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How not to solve the world debt crisis

by Kathy Burdman

Since the September 1982 bankruptcy of Mexico demonstrated that $700 billion in Third World debt faces a financial collapse, dozens of bankers and economists have pursued a "new Bretton Woods" system to restructure the debt.

Some, such as U.S. liberal Democrat Felix Rohatyn of Lazard Frères, propose that a "new institution" be set up to "stretch out" the debt; Rohatyn specifies a term of 30 years for principal of $300 billion, and a reduction in interest payments by half. These strategists argue that the current IMF system established in 1944 at Bretton Woods is inadequate, and that a new Bretton Woods must create new institutions parallel to the IMF, a demand echoed by "pro-Third World" groups such as the U.N. Conference on Trade and Development and the Brandt Commission.

From the so-called right, U.S. Treasury Secretary Donald Regan, Rep. Jack Kemp (R-N.Y.), and the NATO Atlantic Council demand that all the debt be paid, but also look toward a new Bretton Woods conference to reform the international currency system.

This is a rigged debate, as indicated by the fact that the new Rockefeller commission on Latin American debt, comprising both "liberals" and "conservatives," has been preparing multinational corporations to lobby for a "new Bretton Woods" debt plan with the threat that they will otherwise pull their operations out of the continent. Every plan for a new Bretton Woods, left and right, can be traced to the Bank of England; to the Swiss-based "central bankers' central bank," the Bank for International Settlements (BIS); and to their agency for controlling the underdeveloped nations, the International Monetary Fund (IMF). They plan a new global system, not run by nation-states which are more or less accountable to resistance against austerity by industry and labor, but one openly run by central bankers and private banks.

"For some time, people have operated under the fiction that credit arrangements with countries are sovereign matters. This is a lie," a consultant to the bankers at the Overseas Development Council in Washington, D.C. said recently. "We are on the edge of ending once and for all the idea that, on an international

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Stuart Lewis/NSIPS

The founding press conference of the Rockefeller debt commission, formally known as the Commission on Western Hemisphere Foreign Debt and Public Policy. Left to right: John D. Macomber of Celanese Corporation, former Chase Manhattan chairman David Rockefeller, and Robert Hormats of Goldman Sachs investment bank.

scale, credit is a sovereign instrument, regulated by individual countries and their banks. Credit is to be regulated and directed according to international arrangement and in no other way."

To the United States and other industrial nations, the new system would not mean recovery, but rather the institutionalization on an international scale of the kind of credit controls which Federal Reserve Chairman Paul Volcker has imposed upon the American economy since October 1979. Although Rohatyn and other proponents of "debt relief" claim that lower debt payments will mean more U.S. exports to the LDCs and will thus stimulate recovery, in truth overall world credit flows would be reduced dramatically, causing a collapse of U.S. export industries, especially agriculture.

The United States itself, if it signs such an international agreement, would be committed to maintaining a tight credit policy regardless of who runs the Federal Reserve or the White House. "The Reagan administration will not subscribe to this idea," said the ODC source, "but they will be forced by the crisis to accept it." The United States is to be treated "like a developing sector country," he stated. "We are all in the same boat."

Proponents of the new Bretton Woods openly state in particular that under the agreement the United States would not be allowed to engage in the levels of defense spending necessary for President Reagan's new strategic commitment to a high-technology directed-energy beam weapons program. "Reagan's proposal won't come to anything after what we have to do to the entire U.S. defense budget," Frank Southard, author of the NATO Atlantic Council's new study, "The International Monetary
International Indebtedness," told *EIR*.

Origins of the debt crisis

Most of the players in the debt game do not grasp the fact that the current debt crisis was politically triggered to consummate the bankruptcy of the 1944 Bretton Woods system. The British government's April 1982 shooting war against Argentina was the pretext. Since then, central and commercial banks have essentially pulled the plug on $700 billion in debt. Argentina, Mexico, Brazil, Venezuela, Peru, Colombia, Nigeria, Indonesia, and a dozen other nations, whose development programs were "perfectly viable," in the words of IMF officials, were bankrupted deliberately by sudden unfounded bank loan refusals.

