

## Fed plays chicken game with world credit system

by David Goldman

The Federal Reserve and the Bank of England have secretly agreed to impose a tight-credit regime on the private international lending markets, according to background discussions with several Fed officials. In effect, they are playing chicken with Brazil, which has stubbornly refused to cut its growth rate in return for credits from the International Monetary Fund, and with the leading members of the European Monetary System, who have not accepted the ascendancy of the IMF in world financial affairs.

How drastic the consequences of this monetary “flight forward” will be for international trade, investment, and currency markets is not possible to say. However, Federal Reserve officials admit candidly—if not for attribution—that their object is to “create a crisis which will demonstrate the existence of risk” to leading market participants. At the last IMF meeting, the American delegation fought for measures which would transform that organization into a world central bank with its own currency, the Special Drawing Right, and authority to dictate domestic credit policy to its members. The same objectives were restated at length by New York Federal Reserve Bank president Anthony Solomon in remarks before the National Foreign Trade Council on October 21.

### The Brazilian battle

Despite the low-keyed role that the Europeans took at the IMF meeting, the Europeans have had an entirely different response to the world monetary mess than the

British, Americans, and IMF staff want. First of all, the French have provided substantial bilateral credits to Brazil, improving the bargaining position of Brazilian Economics Minister Delfim Netto in his current negotiations with the private banks and the IMF. Brazil must raise over \$10 billion during the remainder of this year, and is living on short-term extensions of trade and other credits from the private banks, as *EIR* reported last week. The Anglo-American monetary authorities have not merely insisted that Brazil must accept IMF conditionality in return for IMF credit and rescheduling of government-to-government loans; they have also told Citibank and other big American lenders to Brazil that any loans to Brazil under the terms the Brazilians are willing to accept will make it difficult for Citibank to come to the Federal Reserve discount window when trouble arises in the future.

Nonetheless, Netto told the press during a visit to Paris last week that Brazil would only accept loans under terms which left its ambitious investment policy intact, to the immense consternation of its major private banking creditors, the U.S. State Department, the Treasury, and the Federal Reserve.

What hangs on the Brazil affair and similar individual situations is much more than the rate of economic growth in those countries. It was obvious at the International Monetary Fund meeting that the projected \$80 billion payments deficit for the developing sector in 1981 presages a major crisis for the second half of next year. Denied funding by the rich petrodollar countries

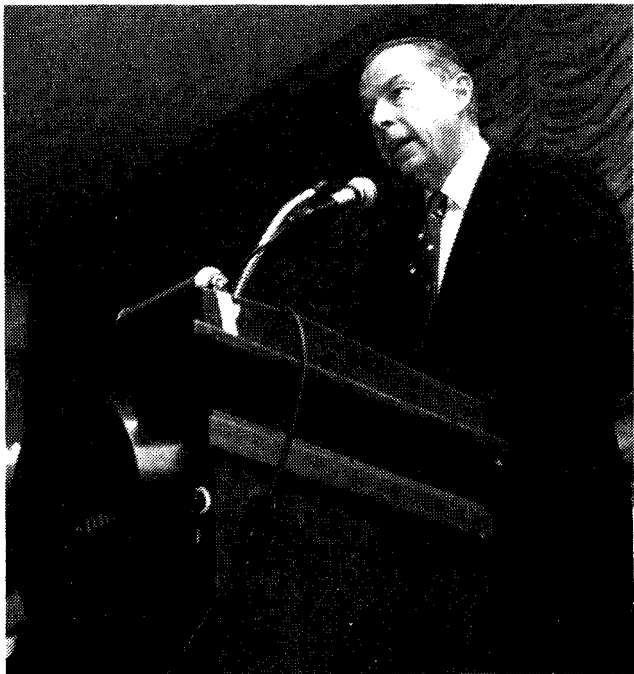


Photo courtesy of Citicorp

Walter Wriston of Citibank: an SDR booster.

and by the U.S. Congress, the IMF has neither the cash nor the political clout to manage such a crisis. The private lenders are extending short-term loans to hold the immediate situation together, at a rate which the central banks have warned them is not sustainable.

Most of the big international financial meetings over the last two years have resembled a game of poker between the U.S. and Britain on one hand—the International Monetary Fund side—and the French and Germans on the other. Now that the game is close to being called, both sides are showing some of the cards they had in the hole.

### European Community initiative

The most important action of the Europeans since the IMF meeting was the expansion of a proposed European Community borrowing (to handle the payments deficits of weaker European countries) from \$3 billion to \$10 billion. At the European finance ministers meeting last week which decided on this step, Britain's Sir Geoffrey Howe proposed that lending of these funds be made "conditional" on domestic austerity programs, in imitation of the IMF's lending policies. The proposal was refused. Most important, the loan will be denominated in European Currency Units, or ECUs, a composite European currency in which European Monetary System transactions are conducted.

The big European loan will create a secondary market in ECUs, introducing their use for the first time to the private market in an important way. This is

groundwork for the use of the ECU as a real currency, in the event that the U.S. and British monetary authorities come to grief in their chicken game with the big deficit countries. When New York Fed president Anthony Solomon called for immediate measures to make the IMF's Special Drawing Right more acceptable to the private markets, Fed officials said, his motivation was preemptive. The Fed does not want the ECU to go over well on the private markets while the SDR remains in limbo.

For obvious reasons, the big American banks are anxious to make the SDR succeed. Citibank this year began offering SDR-denominated Certificates of Deposit, without notable response. Various published reports over the past several weeks have emphasized that the major obstacle to the IMF borrowing on the private markets—one way in which the IMF hopes to raise money to cover next year's big deficits—is the unacceptability of the Special Drawing Right to private lenders.

The card Europe has tipped by the aggressive ECU loan program is that the European Monetary System, now in its first phase, could move quickly into "Phase Two" if the U.S. authorities push their point to the edge of a major international crisis.

### Down to the wire

Heedless, the Federal Reserve is prepared to do this. "We can manage if Brazil goes belly up," one official insisted. "We have discussed this with the central banks to the last detail. We know precisely how much Brazil owes to every commercial bank. Maybe the Federal Reserve and the central banks would have to make some bridge loans to the banks, but it could be isolated. Remember what Volcker did to Bunker Hunt [when he tried to corner the silver market in the first months of this year—D.G.] Did Bunker Hunt make money? Volcker made him pay for the whole thing! The Brazilians are going down to the wire. But they can't drive us off the cliff. They'll get hurt worse!"

The Fed is already telling the major banks that the "spreads," i.e., the difference between the banks' own cost of funds and what their borrowers pay, on loans to Brazil should be not 1½ percent but 4 percent. As noted, the Fed is warning that the discount window may be closed to violators.

Last week, we asked whether the proponents of "shock therapy," such as the Group of 30, had thought through the ultimate consequences of their actions. The above report is an answer of sorts. The U.S. monetary authorities have neither the muscle nor the competence to manage the crisis they propose to bring about. If they persist, the Eurodollar market will undergo a shakeout that will make the Herstatt failure in 1974 feel like a hiccup.