EIR Economics

Operation Juárez emerges out of the Brazilian crisis

by David Goldman

An Ibero-American debtors' cartel will form at the end of June, drawing the continent's major debtors behind Brazil's confrontation with the International Monetary Fund(IMF).

As in all such preparations for conflict on the grand scale, events have moved faster than either the Brazilians or their major creditors predicted or desired, and the inner dynamic of the past weeks' events has often been obscure to the principal participants. Nonetheless, both the creditor and debtor sides have decided upon a crisis now, rather than later; and this decision has touched off a chain of events which break apart the rules of the game as it has been played since the Mexican crisis broke in August 1982. A fledgling Ibero-American movement for a common market, following the outline offered by this publication's founder one year ago in the document, "Operation Juárez," has inserted itself into calculations previously based on a view of the continent as the passive battlefield upon which creditor interests would be fought. See, for example, the interview below with Carlos Alzamora, the permanent secretary of the Caracas-based Latin American Economic System (SELA), one of the principal spokesmen for the need for continental integration around the perspective of economic development. Alzamora's message is clear: the debts will be paid only on the condition that the standard of living of the Ibero-American population and the prospect for economic development are maintained.

As *EIR* has reported, the failure of the IMF to disburse over $400 million of Brazil's earlier loan tranche at the end of May compelled Brazil to postpone an equal payment to the Bank for International Settlements, the source of another short-term "bridge loan." Brazil has built up over $2 billion in arrears during the second quarter to date, largely because the flow of short-term "interbank" credits to enable it to meet payments has dried up, and the failure of the IMF to disburse the previously negotiated credit would break its external finances and force a default. The creaking, sagging commercial bank rescheduling package for Brazil depends on the success of the IMF program, and the IMF's refusal to disburse would knock down the entire house of cards.

Brazil's inability to obtain the IMF funds is a response to the country's "non-performance" with respect to conditionalities ordered by the IMF, including restrictions on Brazilian government spending which cannot be met without mass layoffs from government enterprises. Although the Brazilians have managed to bring their external payments situation into *apparent* balance, with a $1.4 billion trade surplus during the first four months of the year, the improvement owes heavily to misreporting of exports and statistical fraud.

In a way noticed by certain agencies of the U.S. government and by well-informed financial circles in Western Europe, the Brazilian internal situation "snapped" during the first week in June. The outer symptoms of this include a report June 1 that Brazilian central bank president Carlo Langoni had resigned; the report, subsequently denied, is a foretaste of the fall of Brazil's "economic triumvirate," Langoni, Planning Minister Antonio Delfim Netto, and Finance Minister Ernane Galvêas.

According to Brazilian and U.S. administration sources, military circles in Brazil's presidential palace have decided that the latest proposed round of austerity measures was politically unacceptable, especially in view of the jobless riots in major cities a month ago. Langoni's reported resignation—a headline item in Brazilian newspapers ignored by the international wire services—came in response to Delfim Netto's failure to introduce new austerity measures sufficient to bring about the IMF credit. The central banker, apparently, does not want to be in office at the point of default.

Sources close to Brazil's financial triumvirate argue that "the world will never let Brazil go under," and, especially, that the International Monetary Fund will bend the rules sufficiently to permit Brazil to obtain the required credit. At this point, the sources maintain, Brazil will be in position to approach the financial markets for a new "jumbo credit," taking sufficient pressure off the country's external finances to limp through to the early fall. What will happen then? "The world will not allow Brazil to go under," repeat the triumvirate's advisers.

Confrontation now rather than later

Although the illusions at the planning ministry in Brasilia are, by and large, shared by a majority of the American creditor banks, most of the latter are already preparing for a sharp confrontation at the end of the month. "There will be a few days of brinksmanship," says the head of risk analysis for one of the top New York banks. "We will go eyeball to eyeball, and then both sides will back down." Although detailed scenarios for avoidance of default are in circulation, none of them appears relevant.

