Bank for International Settlements conference maps a clampdown on international lending

by Kathy Burdman

A "secret and confidential" summit of bank regulators from Basel's Bank for International Settlements convened in Washington at the Federal Reserve Board Sept. 24-26 to plot controls and credit cutbacks on the international Eurodollar markets, Fed sources have told *EIR*. No press or private bankers, or anyone but central bank regulators, was allowed in but *EIR* has obtained firsthand reports.

The meeting was the annual session of the International Conference of Banking Supervisors, a group of 80 central bank regulators from around the world. BIS, the "central banks for central banks," has, with increasing success, imposed the principle that economic growth is "inflationary" and credit restriction to industry imperative. The conference, which included Third World central bankers and others, considered "mickies," by the elite at the BIS, was called to spread the thinking of the bank's select Cooke Committee. The Cooke Committee, headed by Bank of England Director of Bank Regulation Peter Cooke, includes only the 11 top members of the BIS led by England, the U.S., and Switzerland. It was founded after the bankruptcy of Germany's Herstatt Bank and the New York's Franklin National Bank in 1974, to lay down all central bank laws for private bank lending.

Peter Cooke himself opened the meeting with a shocker. Mr. Cooke revealed that a recent study by the Bank of England had found that any new "crisis" in the $1.2 trillion Eurodollar market could be blown out of control by the over $900 billion in that market held in *interbank* deposits.

Mr. Cooke explained that, as the Euromarkets have grown, the size of the interbank market, or what banks deposit with each other, has grown "quite rapidly. The internationalization of the banking system," he stated, "has grown with the interbank market at an alarming rate, as banks of all nationalities become drawn together by a fine web of deposits amongst themselves which supercedes national boundaries."

The very existence of such a market poses a danger to the world banking system, he stated, because "they create such a web that if one participant should fail, it would be very difficult, almost impossible, for other banks to withdraw."

Mr. Cooke noted that with the age of electronic funds, banks are also shifting deposits among themselves far more rapidly. "This is more efficient," he said, "but, paradoxically, it also presents more problems. If trouble occurs, it could work its way through the system instantaneously."

Mr. Cooke's alarming speech was buttressed by a 10-page study, "Eurobanks and the Interbank Market," issued in the Bank of England's latest *Quarterly Bulletin* in September. It concludes:

"The existence of the interbank market does not in itself increase the likelihood of a Euromarket crisis . . . The growth of the interbank market does, however, mean that if a crisis should occur, its results could be farreaching."

The very size of the interbank market, "has increased the volume of funds which would be involved in any Euromarket crisis," the bank writes. By so doing, it has also increased "the number of transactions with which the banks have to deal. Interbank activity has thus intensified the pressure for setting up more efficient clearing systems [such as electronic funds computer systems], and now their very efficiency could result in any ripple effects from a crisis of confidence being transmitted very rapidly through the Eurobanking system.

"A slightly more subtle concern arises from the impact of interbank transactions on the flexibility of the market," they continue. "If funds pass through chains of banks between deposits and final borrowers, this increases the number of parties which could be affected in the event of a bank facing liquidity difficulties." This was the same conference where U.S. Federal Reserve Governor Henry Wallich raised the spectre of world debt problems, and called for severe BIS restrictions on commercial bank lending to LDCs.

Focused on "lending risk," Wallich's speech was aimed at enforcing the policy enunciated by U.S. Treasury Secretary Regan at the IMF's annual meeting in Washington: that world credit to the developing sector must be drastically cut. Wallich tacitly invoked depopulation policy: as a Washington spokesman for the Overseas Development Council told *EIR* recently, statements by the ODC and the Draper Fund that population is a "risk" for lenders has already caused many banks and corporations to halt investment in the Third World.

Wallich notes that under current circumstances banks are issuing new loans to cover rescheduling of principal and even interest, which he terms bad policy, although the alternative for many LDCs is starvation. He then proposed various extreme regulatory measures to halt rescheduling and slash net lending—and, in effect, world trade.

