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The Rise of Monetarism as a Social Doctrine

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The Rise of Monetarism as a Social Doctrine

Introduction

It is hardly worthwhile to discuss the contents of monetarism. The really interesting question is how this ideology steadily gained ground to become the creed of the ruling circles in some countries and at least of very influential circles in others.

It should be noted at the outset that monetarism — in present-day practice, if not necessarily in theory — is associated with *restrictive* monetary and fiscal policy.[1] Our basic observation is that such restrictive policies have always been supported by banks and financiers (the City, Wall Street) more than by any other group in the economy. It is they who have consistently clamoured for high interest rates and for restrictive budgetary measures. The specific monetarist theory has found a home in those circles more than anywhere else.

Cui bono?

The question immediately arises as to why this should be so. What interest is served by following restrictive monetary and fiscal policies? The answer comes most naturally on ideological grounds. Monetarism attributes to the control of money supply and to the banking system the central regulatory role, a strategic position almost comparable to the central planning office in a socialist state. This cannot fail to flatter the bankers' vanity. But more than being merely flattering to "high finance", monetarism articulates an ideological attack against the Keynesian doctrine. Monetarism intends to displace Keynesian policies which threaten the social power of the banking system by relegating it to one of the instruments of government policy in maintaining full employment. It is by no means necessary to recall the "euthanasia of the rentier" which bodes ill for the banks also, but it is quite sufficient to state that Keynesian policies entail an enormous strengthening of the national government's hand in the conduct of banking policy. This cannot find favour with the banks, unless they feel confident that the economic policies of the national government would be run more or less exclusively in the interest of "high finance".

Faced with the historical experience of the interwar years, J. M. Keynes, although in principle a liberal, was driven to support national economic policies designed to defend the level of home employment against depressive influences coming from the outside world. Such defensive national policies might involve devaluation, protectionism, exchange control, etc. These essentially entailed severe restrictions on the

international role which the City had enjoyed under a gold exchange standard with the pound sterling as a reserve currency.[2]

Let one of us (J.S.) indulge here in an historical reminiscence. Kalecki used to interpret the events in Britain around 1931/32 in terms of a shift of power from the City to industry. The interest of the City was overruled by abandoning the Gold Standard, adopting a floating exchange rate and establishing the Exchange Equalization Account. Industry got protection again and free trade was rejected in a major turn-about of British economic policy. This change was connected with a decline in the international status of the City as the financial centre of the world. Kindleberger (1973) maintains that the City was neither able nor willing to plug the holes that had appeared in the network of international finance and thus prevent the snowballing effect which led to the breakdown of the entire structure in 1931. With this tarnishing of the international image of the City, the centre of gravity of British economic policy shifted to the home-front in favour of domestic industries. This provided the necessary socio-political base for the acceptance of Keynesian policies.[3]

In order to answer the question "Whose advantage?", it is worth stressing that a high interest rate policy is generally beneficial to banks under normal circumstances, i.e., as long as they do not become the victims of a financial crisis.

It is true that those financial institutions which have a lot of long term investment committed at low interest and are forced to borrow short at very high interest tend to lose money on that account. In more extreme cases, they may even face financial ruin, as is apparent from the threat of bankruptcy which hangs over the head of many American thrift institutions at present. But, by and large, commercial banks neither in the U.S. nor in the U.K., although some in Germany, have been locked in such a situation of borrowing short at a high rate and lending long at a low rate. Long term government bonds are not a large part of the financial portfolio of the commercial banks either in the U.S. or in the U.K. nowadays (of the order of one tenth perhaps), so that this consideration is not of overriding practical importance to them. In addition, new credit instruments have emerged which facilitate long or medium term lending at variable interest rates determined by a spread over the interbank lending rate (for example, LIBOR, i.e. the rate which the London banks charge each other for short term money). The share of outstanding debt of developing countries carrying such floating interest rates is estimated to have increased from about 28 per cent in 1973 to nearly 60 per cent in 1980.[4] Increasingly, longer term loans are being committed only on the basis of floating interest and the practice today extends in large measure even to newly issued industrial bonds. Such new credit arrangements have helped to insulate the banks against the only disadvantage which an increasing level of interest rates may have for them.[5] Otherwise, high interest means increased earnings on loans advanced by banks, while small saving

deposits usually do not get a proportionate rise in interest payments and demand deposits get none.