In May 1982, with the participation of BIS chief economist Alexandre Lamfalussy and IMF Managing Director Jacques de Larosière, and directed by Barclays International Manager Sir Peter Leslie, the bankers allied with the BIS established a formal creditors' cartel, the Ditchley Group, now known as the Institute for International Finance.

Shortly thereafter, the basic outlines of the new Bretton Woods were announced by spokesmen for the central banks themselves. The key statements on the use of debt for imposing austerity upon the Third World were made by former British minister Lord Harold Lever, in his summer 1982 Churchill Memorial Lecture, and by Giovanni Magnifico, Central Manager of Operations at the Bank of Italy and spokesman for Venetian financial interests, in a London speech on Dec. 10, 1982.

Lever announced that the post-war Bretton Woods system had permitted too much world lending, allowing the Third World to aspire toward development, and must be redesigned to halt this. He also pointed out the danger of a debtors' cartel which could hold the BIS banking system "hostage." To reorganize the system, Lever called for the formation of "an International Bank—a sort of central bank of central bankers."

That institution would see to it that this sort of debt expansion never reoccurs: it would impose credit controls over all new loans. Nations would have to "pool" their sovereign control over the issuance of future new credit. This was the purpose of calling in the loans in the post-Malvinas credit cutoff to most of Latin America: to enforce reductions in their total of future credit.

A debt exchange

However, to maintain control over the old loans, Lever said at the time, the International Bank would have to restructure them through a debt exchange. It was stressed that the BIS central banks and private banks of the North must control this process. Lever proposed that the Bank exchange its own long-term bonds to the private banks and take on their holdings of LDC short-term debt. In other words, the Bank would become the creditors' collection agency. The terms of collection of the old debt, however liberalized, would stipulate reduction of new credit volume.

Giovanni Magnifico of the Bank of Italy suggested to a London audience shortly thereafter that the debt exchange could be illustrated with the example of the World Bank as the collection agency. "The World Bank could help to fund a part of the LDCs' short-term foreign debt, by issuing special bonds and using the funds raised to grant 'funding loans' to the LDCs, who would be required to use these loans to reimburse their short-term bank debts," he said. Magnifico pointed out that if the collection agency were thus "linked" to the IMF, the IMF could have conditionality powers over LDC debtors to ensure payment of restructured debt.

The new agency could also be a "sister fund" of the IMF, turning the IMF into a "world central bank," former U.S. Treasury Secretary Henry Fowler, now at Goldman Sachs investment bank, told the Senate Foreign Relations Committee on Jan. 10, 1983. Control over world credit "is not provided for in the IMF charter," Fowler complained. "That gap has to be filled. We should look at the IMF and see if its charter needs to be revised. Now is perhaps the time to talk about a world central bank."

In a Sept. 27, 1981 speech given to the IMF annual meeting, then BIS president Jelle Zijlstra had made one of the first public calls for a "new Bretton Woods" currency system of "fixed but adjustable rates of exchange." Zijlstra called for an international monetary conference at which the central banks of the Bank for International Settlements would re-establish an official gold price.

Zijlstra in effect showed how the industrial nations of the OECD were to be placed under the same regime as the Third World, using currency rates rather than debt agreements per se. To enforce a currency peg, the BIS central banks must be given veto power—"harmonization"—over the domestic policy of member nations, including control over credit, over budget deficits, and wage and price controls, he said. This is the reality of the "Rohatyn Plan" currently being peddled to the Third World under the rubric of debt relief, and to the advanced sector as the only means to enforce "fiscal responsibility."

A pre-emptive effort

As *EIR* has reported for the past several years, Lord Lever, Magnifico, and Zijlstra are correct in one essential respect: The Bretton Woods system was quite definitely completely bankrupt, even before the creditors' cartel pulled the April 1982 plug. The economic policies of the BIS central banks have kept the world as a whole on a negative growth path for two decades, making it impossible in any case for the Third World to generate the revenue required to pay $700 billion in foreign debt.

Global central bank is unconstitutional

Plans to assign control over U.S. foreign lending to the International Monetary Fund (IMF) and the Bank for International Settlements (BIS) are in flagrant violation of the Constitution.

