetary authorities have, therefore, lost track of capital flows, the IMF *Survey* quotes Federal Reserve official Charles Lucas. In 1982, Lucas said, "We had a lot of data on the international exposures of developing countries because we had banking data. In a securitized world, you know a lot about who the borrower is but you don't know who the lender is. You don't know if the lender is internal or external. You don't really know anything. How can you do country risk assessment if you don't know where the assets are lodged. . . . There's a group of guys at the IMF right now trying to think about the current-account implications of this. If you don't know who the asset holders are . . . you can't estimate accurately."

Lucas was referring to the $200 billion "discrepancy" in world balance-of-payments statistics, reflecting unregistered flight capital arising from narcotics traffic, among other things.

Economist Peter Kenen of Princeton University, a longtime advisor to the International Monetary Fund, added that the reliability of payments data "gets worse and worse. . . . We could be off by hundreds of billions of dollars in our estimate of the current account" deficit of the United States.

Former Federal Reserve official Roger Kubarych, now chief economist at the New York Stock Exchange, warned, "There's a nagging uneasiness that somewhere people might not know what they're doing and . . . that a major dislocation might occur," as a result of the banks' gigantic expansion of their liabilities. But a return to regulated markets "would be the wrong way to go," Kubarych warned, for a simple reason: The United States could not finance its enormous payments deficits without the dirty-money market.

The expansion of off-balance-sheet operations "inadvertently has weakened some very important helpful disciplines in the economic system. There's no way that the kind of trade or current-account deficits that the United States has been running and financing in recent years would have been possible 10 or 20 years ago. The private capital movements that would have been required could not have been forthcoming, certainly not with the kind of smoothness that we've seen. And by the same token, it's hard to visualize how the kind of surpluses now being amassed by Japan or Germany or other European countries could have been invested without serious objections, prior to financial liberalization."

There is one disingenuous note in Kubarych's account. Japan accounts for only $60 billion of America's annual $150 billion financing requirement; another $80 billion comes from the dirty-money market of unregistered securities, held by dope-traffickers and their ilk in safe-deposit boxes.

In fact, no "financial liberalization" is required to persuade the Japanese to put their export earnings into the United States. This they do for political reasons, and in the most conventional way, by buying Treasury securities at public auction. The fancy stuff to which Kubarych refers is the province of Dope, Inc. It finances corporate mergers and acquisitions, heavily margined stock purchases, real-estate deals, and other operations which have produced the biggest bubble in U.S. financial history—now giving way to the biggest collapse.