These general arguments find some empirical support in the fact that the British banks have done particularly well at a time when industry has withered away under high interest rates (as can be seen in Table II).

The shift of power

The rise of monetarism from a local sect to world wide eminence has been preceded by a shift of power from industry to the banks. Perhaps this shift was nowhere as clearly marked as in Britain.

All existing evidence regarding the scope of operation of traditional financial centres like the City or Wall Street tends to suggest that such a process of shift in relative power has indeed been steadily taking place over the last two decades or so.

Table I gives an indication of the extent to which the City has managed to extend its scope of operation during the 1970s. It shows that overseas lending has increased more than eight-fold, lending to private domestic customers has increased five-fold and lending to the public sector has increased only two-fold. The total assets of the U.K. banking sector were 78 per cent of the G.D.P. in 1970 and 122 per cent in 1979. This illustrates the tremendous increase in the relative power and control wielded by the City. At the same time, the much faster growth of overseas operations allowed the banks to enjoy a certain degree of independence both from the national government and from the domestic public sector.

Table II shows the ratio of undistributed income of financial companies to that of industrial and commercial companies. This ratio is seen to rise steadily 1960-78 and then to jump to extraordinary proportions in 1979 and 1980, the years of consumption of monetarism when the banks continued to prosper while industry decayed.

As Table II shows, the undistributed profits of the British banking sector as a percentage of those of the industrial-commercial sector rose spectacularly from 7 per cent in the early 1960s to 28 per cent in 1980. In the absence of access to similar data from many other OECD countries, it is hard to judge how "special" is the British case. Nevertheless, since the British banks' fortunes were connected with the rise of the Euro-market and the transfer of oil money, and since other countries' banks shared this experience, we may guess that a similar shift in the distribution of profits has taken place in other industrialized countries, although it has probably gone nowhere as far as in Britain. It has to be pointed out here that a traditional divergence of interest exists between banks and industry in Britain owing to a general reluctance on the part of industry to indebt itself and borrow from banks (Samuels, Groves and Goddard, 1975). It is arguable that to a large extent this peculiar alienation has also been

TABLE I

U.K. Banking Sector's Assets

(Total Lending £m)

	Public Sector Total	Index	Private Sector Total	Index	Overseas Sector Total	Index	Total Assets Total	Index	GDP GDP	Bank Assets as per cent of GDP
1970	7.474	100	10.786	100	15.471	100	33.727	100	43.530	78
Proportion	22		32		46		100			
1979	17.305	232	53.602	497	128.678	832	199.585	592	163.647	122
Proportion	9		27		64		100			

Source: CSO, Annual Abstract 1981.

TABLE II

U.K. Profits: Industrial and Commercial as Compared to Financial Companies

(£m., annual averages)

	1960-64	1965-72	1973-78	1979	1980	1981
Undistributed Income *						
1. Industrial and Commercial Companies	2468	3523	12251	19795	15238	16266
2. Financial Companies	169	391	1664	3687	4290	3327
3. Financial in p.c. of Industrial Commercial	7	11	14	19	28	20
Undistributed Income plus Dividends**						
4. Industrial and Commercial Companies	3584	5021	14108	24099	19306	20333
5. Financial Companies	337	642	1998	4175	4882	3999
6. Financial in p.c. of Industrial-Commercial	9	13	14	17	25	20

* Before providing for depreciation, stock appreciation and additions to reserve; net of taxes.

** Dividends are net of tax after 1973; the data before and after 1973 are therefore not comparable.

Source: CSO Economic Trends, Annual Supplement 1982 Edition and July 1982.

caused by the long-standing international position of the London-based banks, who often find their foreign business more profitable than lending to domestic industries.