The Swiss view of the matter agrees as to timing, but has a different edge: the Brazilian debt has been written off in Zürich and Geneva. The chief economist for one of Geneva's oldest and nastiest private banks argued recently, "No one can sell that IMF austerity policy in Brazil, no more than [French Finance Minister Jacques] Delors can sell it in France. Many Brazilians are asking just how many more people they are supposed to kill in São Paolo, and what for, because the rise of the dollar is eating up all the savings of the austerity program," by increasing the cost of imports and debt service.

"If the Brazilians say 'No!' at the end of the month, and there is hardly any way they can do anything else, then the Swiss, Germans and Dutch will have what they want: the United States will have to cough up the money. This is the climax. And that idiot Don Regan, with his stupid statement [at Williamsburg May 31] that he wants to put a ceiling on the growth of the money supply—that sent the dollar soaring, and the Swiss and the Germans are gleefully fanning the flames, just by buying small amounts of dollars to let the markets know they want a high-flying dollar."

"The probability of a full crisis is growing," the Swiss banker added, "all the more so because the monetarists regained the upper hand at Williamsburg. Of course, if I were a Brazilian I would say there is no other solution but to break the rules of the game."

English-speakers and German-speakers

The choice for an early confrontation has been made not only in Brazil, for urgent political reasons, but in Western Europe as well. At the end of April, Swiss National Bank president Fritz Leutwiler (also the chairman of the Bank for International Settlements) appeared in London to attack central banks who asked their commercial banks to continue to extend short-term interbank credits to Brazil and other debtor countries. This stunned the British; it was a direct, public assault against Bank of England Governor Robin Leigh-Pemberton and Federal Reserve Chairman Paul Volcker, who have armtwisted commercial banks to maintain short-term credit lines to Brazil and others in danger of default.

According to a senior official of the West German central bank (which belongs to a "German-speaking" central bankers' group as opposed to the "English-speaking" central banks), postponing the crisis might bring up "unforeseen consequences." Time is on the side of the Ibero-American faction which wants a debtors' cartel, the Bundesbank worries; a collateral problem is that the American administration might take a form of unilateral action which would leave both the International Monetary Fund and the Swiss-German group out in the cold.

The interbank credit issue has a great deal to do with why the German-speakers want a crisis now, rather than next September. It is not merely, as Leutwiler said in London, that substitution of overnight interbank lines for what should be medium-term balance-of-payments financing violates conventional banking practice, the German central banker argued: where the Swiss have drawn the line is around the issue of austerity.

IMF programs for Brazil, Mexico, and other big debtors have already cut those economies to the bone, without making a dent in the financing problem; the Swiss argument is that the cuts must continue no matter how severe, and that new credit must be shut off as a means of enforcing such cuts. Any "flexibility" on the part of the International Monetary Fund in the Brazilian case would set off a "chain reaction," the Bundesbank argues, making countries believe "that there is easy money available."

"The principal encouragement to this belief," the central banker added, "is the special lines of interbank credit that have been made available to countries outside the normal negotiating channels." This is a reference to about $40 billion of interbank lines opened up to the major Ibero-American debtors between August and February, including about $12 billion to Brazil. While the commercial banks continue to dicker about a mere $2 billion in missing so-called "Project Four" credits as part of the overall Brazilian rescheduling package, the biggest creditors have all had to cough up substantially in excess of that amount. This leaves some banks with two and three times their shareholders' capital exposed to Brazil; Manufacturers Hanover, Chemical, Chase and Citibank are furthest out.

The Swiss objective (with West German support) is to trigger a collapse of the interbank credit pool, leaving the major American banks with sour interbank deposits in excess of their shareholders' capital. In a recent discussion, the Swiss National Bank's chief of bank regulation, Dr. Baltensperger, elaborated this viewpoint:

"As of now we know the sorts of things that are a danger to the system, and we can distinguish that from dangers to a bank or banks. A bank is not essential to the system.