As Mr. Cooke told the gathering, "National bank regulators must deal with this on a supranational level. The interbank market shows that your banking problems are mine too." Cooke ended with a call for "new cooperation" on reducing international lending.

Excerpts from Governor Wallich's Sept. 26 speech:

There is a need to individually adapt our national laws and practices into an international framework. . . . For my part, I shall discuss some aspects of international lending risk. . . . In particular, I intend to address the questions of anticipating international lending problems, banks' rescheduling of country debt, and the degree to which banks are preparing themselves to meet such risks by charging appropriate spreads and by building up adequate capital positions.

Analysts of lending risk in the international sphere have focused, in recent years, on the assessment of country risk—especially the risk of lending to developing countries. The past few years' experience suggests that our ability to anticipate future problems in this sphere is modest. First, problems have sometimes cut across country lines, involving particular industries such as shipping, steel, and real estate. Second, some country problems do not involve developing countries, as the present debt situation of a certain Eastern European country exemplifies. Third, among developing countries themselves, difficulties have been experienced with countries of very good credit standing, as was the case of Iran. . . . It is sometimes thought that the usual rules of lending risk do not apply to sovereign borrowers. It has been said that lending to countries is less risky than lending to businesses or individuals because a country will always be around. . . . All that is needed is occasional rescheduling that gives the lender a breathing space and does not significantly affect the earnings or capital of the lending banks. In my judgment, this is too complacent an attitude. . . .

If short-term credits are regularly rescheduled, banks may be less willing to extend such credit generally—a development that could eventually be very damaging to the borrowing country. Moreover, from the standpoint of the borrower, it needs to be noted that rescheduling may increase in a nonproductive way. . . .

One common way in which the international financial community seeks to ensure appropriate use of the rescheduling mechanism is to make debt restructuring contingent upon a standby agreement with the IMF ... contingent upon an economic stabilization program. . . . The Fund's conditionality then serves the purpose of altering the policies of the borrower. . . . For this reason, our own governments should insist that the IMF adhere to a strict line on conditionality.

Should it bow to pressures to greatly expand its lending on relaxed conditions, the long-term viability of borrowing countries may be threatened, and the integrity of the rescheduling process could be undermined. These developments would jeopardize the availability of private credit to the developing world.

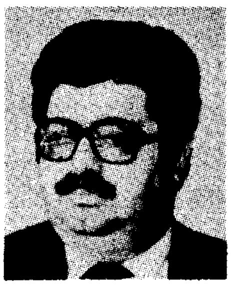
Situations where a country might begin to rely on rescheduling for the indefinite future should be guarded against. Rescheduling then could become a Ponzi game in which the banks would be lending the borrower the interest so as not to have to treat the ever-mounting loan as non-performing. When the unpaid interest on a loan is capitalized, i.e., treated as part of the principal whose repayment is deferred, a first step is being taken in that direction. . . . The extreme case of a country altogether repudiating its obligations may be unlikely. . . . But an intermediate case—suspension of payments or whatever the term might be—surely cannot be ruled out as a possibility. . . . To play our own roles in averting this possibility, we should pause to ask ourselves whether the present rate of growth of international bank lending is warranted by real needs and economic capacity on the part of the borrowers. . . . For two reasons, it may be argued that the world has reached the point where a slowing down in the rate of growth of debt is necessary. First, the higher proportion of rescheduled debt should make us uneasy. . . . Second, the high level of interest rates unfortunately also adds to the risk inherent in any given level of debt. . . .

In particular, the question arises at what point the banks should begin to set up reserves against such loans. A recent multi-country review of country practices by the BIS found that in no major country are delays in payment or interest on sovereign loans automatically classified as doubtful assets. . . . In the United States, only loans that are explicitly delinquent must be placed in a non-accrual status by the banks. Rescheduled loans seldom reach this state . . . loans to Poland and Turkey are not now considered in a non-accrual status by U.S. banks.