Under Article I, Section 8 of the U.S. Constitution, Congress and only Congress has the power to regulate currency and credit. Further, under Article II, Section 2, the President has the sole power to make foreign policy, with the advice and consent of the Senate where treaty arrangements are involved. None of these powers may be legally given or delegated to a supra-national body such as the IMF existing *above* the nation-state, which is the highest juridical form recognized by a sovereign republic and by the Constitution.

Under legislation pending in the Senate and House Banking Committees, the Federal Reserve and the IMF would be given total control over setting all U.S. foreign loans and over classification of "country risk" in the Third World. Comptroller of the Currency C. Todd Connover

EIR founder Lyndon H. LaRouche, Jr. for years has called for the reorganization of the system, starting with a moratorium on the entire $700 billion.

In fact, the three central bankers' plans can be seen as a twisted Malthusian plagiarism of one part of LaRouche's proposal, which was published in June, 1982 under the title "Operation Juárez."

LaRouche proposed two basic steps. First, the nations of the industrial North and the Third World must agree to stabilize the debt; a "debtors' cartel" may well be required to bring the North to the table. The debtors should exchange their unpayable, short-term, high-interest debt paper with the banks for an equivalent amount of 20- to 30-year long-term bonds at 2-4 percent interest rates. LaRouche was the first to propose the idea of the debt exchange, but only under the strict sovereign control over credit by nations, acting on behalf of the growth and well-being of their populations—not by the IMF and other supranational institutions loyal only to the supranational, neo-colonial principle of subordinating and reducing the "lesser races" and suppressing technological advancement.

Second, LaRouche insisted—and this specification has since been taken up by leaders in Japan, India, and Latin America—that there be massive issuance of new credit to ensure industrialization of the Third World, incidentally the only way the debt can ever be paid in any case. LaRouche proposed that nations establish a new international institution, a gold-backed international facility at which the bonds could be rediscounted, to generate several hundred billion dollars annually in export credit.

Otherwise, the bonds remain as worthless as the current debt structure.

Any bank which maintains that policy may participate. The BIS, IMF, and World Bank are cut entirely out of the picture to the extent they do not reverse their present animus toward industrial expansion.

Lever proposes the reverse, as LaRouche has pointed out: the use of a new international institution controlled not by governments, but by the private banks, and set up not to issue new credit, but to ration credit.

This, LaRouche said, is "a system in which bankers try to maintain their political power—and they, along with the rest of the world, lose a lot of money." For the austerity plans which have already caused sweeping bankruptcy will result in a crash which will be far more destructive than the 1929-32 catastrophe.

has pointed out that "this will very quickly become the most important decision made about economic relations between the United States and those countries."

The overriding principle of the new legislation is that the Federal Reserve, working with the IMF, will be given leading authority over the volume and direction of U.S. foreign loans, weakening all the current powers of the U.S. Treasury and related agencies such as the Federal Deposit Insurance Corporation. The effect will be to consolidate all regulatory power over U.S. banking under the Federal Reserve, in effect setting up the Federal Reserve as a giant new "super-regulatory agency" as was proposed during the last days of the Carter administration. The Federal Reserve will determine all this based on information it is given by the BIS and the IMF.

The law also states that the IMF should set up "limits" on how much countries can borrow, both Third World countries, and big countries like the United States. "The United States is really calling here for a new role for the IMF, a new order in which the IMF is going to be policing all world lending markets," one bank expert said.

No principle is more fundamental to America's Constitution than the notion of national sovereignty. Documentary evidence demonstrates that the notion of national sovereignty embodied in the Constitution is that of Grotius, Leibniz, Pufendorf, and Vattel, in which the sovereign lawful powers and authority of the U.S. government cannot be abrogated or subordinated to any other legal authority or supra-national body.

The exercise of national sovereignty involves certain fundamental powers necessary to carry out the great objects of the Constitution. The power to regulate credit and currency is one of the most fundamental powers given to the national government under the Constitution. This power was eloquently affirmed in Supreme Court Chief Justice John Marshall's historic decision in the 1819 case *McCulloch v. Maryland.*

The Federal Reserve System itself is of very doubtful constitutionality, functioning as it does as a "fourth branch" of government outside the constitutional framework of Executive, Legislature, and Judiciary. To then give such a "fourth branch" virtual dictatorial powers over U.S. banking and U.S. lending, is in total violation of the Constitution; the illegality is compounded by allowing the Federal Reserve to operate as an arm of the supranational IMF and BIS.

