Crisis-management options for a bankrupt world monetary system

by Renée Sigerson

It is an unspoken truth that the more than $1 trillion Euromarket is bankrupt. As the result of a decade of global economic downturn, the potential write-offs on nonperforming Euromarket loans is currently greater than the total capitalization of all Euromarket banks. Technically, the term used to describe such a state of affairs is bankruptcy.

Many financial experts protest that all that has occurred in recent years is that global debt, particularly the $500 billion owed by Third World governments to international banks and Western governments, has grown in order to "keep pace" with the rate of inflation. Although it is true that the ratio of nonperforming debt to Euromarket capitalization has been a problem for many years, the situation has seriously worsened since 1979. When dollar interest rates took off starting October 1979, on top of a new oil crisis, the ability of commercial banks to pretend the problem was not serious evaporated. It is no longer possible for the banks to keep feeding loans to their own debtors to match annual interest payments and rollovers of principal, when high interest rates mean that interest alone is growing by $15 to $20 billion per year.

The crisis on the Euromarkets was succinctly summarized recently by former French Interior Minister Michel Poniatowski in an interview in the May 1981 issue of the scientific journal *Fusion*. Asked to comment on the role that nuclear power exports to the Third World might play in raising real productivity in the developing sector, Poniatowski underlined:

> At the end of 1980, the developing-sector countries will find themselves with a deficit somewhere between $375 and $400 billion, *with about 20 countries in a state of absolute bankruptcy*. To a large extent, this situation is the result of the oil crisis.

Since 1979, Turkey, Peru, the Sudan, Zaire, Bolivia, Nicaragua, and Jamaica have gone through debt reschedulings to stretch out payments on principal they were failing to meet. In August 1980, Turkey was turned down by its creditors when its government came begging to London for a new debt rescheduling agreement which it was desperately attempting to have pegged to slightly lower interest rates. In 1980, Turkey allocated a full 76 percent of its foreign-exchange earnings to interest and oil import payments alone.

Morgan Guaranty's analytical subgroup of the 12 largest non-oil-producing Third World countries is reported to have allocated an average of 44 percent of total export earnings in 1980 to interest and oil import payments. In mid-March, Poland—which is not a member of the subgroup, but which otherwise ranks number three worldwide in total size of debt to Western creditors—halted payments on principal. For 1980 and 1981, it is estimated that Poland will spend 110 percent of its export earnings on debt amortization. Without a cash injection of between $1.5 and $3 billion, Poland will have no funds for essential food and raw materials imports.

All the countries of Central America and West Africa are considered likely candidates for emergency rescheduling. Last year, Brazil only avoided a cutoff of rollover loans by agreeing to pay a high spread of 2 percent over the London Interbank Rate (LIBOR) on its 1981 borrowings.

Warnings and dangers

The March 1981 South African financial monthly *Standard Chartered Review* reveals that the squeeze created by nonperforming bank portfolios was intensively reviewed last year by the Bank for International Settlements (BIS), the semiprivate central bankers club in Basel, Switzerland. The *Standard Chartered Review* writes:

> The danger to the Euromarkets lies in a loss of confidence which could arise from the failure to service debt of an important borrowing country leading to difficulties for a major bank in renewing short-term deposits from the market. Central bankers at a . . . BIS meeting last year called for improved supervisory practices by regulatory authorities, with the emphasis placed on prudential

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> control. . . . In effect, the authorities are saying to the international banks "All right, get on with it, but we shall be watching."

Debate in the financial press about the strains which undercapitalization of the Euromarket banks is placing on the ability to sustain debt rollovers has become so widespread that we have little doubt that at least one "major bank" if not more has already hit against the default crisis warned about here. Since only the BIS and a handful of private bankers have a detailed breakdown of who has lent what to whom, it is a simple matter to keep such developments secret.

For example, we also find the Euromarket crisis warned about in great detail in the mid-March annual banking survey of *Far Eastern Economic Review*, which is published by one of the leading "insider" cliques in offshore banking, the Hongkong and Shanghai Bank. The *Far Eastern Economic Review* explains that the Eurobanks are trying to persuade oil-exporting countries, which have deposited huge sums in short-term deposits with commercial banks since 1974, to spread their deposits out to a wider array of institutions. Such deposits currently outweigh permanent shareholder deposits to such a degree that the Eurobanks can no longer guarantee interest earnings to their Arab creditors. The *Review* notes:

> At the end of 1979, oil-exporting countries had U.S. $115 billion in bank deposits; by now the figure is probably near U.S. $150 billion. The vast majority of these deposits are placed with the largest banks in the world—90-95 percent of them with a group of almost 90 banks. A rough estimate of the total shareholders' funds of these banks is U.S. $136 billion, while their total deposits were U.S. $3.150 billion.

The ratio of shareholder funds to oil-export deposits noted above, which is nearly 1 to 1, is based on the shareholder deposits of home-country parent banks. When the Eurobanks are isolated out, the ratio of oil-exporter and other large short-term deposits to shareholder monies becomes nearly negligible.

Reporting on the period from December 31 to March 25, the U.S. Federal Reserve recently revealed that a marked pattern has emerged of U.S. multinational corporations taking loans from Euromarket subsidiaries of U.S. banks, instead of from their usual home-based creditors. The Fed—whose estimates are probably on the low side, since there are numerous channels for such loans which do not fit into their reporting system—cites a $5.5 billion reduction in domestic business loans for this three-month period, coincident with a $2.5 billion rise in Euromarket loans to U.S. customers.

Such loans reveal that Euromarket branches are attempting to beef up income-earning loans in the face of their growing international payments crisis.