The relative independence of finance from domestic industry in Britain owes a lot to the old tradition of the City as an international financial centre. Indeed in the two historical reserve currency countries—the U.K. and later the U.S.—the City and Wall Street could play their international financial role without necessarily being constrained by the growth of domestic industries.[6] In contrast, the transnational banks from countries like Germany and Japan, where industries have been reconstructed in the post-war period largely so as to poise them favourably in terms of international competitiveness, have had their operations grow more in line with the interests of their transnational corporate business.[7]

The sources of the banks' prosperity

In attempting to understand the reason behind the shift in power from industry to the banking system which has been taking place over the last two decades or so, it is essential to consider both the national and the international dimension of the problem. Undoubtedly these two aspects have tended to reinforce one another in facilitating the process of shift of power in favour of the banking system, but for the sake of clarity in exposition, we wish to separate them here.

On the *national level*, the long post-war prosperity of capitalism saw a renewed growth of rentier interests. It resulted in significant accumulation of personal savings held in the form of financial assets in most OECD countries (Steindl, 1982). Alongside grew the public debt which, in large measure, only reflected the growing rentier interest. As inflation tended to erode the real value of accumulated savings and the real interest rate, the rentiers interest in trying to find compensation in the high interest rate of a "dear money" policy become more pronounced. Insofar as such a policy is normally also favoured by the banks, as we have seen above, the rentier becomes a natural political ally of the banks in his insistence that inflation is a more serious problem than unemployment.

In its *international aspect,* it hardly needs to be stressed that finance is a surface phenomenon reflecting the underlying relations of economic power between nations. The unchallenged "reserve currency" status of the dollar under the Bretton Woods System merely reflected the new hegemonic role of America in the international capitalist system. Both as an international unit of account and as a store of value, the dollar played the role of international money for more than a quarter of a century. And it was the store of value or reserve currency status of the dollar which also allowed America to buy freely in the whole world with her paper liabilities which the foreigners willingly held as assets and considered as good as gold. Thus, under the reserve currency status of the dollar, America was able to finance not only some of her worldwide military expenditure, but

also a large flow of private foreign investment into Europe. American multinationals could take over European firms, while the Europeans had to be satisfied with an equivalent dollar holding in exchange.[8] It needs to be stressed that these financing operations were increasingly routed, not through official transactions among central banks (as visualized under the Bretton Woods System), but through transactions conducted by large international commercial banks whose dollar claims became the basis for loans denominated in dollars. The result was the birth and growth of a massive *Eurodollar market,* where expatriate dollars, detached from their national monetary base, were held in commercial banks located outside the United States. It is hardly necessary to add that the motive for the expatriation of banking business from the U.S. (as well as from other countries where the same happened) was strengthened by the desire to escape from national monetary controls and national taxation.

In time the Eurodollar market developed into an international commercial money market, comprising not only dollars but all other major convertible currencies as well, all of which were also detached from their national monetary base. The total value of such expatriate currencies held in the commercial banking system is estimated (November, 1981) at 1.35 trillion U.S. dollars—a 3,353 per cent increase from the 39 billion U.S. dollars recorded in 1965, the earliest measure of the Euromarket's size.[9] And, even as early as 1973, just before the quadrupling of the oil price, the volume of the commercial banks' transactions in such expatriate foreign currency exceeded the total value of foreign exchange transactions by all central banks and monetary authories taken together (Engellau and Nygen, 1979).

Such phenomenal growth of the Eurocurrency market dramatically altered the balance of power, at least temporarily, between the international commercial banking system and the national monetary authorities and their central banks. Like multinational corporations in their field, international commercial banks emerged as a main focus of financial power, largely independent of the control of national monetary authorities.[10] The Keynesian view of the economic autonomy of the national government in the conduct of economic policy and maintenance of full employment at home became almost anachronistic in this context. As economic power continued to shift steadily in favour of large commercial banks, a new economic ideology, as an antidote to Keynes, was called for.