The e BIS and IMF proposals would mean that some of the most fundamental and important sovereign powers of the federal government are being assigned to a supranational cabal of Swiss and British bankers. That cannot be permitted by those whose oaths of office pledged them to uphold the U.S. Constitution.

'Banking system hostage to its debtors'

These excerpts are from Sir Harold Lever's summer 1982 Churchill Memorial Lecture.

The Eurodollar market became a mechanism for channelling the huge banking and other funds which could not find a satisfactory outlet within the stagnating economies of the advanced countries . . . but it had many shortcomings and many dangers. . . . What could be more enjoyable than a financial conjuring trick which transferred hundreds of billions to the weaker nations. . .? Governments and bankers continued to assert that this ever-mounting debt . . . which has the structure and stability of a chain letter, could continue indefinitely. The flaws in this arrangement are now clearly revealed. . . .

As a result, the system causes us to be seen as neo-imperialist usurers. In reality, the lending constitutes an unrequited transfer of resources that dwarfs the Marshall Plan.

The banking system as a whole, therefore, is at all these points heavily exposed—and to a unique degree. This pressure at worst threatens its solvency. . . . *The banking system is becoming hostage to its impoverished debtors* [emphasis added]. . . .

The governments of the world must now accept some responsibility for past lending and undertake the necessary supportive action. For past lending, ideally, governments should agree on joint action to protect the world's banking system by setting up an International Bank. It would act as a lender of last resort in appropriate cases, and would exercise the kind of general supervision over international lending that is now exercised by central banks over domestic lending. . . . This might be done by a committee of central banks, preparing a periodic outline of the total volume of bank lending needed. This overall sum would then have to be apportioned between the prospective borrowing countries: for this purpose, lending banks would be required to notify proposed loans to the committee so that the overall Eurodollar lending would be brought under the general central bank supervision.

'Give the World Bank a new role in LDC debt'

Excerpts from a speech by Bank of Italy Operations Manager Giovanni Magnifico in London on Dec. 10, 1982.

In normal circumstances, short-term loans can be rolled over smoothly, which is what has happened for a number of years now. But once a confidence problem arises, refinancing becomes difficult. In order to reduce the risk of insolvency of debtor countries and the fragility of the international financial system, short-term debts need to be reduced.

The problem is how to fund the international floating debt. It will be necessary to invent new mechanisms and methods to pilot through the '80s what could amount to the largest international debt management operation ever.

I believe that the World Bank should be given a more important role in the management of the huge debts accumulated by the LDCs [Less Developed Countries]. Specifically, the World Bank could help to fund a part of the LDCs' short-term foreign debt, by issuing special bonds and using the funds raised to grant "funding loans" to the LDCs, who would be required to use these loans to reimburse their short-term bank debts. To place its bond issues, which would have an average life of 10-12 years, the World Bank would set up consortia with the leading international banks, i.e., with the creditors of the LDCs, but the bonds should be placed primarily with the various categories of private and official investors.

To be able to put this into effect, it would be necessary to modify some clauses of the bank's statutes as well as some of the criteria upon which its lending has been based to date.

It might be advisable to make World Bank funding dependent on the successful conclusion of negotiations with the IMF. It might also be advisable for the World Bank to be fully involved in these negotiations, to which it would bring its experience in the field of policies.

Whereas loans granted by the IMF involved the creation of money, this World Bank solution would not increase liquidity since it would be financed by the market. . . . A solution of this kind as far as the World Bank's role is concerned, avoids having recourse to the creation of liquidity.