The available options

During 1980, a series of patchwork arrangements was designed to get the global credit system to squeak through 1981. It is estimated that total balance of payments financing needs of governments worldwide will be no less than $90 billion this year, and more likely, will be $110 billion.

Commercial banks can forward around $50 billion in total "new" credits worldwide to meet these requirements. The International Monetary Fund/World Bank is expected to increase lending operations to over $24 billion this year. The $14 to $34 billion shortfall is expected to be filled by a series of complex arrangements including reschedulings, foreign aid from Western and Arab governments, and short-term bridge-financing loans from diverse sources including the Bank for International Settlements.

There is universal agreement among informed financial officials that the arrangements described above merely give a "breathing space" for longer-term options to be put into effect.

There are currently three options to reshape international long-term debt.

One would be a replay of the 1931 collapse of international banking which ushered in a decade of world depression.

Commercial banks in distress might simply shut down their hard-hit foreign branches and concentrate all lending activities at home offices. In October or November 1981, the U.S. Federal Reserve is scheduled to approve state applications for creation in the United States of a number of "International Banking Facilities" (IBFs), which will allow U.S. commercial banks the same privileges of lending without obligatory reserve requirements which exist on offshore markets. The inception of IBF lending activity may be the signal for throwing nonpaying international debt at London or Caribbean-based branches off board.

The IBFs may also be used in combination with a second, less extreme option which aims to reduce the portion of nonperforming debt on the banks' books, through a "weeding out" process.

There are moves by U.S. corporations to book loans at offshore offices of U.S. banks, described above, which is one signal that this policy is already under way.

Banks are also attempting to shift out of generalized "payments financing" loans into what they call "project" financing. A consortium of British banks recently pulled together a $2 billion package for a loan to Hong Kong to expand power-generating facilities. U.S. and British banks have also lent heavily to Mexico—which has just gotten a $300 million credit to build two

fertilizer plants—and to Brazil in recent months. The difference between project loans and rollover lending is that earnings are linked to specific assets, rather than to collapsing productivity.

Both of these options, which can also work in combination, presume that multinational financial institutions, including the IMF/World Bank and the BIS, will assume even greater importance in international monetary affairs.

At a conference of the private advisory group called the Group of 30 this week in Frankfurt, West Germany, former IMF Executive Director Johannes Witteveen asserted that unless a policy along these lines is implemented, the Third World will financially collapse. Witteveen—who is no friend of the developing sector—emphasized that renewed intensive austerity in the industrialized countries should be the foundation for combining Third World debt with performing loans. Witteveen noted that the IMF and other multilateral institutions could back a lowering of interest rates worldwide, if Western industrial countries would implement broad-scale programs of wage and price controls.

The decade of depression which these schemes assume can be averted by smoothly replacing current debt relations with government-backed institutions modeled on the European Monetary Fund (EMF).

The EMF is a pool of approximately $100 billion in official reserves of member European countries, scheduled to come on line in coming years.

The EMF can work in two directions to freeze and replace current Third World debt. By issuing bonds to commercial banks, which, because they are pegged to gold, are inflation proof, the EMF would soak up nonperforming Third World debt. The credit infusions from commercial banks simultaneously can be used to issue large new lines of credit to developing countries—not to refinance old debt, but to import productivity-building capital equipment from Western companies.

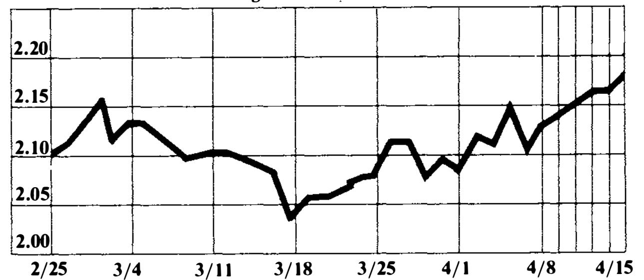
If the United States and oil-producing countries agree to associate status in the EMF, as has been offered by European leaders, then the mass of liquidity that would come together to generate new loans would be on the order of $300 billion, more than enough to wipe up the bankrupt Euromarket. An EMF-type arrangement may emerge in the near future, moreover, in current negotiations between the Soviet Bloc and Western creditors on reorganizing Poland's defaulted debt payments.

The French have proposed that Poland be given a 10-year rescheduling on debt due between now and 1984, including at least $6 billion in new long-term funds. If European governments issue gold-backed bonds to bolster these credit lines, then a precedent-setting test case for the EMF will have been brought into being.

Currency Rates

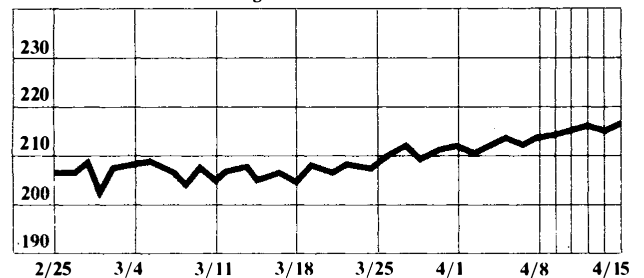
The dollar in deutschemarks

New York late afternoon fixing



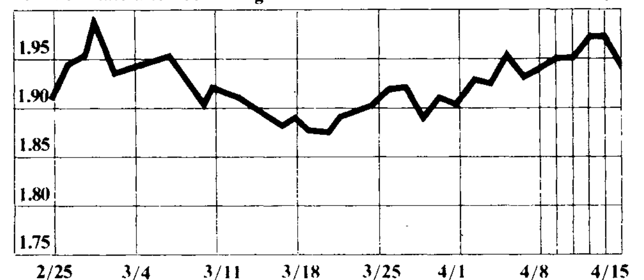
The dollar in yen

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