Superimposed on this trend of growing independent financial power of international commercial banking has been, since the quadrupling of the oil price in 1973, the emergence of a class of international rentiers from the OPEC countries.[11] Not only did it vastly augment the deposit base of the large commercial banks, where most of the petromoney was held in short-maturing deposits, but it also made the entire international payments system crucially dependent on the commercial banks. The non-oil developing countries' current account deficits were increasingly met

TABLE III

Role of private credit in current account financing of non-oil developing countries (1973-1982)

(In billions of U.S. dollars)

Year	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	Cumulative total 1973-81
O. Total to be financed (i)	21	39	44	46	41	55	71	91	100	101	508
1. Borrowing from international markets (banks and bonds) (ii)	11	16	16	23	18	34	44	50	52	N.A	264
2. Credit from commercial banks (iii)	N.A	N.A	N.A	18	18	23	37	34	37	N.A	N.A
3. Publicised Eurocurrency lending to non-OPEC developing countries (iv)	N.A.	N.A.	N.A	N.A	N.A	14	27	24	33	N.A	N.A
4. Total publicised Eurocurrency lending (v)	N.A	N.A	N.A	N.A	42	70	83	77	133	N.A	N.A
5. Per cent share of non-OPEC developing countries in publicised Euro lending	N.A	N.A	N.A	N.A	N.A	20	33	31	25	N.A	N.A

Table III: Sources and Notes

(i) Row (O) is the algebraic sum of current account deficit and reserve accumulation giving ex-post financial requirement. Current account deficit is the net total of balances on goods, services and private transfers, as defined in I.M.F. *Balance of Payments Yearbook.* Source of Row (O): World Bank (1982), Appendix B, Table 25.

(ii) Row (1) estimates finance raised through bank loans and issue of bonds. The latter item of bond issues is only around 10 per cent of the total for developing countries (1979-80). See, *Economist* (1982a, p.83) on the relative composition of bonds and bank loans, estimated from three different sources namely, OECD, the World Bank and Morgan Guaranty Co. Row (2) is compiled from I.M.F. and B.I.S. sources.

(iii) Source: *First Chicago World Report (1981).* Reported in R.W. Lombardi "Multinational banking and the Third World" — *International Herald Tribune* (1981b, p. 85).

(iv) Source: Morgan Guaranty Co., *World Financial Markets*, various issues. Morgan Guaranty estimates are somewhat lower than estimates by OECD and the World Bank (see Economist, 1982d for comparison); also *International Currency Review* (1980), No. 6, p. 9 using Morgan Guaranty estimates (for 1978-80).

(v) Sources same as note (iv) above.

through commercial borrowing and the commercial banks' usual ability to create credit was applauded as an international virtue in the name of "recycling" on a global scale (see Table III).

A remarkable feature about Table III is the heavy reliance of non-oil developing countries on borrowing from international capital markets which financed approximately half of their financial requirements. Mostly the credit came directly from commercial banks which accounted for over 70 per cent of total borrowing during 1976-81, (Table III, row 2 ÷ row 1). Well over half of such credit from commercial banks during 1978-81 was publicised Eurocurrency lending (Table III, row 2 ÷ 3) which typically requires syndication of credit. Nevertheless, Table IV also shows the somewhat self-contained nature of Eurocurrency lending in spite of all the attention paid to the global recycling phenomenon. It will be noted (from Table IV row (1) that non-oil developing countries together account for about 1/3 of total Eurocurrency bank credit, while industrialized countries still have the major share (50-60 per cent)[12].

In light of the above evidence on international bank credit, it would be rash to maintain that the present system of international banking is crucially dependent on the market for non-oil developing countries in general. Instead, the broad picture that emerges is the *crucial dependence of a few borrowers among* non-oil developing countries on the international banking system (see Table IV row 2 and 3). It is on these selected few countries—less than a dozen in number, all belonging to the middle to high income group among developing countries and most of them trying to industrialize typically through what are called "open trade and investment policies"—that international banks' loans have been showered on an unprecedented scale during the last decade or so. At the same time, poorer non-oil developing countries have not had any significant access to large commercial loans. In the pattern that increasingly emerged in recent years, the domestic savings of OECD countries and the liquid surplus of OPEC merged to result in a powerful rentier interest that got tied to the smooth operation of international commercial lending. On the receiving side of commercial loans were some OECD countries with serious balance of payments problems, a few socialist countries as well as a handful of selected developing countries belonging to the middle-income group.