"Now, up to now, we have said we are not sure that the IMF would need unusual financial resources, but that could of course change dramatically and quickly. The problem with letting the IMF just go to the open markets is that this money would not be available in other markets. In other words, we need a similar ability to distinguish between countries: it makes no sense to try to salvage countries that are in a hopeless position just by creating new IMF instruments, and then end up destroying the capital markets in the industrial countries, and other markets. That would have its effect on the domestic economies, and the pressure for reflationary policies would be practically irresistable.

"So, we have to be able to distinguish among various cases. The IMF has the advantage that it is the only institution that can apply and enforce conditions, but the IMF has problems making the necessary distinctions among countries. Our attitude is, if the IMF is willing to help, okay, but if it does not work, then do not try to shift the responsibility to other institutions."

To the extent the Swiss argue on grounds of banking principle, it reflects that nation's special gift for Calvinist hypocrisy. Rather, the Swiss banks believe that a general crisis in the American banking sector will force the United States government to pick up the bill. Added to the already uncontrollable federal budget problem, the new crisis will break American finances, and ultimately put the United States at the mercy of the international institutions (the Bank for International Settlements in particular) for help in sorting out the international consequences of its domestic policies. The crisis would represent, in the Swiss view, a mortal leap from the mere phraseology of "multilateral surveillance," as expressed at the most recent industrial nations' summit discussions, to surveillance of the type which would dictate domestic budgetary policy to the United States.

Baltensperger added in this vein, "Of course, we too want 'one world,' but not one unified, uniform world. We are dyed-in-the-wool federalists, not centralists. We like variety."

The Swiss central banker explained that the interbank problem—the huge borrowings of the major Ibero-American banks on the New York market—would become the bludgeon that broke the United States:

"American banks are already willing to accept the fact that they are not the cornerstone of the system any more. The European banks have already learned their lesson, which is that they have to stand on their own in the Euromarkets. Now, all this talk about how or whether to stretch out the debt is really just a demonstration of how much the U.S. banks have already lost much of their power. . . .

"We have the revision of the Basel Concordat [the agreement between central banks on division of responsibilities for the solvency and liquidity of international banks' branches in foreign countries—D.G.], although we are still not sure that everyone will accept it. Under the revision, if, let's say, a subsidary of a Brazilian bank in the United States, with free access to the short-term U.S. money markets, were to get in trouble, it is obvious that this bank is not merely a Brazilian bank. It is also an 'American bank,' under the responsibility of American authorities. Our banks are very sensitive to American banking behavior on this point."

The implication is that the Federal Reserve will be stuck with the consequences of domino-style failures of Ibero-American bank branches in New York. According to Federal Reserve officials, the problem is that Banco do Brasil and other big Brazilian banks have borrowed perhaps $12 billion on the overnight money markets in new York, and re-lent the money to their central bank for eight years (this is reported as "medium-term debt" in Brazil's foreign debt accounts!). Should the central bank suspend payments, the New York office of Banco do Brasil will not be able to meet its obligations, leaving the a $12 billion hole in the money markets.

The conclusion is that the International Monetary Fund, which the banks ran to for money as well as political clout when Brazil ran into major trouble late last year, has led the banks into an ambush. Not only has the IMF policy ruined Brazil's payments capacity, but the political squeeze in the form of "conditionalities" is about to backfire massively. The Swiss attitude, under the circumstances, is that whichever player endures in the poker game the longest will collect all the chips.

Operation Juárez

About a year ago, *EIR*'s founder and contributing editor, Lyndon H. LaRouche, Jr., argued in the policy paper "Operation Juárez" that the Ibero-American nations should form a unified debtors' cartel and common market. This new institution should then offer to negotiate a long-term stretchout of the continent's debt, along with new export credits; the credits should facilitate the completion of "great projects" in the water, transport, and energy spheres, permitting a wave of rapid industrialization across the continent.