For all these reasons, it seems advisable to me that regulators begin to formulate ideas about the balance-sheet and income-statement treatment of rescheduled loans. . . . We will first have to address a number of questions such as: should reserves apply only to country loans or should they be maintained on rescheduled commercial loans as well? How do regulators discern the difference between a refinancing and a rescheduling? Should all rescheduled loans be accorded the same treatment, or should supervisors have discretion? If reserves are to be set aside, how big should they be in relation to the loan, and how long should they be maintained? . . .

It is evident that an explicit set of policies will not be developed in the near future. Meanwhile it is up to us to make sure that banks have, or are on their way to achieving, adequate means to protect themselves against sovereign risks. We should ask questions such as: are they pricing this risk properly, building earnings that will offset any eventual losses? Are they adjusting their capital to serve as a buffer against potential international lending losses?

Interview



Turgut Ozal on the IMF and Turkey

Turkish Finance Minister Turgut Ozal held the following discussion with *EIR* Economics Editor David Goldman during the Sept. 28-Oct. 2 meeting of the International Monetary Fund in Washington. Ozal's brother Kurkut is a leader of the National Salvation Party, a Muslim Brotherhood front; his brother Yusuf is at the World Bank; and his son Ahmet works for the IMF. Cited by *Euromoney* magazine as Economy Minister of the Year, Ozal has taken charge of an economy that 20 months ago had become the most cited example of a developing sector economy in real trouble. Since then the country's economy—at least from the standpoint of its creditors—has turned around, although at the cost of a fundamental postponement of Turkey's industrialization goals.

During the first eight months of 1981, Turkish exports rose 58 percent compared to the similar period in 1980, a result comparable to that achieved by South Korea or Brazil.

However, unlike the South Korean case, Turkey did not break into markets for industrial goods previously dominated by industrial nations, but concentrated on consumer items aimed at relatively familiar markets, particularly the Mideast and North Africa.

Ozal wrenched the Turkish growth pattern out of production for a domestic market, including substantial state-backed investment in heavy industry, toward a light-industry export program aimed at taking advantage of the nearby Mideast market. The minister provides a philosophical explanation for the change in the following interview, but the new government's program was the only option left by the country's creditors. In contrast to the Philippines, which threatened to walk out of the International Monetary Fund if IMF loan conditions were toughened, Turkey is relatively uncritical of the Fund. The difference may be found in the fact that while the Philippines have Japan to back them up, Turkey is at the mercy of its creditors.

Goldman: President Reagan in his address to the IMF meeting stressed the role of private enterprise as the solution to world development problems, speaking to an audience of countries whose economies are for the most part heavily based on state-sector enterprises. What is your reaction to this?
Ozal: I would prefer to talk about my own country—I cannot speak for others. Even a country like Turkey has more and less developed regions, so it is very difficult to generalize. But generally what President Reagan has said is true. I don't deny the role of the state, building up of infrastructure from which everyone can benefit. This cannot be done by the private sector. Then this infrastructure is used by the private sector.

Goldman: The developing countries objected strenuously to the argument of the Interim Committee that their deficits had to be reduced by cutting back imports. What is your view of these differences?
Ozal: My remarks will be limited to the case of Turkey. Private companies and individuals could play a more important role than before, in bringing about less inflation and a higher growth rate. I believe that private individuals have a better chance to do this than state enterprises. We have tested this in our own economy. In Turkey we have a mixed economy. Largely it is true that the state cannot produce as efficiently as the private sector. There is also a state role in the economy, but not for micro-level intervention. In my country we have had strict price controls, but they have never worked.

Goldman: The Managing Director of the IMF, Mr. de Larosière, was explicit that the developing nations would have to make even more sacrifices to reduce their balance of payments deficits, by which he meant reducing imports. Turkey has already gone through a difficult period of austerity. Do you think this is possible?
Ozal: That implies, in one sense, reducing balance of payments deficits through a limited growth rate. It de-