Commercial banks' dependence on their clients either as lenders or as borrowers has not been one sided, which ensured them a position of relative autonomy. In particular, the relative importance of OPEC deposits in the total deposits of commercial banks has not shown any clear tendency to increase over time. The OPEC's share in total deposits has remained relatively stable around 10 to 12 per cent throughout the period 1975-80.[13] As a consequence commercial banks have not increased their dependence on OPEC depositors; instead, they have increasingly relied upon international relending of domestic savings of OECD countries.[14]

TABLE IV

Eurocurrency bank credit concentration

Shares of certain groups of recipients in total Eurocurrency bank credit in per cent

	1973	1974	1975	1976	1977	1978	1979	1980	1981	Average 1973-81
1. Share of non-oil developing countries (i)	19	21	39	38	32	38	43	31	26	32
2. **Concentration according to region:** Share of Central and Latin America (ii)	N.A	N.A	58	59	55	55	55	56	N.A	N.A
3. **Concentration according to countries:** Share of 8 major borrowing countries (iii)	N.A	N.A	53	54	52	53	56	55	N.A	N.A
4. **Concentration according to income:** Share of 9 Newly Industrializing Countries (iv)	N.A	N.A	69	67	63	65	71	74	N.A	N.A

Table IV: Sources and Notes

(i) 1981 figure relates to January to November. Source is *Morgan Guaranty and Co.* Morgan Guaranty data relate to non-OPEC developing countries, which corresponds fairly closely to non-oil developing countries data in this context.

(ii) Source: *BIS, IMF and Morgan Guaranty Co.*

(iii)Sources as in note (ii) above. Includes 4 countries, namely, Brazil, Mexico, Argentina and Chile in the Americas, and Korea (South), Philippines, Thailand and Malaysia in Asia. The 4 Asian countries account for about 10-12 per cent of total Eurocurrency bank credit, while the 4 countries in the Americas account for 43-45 per cent on an average.

(iv) Sources: *BIS, IMF and OECD.* These 9 countries are: Brazil, Mexico, Argentina, Korea (South) (as in note (iii) above) as well as Greece, Spain, Portugal, Yugoslavia and Taiwan; they are on a comparable per capita income level.

The fact that only a few selected developing countries in the middle-income range (led by Brazil and Mexico) have been the main borrowers implies that commercial banks' dependence on their borrowing clients in the developing countries has been highly specific. It would be wrong then to presume either a *general* dependence of developing countries on commercial banks or of the banks on developing countries' capital markets. More exactly, a few selected middle-income developing countries depend heavily on commercial borrowing,[15] while rentiers both from OECD and OPEC depend on profitable deployment of their financial savings through 'recycling' carried out by commercial banks.

Escape from national control

Given the concentration of international commercial banking in the traditional financial centres, large banks have increasingly shown a tendency to become more independent of their home governments and domestic industries. The development of Euromarkets, in allowing commercial banks to operate extensively in *foreign* currency, has also meant that the traditional business of international liquidity creation has largely got detached from the control of national monetary authorities. In a fundamental sense, therefore, restrictive national monetary policies do not any longer affect so severely the international commercial banking system; the banks can reap the benefits of a high interest policy without having to surrender to the control of central banks. The special attraction of monetarism for commercial banking lies precisely in this paradoxical fact that a restrictive national monetary policy is largely ineffective in curbing their international operations. And, evidence seems to suggest that a "dear money" policy hits domestic industries, while international commercial banks do not seem to suffer particularly from it (see Tables I and II).