'Halt the excesses in budgets and wages'

From the speech by Bank for International Settlements president Jelle Zijlstra, then chief of the central bank of the Netherlands, to the IMF annual meeting on Sept. 30, 1981:

In my speech to the Annual Meeting of the BIS in June of this year, I said, and now I quote: "If the domestic price of money is not to be disregarded, why should its external price be? We cannot safely adopt as a principle that exchange rates should be left to their own devices. The exchange rate is too important a macro-economic variable." My own answer is a paraphrase of Walter Bagehot: "rates of exchange will not manage themselves," or "rates of exchange are too important to be left alone." The principle in that answer is explicitly recognized in the Bretton Woods type arrangements which exist within the European Monetary System for fixed but adjustable exchange rates, with narrow margins of permitted fluctuations, between the currencies of participating countries. For that to be possible there must be sufficient harmonization of economic policies. . . . In my opinion, control of the money supply is necessary but not sufficient. Fiscal policy [budget cuts] plus wage and price policies [controls] cannot be dispensed with. . . . Money creation run wild induces excesses in the budget and in wages, or prevents them from being corrected. In my country, we have had for many years at our disposal the instrument of credit ceilings. If the expansion of money supply threatens to assume unduly large proportions, the Netherlands Bank can impose restrictions on the volume of lending by the banking system. In the past, this power was exercised repeatedly; the last restrictions were imposed as from 1977. . . . It is most frustrating that, sales against foreign exchange apart, there is no systematic manner in which this reserve component can be used. . . . I feel that it is necessary for us, within the Group of 10 [industrial nations] and Switzerland, to consider ways to regulate the price of gold, so as to create conditions permitting gold sales and purchases between central banks as an instrument for a more rational management and deployment of their reserves. . . .

'A crisis will bring Reagan into line'

From an interview last month, provided to EIR, *with an official at the Overseas Development Council:*

Q: Why is there so much discussion about a "new Bretton Woods"?

A: It is needed to create a sense of urgency. I am certain, that with the briefings going into the White House, the effect will be achieved.

There were some stupid people like Citibank's Wriston who said that every penny of the debt would have to be paid. He has even been forced to change his mind.

The solutions being discussed are all converging on one general plan. First, that developing nations will be given what is called an "international Visa card" with a credit limit for both private and public borrowing. In addition, the IMF, with enlarged funds, will provide backup. The banks will provide loans to pay interest on existing loans and in most cases allow moratoria on principal payments. There is going to have to be some kind of global operation to exchange short-term paper for long-term paper and an orderly writedown of non-performing paper.

For some time, people have operated under the fiction that credit arrangements within countries are sovereign matters, that how much somebody lends, to whom and on what terms, are sovereign matters. This is a lie. . . .

Felix Rohatyn is selling snake oil

In the early 1980s, a major publishing firm quitted its New York City headquarters after decades of residence, citing the steep escalation in commercial rents and the collapse of the supporting urban infrastructure—which the firm said made it impossible to conduct business in New York any longer. Of the companies that have remained in "Fun City," there isn't one that hasn't experienced a drop in employee productivity owing to the breakdown in transportation and other services that are necessary to maintain a productive work force.

The individual who is, above all, responsible for the gutting of New York's productive economy—and the flourishing of real estate speculation and the illegal economy—is Felix Rohatyn, the investment banker from Lazard Frères. As architect and chairman of the Municipal Assistance Corporation (MAC), Rohatyn designed the "stretch-out" of New York short-term debt in 1975 which purportedly brought the city back from the brink of financial crisis. New York City's short-term debt was rolled over one more time; its creditors exchanged their worthless city paper for MAC bonds backed by the state of New York; services were slashed and capital spending cut to the point where today the city's sewers are on a 300-year replacement cycle.

Now Rohatyn is proposing to put the world economy through the same "pain and agony," as he was fond of calling his financial medicine for New York City's 1975 debt crisis.

As noted in the introduction to this Special Report, Rohatyn's program is based on the proposals of Britain's Lord Harold Lever and Lever's co-thinkers. A version of the Rohatyn call for a "stretch-out" of debt, minus the politically explosive proposal for a new institution, is the centerpiece of the new Omnibus IMF Bill in the U.S. House of Representatives, introduced by House Banking Committee chairman Fernand St. Germain (D-R.I.), a close Rohatyn ally.

Rohatyn likes to pose as a liberal. He works with the Harriman-Manatt wing of the Democratic Party; he is being promoted by AFL-CIO president Lane Kirkland as the next treasury secretary in a Democratic administration; and he puts himself forward as a friend of the Third World. But the "debt relief" plan Rohatyn is advocating involves global credit constriction tough enough to shock an arch-monetarist.

In New York, in fact, Rohatyn modeled his financial wizardry on that of Nazi Finance Minister Hjalmar Schacht,