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International Credit by Renée Sigerson

The Fed's new squeeze

The central banks are flexing their muscles against private lending to developing-sector governments.

The March 8 monthly meeting of the Bank for International Settlements in Basel, Switzerland, cast a baleful eye on what central bankers there deem "excess borrowing" by the nations of the developing sector, my Washington sources say. Since the last IMF Annual Meeting in October, central bankers have been demanding that the commercial banks cut out their lending and force the Third World into austerity, but to no avail.

Now the BIS is ready to move, and the U.S. Federal Reserve is, as always, taking the lead. If U.S. Federal Reserve Governor Henry Wallich gets his way, American banks and perhaps others will soon be hit with a new set of central-bank lending controls which could enforce "a real contraction in world credit," my top source at the U.S. Treasury reports.

Wallich is proposing, on behalf of the BIS group, that the U.S. Fed force American banks to set aside penalty reserve requirements on any loan to a developing country which goes into rescheduling. These reserves would be required on extant loans as well as future loans. Since there are, in fact, potentially dozens of billions of dollars of such loans to countries in Eastern Europe, Africa, and Latin America already on the books, this could cost the banks a great deal.

Wallich's proposal, which he printed in the New York *Journal of Commerce* March 3 and 4, is clearly coming from his friends at the Bank of England and the Bank for International Settlements. Christopher MacMahon, Deputy Governor of the Bank of England, told the New Jersey Bankers Association on March 2 that "although the international banking system proved resilient to the upheavals of the 1970s, there is little doubt that . . . the increasing burden of debt is increasing risks in international lending. Decisions on financing the payments deficits of LDCs must be turned over to the bank supervisors and the IMF," he said.

Emil van Lennep, Secretary General of the Organization for Economic Cooperation and Development, the sister organization of the BIS, demanded in Paris the same day that "major LDC borrowers will have to move toward economic strategies which are less dependent on international trade and finance."

Under the title "Weak Loans Need More Rigorous Treatment," Wallich writes that private banks must now be made to stop their high rates of lending. "Rescheduled loans have increased in the past few years . . . and are becoming an area to which bank supervisors and regulators must give increasing attention." Banks should be required "to make a reserve allocation against non-performing loans," he concludes.

This will mean "contraction of world credit," my Treasury source confirmed, because the Fed is expecting a new round of reschedulings due to continued high interest rates and the jitters in the market caused by the Polish debt debacle. If the Fed then requires banks to set aside reserves of as much as 1 percent of their reschedulable loans, it would cost the banks $10 million in lost interest on the money set aside at the Fed for each $1 billion of debt rescheduled.

Since the Fed is also contemplating classifying any renegotiation of a debt as "rescheduling," there is at least some $10 billion in such debt upon which the Fed is ready to slap reserves. That alone adds up to $100 million in direct profit loss, in a sector which can ill afford it.

And, such reserves come directly out of the "high-powered money" the banks would use as a base for multiplying their lending many times, said my source. A $100 million set-aside of reserves could mean $1 billion or more in new loans never made.

The Fed will then be taking a direct, hands-on participation in the renogatiating process, telling Third World borrowers on exactly what terms they can renegotiate the loans, he said.

"It means very subtantial U.S. government interference in the so-called free market. It means telling the sovereign borrowers what to do."

Wallich, he noted, is advocating this extreme position because the Polish debt crisis has not slowed the rate of international lending as much as the Fed had hoped. The Reagan administration is reluctant to make such a government intervention, but "if there is another debt crisis like Poland, Wallich may get his chance."

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