In the ultimate analysis, the social position of industry rests on its being a provider of jobs. It is evident that this function is inadequately fulfilled today by industry in spite of abundant support from the state. In most industrialized countries, basic and traditional industries mainly play the role of petitioners *vis a vis* the government, in some countries one might even say, of old age pensioners in constant need of support. The state subsidises industry even in the case of multinationals who sell their location by auction among the countries who desire their presence. In contrast, as representatives of the mythology of self-reliant private capitalism, the banks have been presenting a better image until recently. Their social influence rests on their nearly unilateral power to grant or withhold credit, to shift funds from country to country and to influence the rate of exchange in a manner which is largely independent of particular national governments' policies. Even the United States government and the Federal Reserve find themselves largely ineffective in regulating such international banking operations. The recent attempts by the Federal Reserve to gain some control of the Eurodollar market by imposing

minimum reserve currency requirements (initiated in April, 1980) have been almost scornfully rejected by the central banks in other countries in an attempt to protect the interest of international commercial banking located in their respective countries.[16] Banking seems to have become internationalized and independent both from domestic industries and from national governments to an extent where even the most powerful of national governments can exert little control over international banking operations. Nevertheless, there is a reverse side to this picture that is now becoming increasingly apparent. The international lending structure, particularly the Euro-market, is exposed to considerable risks which need not to be dwelt upon here. In the event of large scale defaults the banks would have nobody to turn to but the monetary authority and the government of their home country. This implies serious qualifications to the above statement about the freedom of international banks. Their independence has a limit in the consideration they have to show to their home government and central bank, in order to facilitate intervention on their behalf in case of need. The bond to the home base can never be broken completely.

These considerations touch on the inner contradictions in the position of the banks. There seems to be a good deal of "double-talk" in their embrace of monetarism. They praise the restrictionist policy at home in so far as it gives them high interest and high margins, but they escape the restrictions on volume by seeking expansion abroad. The dramatic expansion in the volume of international credit has largely resulted from fierce competition among banks. But the paradoxical outcome of the ensuing recycling process carried out by international banks during the last ten years or so is only now becoming apparent. Most of the handful of developing (and some socialist) countries to which the banks lent heavily (see Table IV) are now in a sort of *borrower's debt-trap*, where they cannot avoid increasing recourse to borrowing, if only to service their outstanding debt. The mirror image of this is the situation in which the banks now find themselves. The fear of technical default by a few of these heavily indebted borrowers can set in motion a chain reaction of defaults, the risk of which has been further aggravated by the "cross default" clause of the usual syndicated lending. A dear money policy encouraged by monetarism and recent devices such as floating-interest loans which shifted the burden of debt-servicing to these borrowers have only contributed further to the fear of widespread default which the international banking system must try to avoid in its own interest (*Economist*, 1982b, pp. 21-24). As a result, banks now find themselves in an uncomfortable *lender's trap*, where they have to keep on lending, rescheduling and rolling over their debts to already heavily indebted borrowers who probably can never pay back. And such debt-rolling must continue to keep the present fragile structure of international finance from crumbling.

It is in this context that we must judge the recent deviations from more orthodox monetarism. The tight money policy is now being relaxed by the

Fed and the Bundesbank, followed by several other central banks; and, interest rates have also begun to decline[17]. While these developments may be connected in an obvious way with the compulsions of electoral processes in these countries, it appears to be more than a merely temporary manoeuvre. Restrictive monetarism has begun to become irreconcilable with the uncomfortable position in which the banks have landed themselves. The insolvency of many of their debtors makes it necessary for central banks to intervene as lenders of the last resort and the Bank of International Settlements has already felt compelled to create at least some modest facility to bail out banks in difficulty. Neither the necessity to inject money into the system to unfreeze bad loans nor the strain of high interest on debt servicing can be overlooked by the bankers any more, while such demands also cannot easily be reconciled with the tight money policy.

It may be concluded that tight money policy cannot continue unless the central banks refuse to intervene effectively, as they did in 1931, which would inevitably have the same consequences it had then (Minsky, 1982). This is not to say that trouble could not arise even if the central banks are prepared to advance credit: in so far as a financial crisis may be an international currency problem as well, it would require a coordinated international action of monetary authorities to deal adequately with it.

The precarious position of the banks is only the logical consequence of their policy and that of the U.S. government allied to the Fed. The harm done to both the developing countries and to industry in advanced countries by the high interest policy and the long-lasting refusal of the U.S. government, upheld still at Toronto, to expand lending facilities of the IMF would certainly have come back with a vengeance to the banks if the U.S. had maintained its position.[18] But then, as Keynes (1972, p. 156) once said: "Banks and bankers are by nature blind". It might be added that some governments, with their monetarist spectacles, have been hardly better off.

Summary and Conclusions

The ascent of monetarism to world-wide influence can be explained as a social and political phenomenon. Without going into the broader political aspects of monetarism, this paper concerns itself with the question of how monetarism has been able to gain so much power despite the evident damage it is doing to industrial capitalism. Monetarism, seen as the ideology of the banks and of the rentiers whose interests are defended by the banks, serves as an anti-dote against Keynesian ideology which assigns to the banks the role of instruments of the government's full employment policy and therefore deprives them of their autonomous power and influence on policy. Moreover, the high interest rates which usually result from monetarist policies are in most cases directly beneficial to the banks as long as there is no danger of a financial crisis.

The rise of monetarism since the early 1960s can be explained by the increase in the banks' influence and power which resulted from the expansion of their business, chiefly through operations in the Euromarket. By 1981 the volume of the Euromarket had expanded to forty times its size in 1965. The lending was not confined to less developed countries; 50 to 60 p.c. was lent to industrial countries. The sources of the banks funds were both the financial surplus of the OPEC countries and the savings of the industrial world. The Euromarket thus constitutes a network of financial relations extending over all parts of the world.

A major attraction of the Euromarket is the escape route it provides from national monetary controls. The large transnational banks, in their support of monetarism, play an ambiguous role: they favour tight money policy which keeps interest high; but at the same time through their participation in the Euromarket they escape the tight credit policy imposed by the monetary authorities. Historically the basis for such a successful policy of expansion of banking business was provided first by the expansion of trade and investment, and subsequently by the re-cycling of petro-money. Since both these favourable conditions have vanished the reverse side of the monetarist medal has become visible. Owing to the protracted recession, to which tight credit policy has largely contributed, the safety of the banks' customers is threatened, both in industrial and in less-developed countries. At the same time, the complicated network of international lending increases the dangers implicit in the instability of the banking system. As a result the position (and the point of view) of the banks has undergone a fundamental change: their interest is now in easier money, because they want more liquidity, so that their customers, threatened with insolvency and forced to borrow, can at least service their debt. This explains the turn-about of the Fed's policy since August 1982 when interest rates were permitted to decline in U.S., followed by those in Europe.

The conclusion is that monetary policy has been of singular short-sightedness, because it has disregarded the interests of the banks' customers (in industrial and less developed countries) until their economic plight re-acted back on the banks. With a recession lasting longer than expected and the fear of growing insolvencies a return to a high interest policy is not likely.

Footnotes:

1. Historically it was not always the case. In 1929 the proto-monetarists Foster and Catchings were inveighing against the Federal Reserves's policy of stopping the stock market boom by tight credit policy (Tavlas and Aschheim, 1981). This stance of bygone times is still reflected in Milton Friedman's monetary history (Friedman and Schwartz, 1963).

2. A recent issue of the *Economist* recaptures this change of mood: "In the particular circumstances of 1931, it is easy to accept the macroeconomic argument that devaluation was a better short-term remedy than yet another attempt to drive down wages and salaries. There was then a downward spiral of expectations of lower prices and costs . . ." (See reference 1, p. 14). The *Economist* then tries to make out that a depreciating sterling is no alternative (to wage cut) today. Indeed, a stable and highly valued sterling serves the interest of the City, and that is our point.

3. Or, in particular, that aspect of Keynesian policy which argued for the economic autonomy of the state in managing demand through public works to provide a sufficient market for domestic industries so as to maintain full-employment.
The attitude of Keynes was evident already in his opposition to the return to gold (1925), a policy which meant putting the interests of the City above the interest of industry.

4. Its consequence has been not only to increase the general debt service ratio (i.e., interest and amortization payments as percentage of exports of goods and services) for the borrower developing countries, but to increase the particular component of interest payment ratio disproportionately. Thus the group of middle-income net oil importing developing countries which account for most of the commercial debt had an almost four-fold increase in their interest payments ratio between 1973 and 1982 while their overall debt-service ratio during the same period doubled. See World Bank (1982), Table 33 in particular.
5. The corresponding reduction in bond prices is likely to affect far more adversely thrift institutions with long-maturing portfolios.
6. In the case of American banks, during the 1960s their expansion into Europe was linked to take-overs and opening of subsidiaries by American multinational corporations. But we suspect that, once the Eurocurrency market assumed its vast size, even American banks could begin to operate relatively independently of their corporations. In the case of Britain, this is a more clearly established pattern.
7. This impression distinctly emerges from an as yet unpublished survey of 84 transnational banks (with 3,941 foreign entities) conducted by the U.N. Commission on Transnational corporations. See its forthcoming report on *Transnational banks: operations strategies, and their effects in developing countries.*
With regard to Germany, however, it must be added that the Bundesbank has an exceedingly strong position of power and that it has pursued time and again since 1967 restrictive policies to the detriment of employment and of domestic industry, contributing very largely to the weakness of private investment in all that time. This happened although Germany, unlike for example Italy, has not been under the compulsion of a chronic and serious balance of payment problem.
8 United States' balance of payments figures for the period 1960-67 suggest that America ran an average annual export surplus of goods and services of the order of 6 billion dollars. But U.S. grant and aid plus net transfer on official exchange account (annual average 5 billion) and foreign private investment (annual average 3 billion) resulted in an overall payments deficit.
9. This figure was reported in *International Herald Tribune* (1981a). (See, article by Carl Gecoirtz, "Euromarkets: a gawky adolescent begins to settle down", p. 15).

10 The main reason for this is the Euromarket of expatriate dollars, Deutsche marks, Swiss francs, sterling, guilders, French francs, yen, Belgian francs and various smaller convertible currencies as well as composite units such as Units of Account, European Currency Units and Special Drawing Rights, which form a varied currency base of commercial banking operations, detached from national monetary bases.
11. Mainly 'low-absorber' OPEC countries (i.e. Saudi Arabia, UAE, Kuwait, Qatar) who accounted for 33.6 billion out of a total OPEC surplus of 34.1 billion dollars in 1977. (See, *World Financial Markets*, September, 1976 and June 1977). On an average till the end of 1980, OPEC invested around 40 per cent of their financial suplus in Euromarkets according to U.S. Treasury and Bank of England data.
12. A more exact percentage break-down based upon Morgan Guaranty data is the following:

Year	1970-73	1974-76	1977-79	1980-81
Industrialized countries	66.2	48.0	38.5	57.8
Non-OPEC developing countries	19.4	30.9	37.8	28.3
Others	14.4	21.1	23.7	13.9

13. The data relate to banks reporting to the Bank of International Settlements (BIS).

	1975	1976	1977	1978	1979	1980
Ratio of OPEC's deposit in total bank deposit	0.11	0.12	0.12	0.10	0.11	0.12

Source: BIS.
14. See *International Herald Tribune* (1981a).
15. For example, three Latin American countries (Brazil, Mexico and Argentina) accounted for 78 per cent of gross commercial lending to Latin America at the end of 1979, which amounts to 51 per cent of their total lending to non-oil developing countries. Similarly, almost the entire commercial lending to Asia is concentrated in a few countries (South Korea, Indonesia, Malaysia, Phillipines and Thailand).
16. See, *International Currency Review*, (1980), where the letters written by several Central Banks to Fed are quoted in part. Thus, the Bank of England wrote: "These proposals appear to us to carry with them an implication that the U.S. authorities consider it necessary to extend their regulatory jurisdiction into the affairs of non-American banks. We would find this a troublesome principle and one which, if generalized, could materially damage effective international cooperation in this field. We feel sure that these concerns could also be shared by a number of other major countries to whose banks these proposed regulations would apply" (p. 16)—letter dated January 11, 1980. Soon the same point was repeated by Deutsche Bundesbank as well as the Bank of Japan in their letters to the Fed.
17. This was written soon after the Fed changed their stance in August 1982.
18. The Administration has in the meantime consented to an increase of the quotas by about 50 p.c. The effect of this on the lending capacity of the IMF will not be felt immediately because of procedural delays.

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