The continent is now dragging itself into such an arrangement, kicking and screaming all the way. This is the situation President Reagan will confront a month from now. Some of his advisers are already telling him that nothing short of a massive debt stretchout, permitting these countries to reduce their debt-service ratios to manageable levels, will prevent disaster. Secretaries Shultz and Regan have not deviated from their old argument that the "recovery" will solve these problems by itself.

President Reagan, under the advice of Japan's Prime Minister Nakasone (see article, page 8), made at least a verbal gesture in direction of cooperation with the developing sector during the just-concluded summit. At least some of his advisers see no other way out. If he adopts this approach, the worst consequences of the debt bomb might be avoided. If he does not, the Swiss may well inherit the world banking system, the way cockroaches reportedly would inherit the world after nuclear war.

Interview: Carlos Alzamora

'We will pay the debt, but not for usury'

In the following interview, conducted by EIR*'s Bogotá bureau chief Maximiliano Londoño on May 21 in Bogotá, Sr. Alzamora spoke on the subject of Ibero-America's debt.*

Londoño: What prospects do you see emerging from the recent initiatives on the debt issue made by the presidents of Ecuador and Colombia on the eve of the Williamsburg meeting?

Alzamora: I believe that the waves from these initiatives, of this Latin American consensus, will reach the political leadership of the industrialized countries in one way or another and make them acquainted with the great anxiety which the present system of debt negotiations is provoking. I believe and hope they will embrace Latin America's concerns and the alternatives it is suggesting. . . .

Londoño: Then this means that the region has to come forth with a joint proposal on debt for there to be a viable solution?

Alzamora: This is the categorical proposal which SELA and CEPAL are puting forward right now. We think the problem is of too great a magnitude to be solved within the individual capacity of the countries, banks, and international financial entities; it demands a meeting of minds at the political level between debtors and creditors. This meeting of minds can only be possible on the basis of a common proposal issued by the debtors.

I refer to a joint proposal of the Latin American countries, which of course should not be confused with a "collective renegotiation," which we ruled out not only because it is technically impossible, but also useless and ultimately unrealistic. But we should propose conditions commensurate with Latin America's ability to pay, and which take into account three main objectives:

1) equitable distribution of the adjustment;
2) preservation of the standard of living of the Latin American population, as a minimum goal;
3) guarantee of the continuance of Latin American development.

The autonomy and sovereignty of national decisions must also be preserved. This is one of the things the political confederation is crying loudest for now.

Londoño: Don't you think that the debt problem is so serious, as ex-President Pastrana of Colombia put it, that it has already transcended national boundaries? And, given that the creditors are organized, as in the case of the Ditchley Group, would it not also be appropriate for the debtor countries, through a collective effort, a collective renegotiation, to impose their own conditions?

Alzamora: Certainly debtor countries have the indisputable right to associate in the form they deem best, and in spontaneous, sovereign form, be it individual or collective. Obviously it will depend on their policy, on the strategy that they want to follow in this case. But they have the right to do it; it is an absolutely inalienable and unquestionable right.

Londoño: Some months ago, you mentioned the proposal for a "debtors' cartel"—at least it appeared in the Latin American press with this headline.

Alzamora: I never used the word "cartel," but rather, "sindicato" [union], because it really is a question of achieving just conditions to pay the debt more successfully and effectively through joint action than through individual actions. We in CEPAL and SELA are convinced that Latin America has the joint capacity to establish these conditions, as long as it takes as its point of departure a principle which also cannot be renounced: the first obligation of Latin America is to itself, to the security of its development, and to the welfare of its people. . . .

Londoño: The Mexican and Brazilian presidents recently signed a series of accords to trade through barter; practically without using a single dollar, they could reactivate much of the economy of both countries. What possibilities do you see for this type of defensive policy, given the crisis situation and shortage of credit which our region suffers from?

Alzamora: I believe that it is very much in keeping with the general strategy of the Latin American countries to make the maximum use of their own potential for commercial interchange, to avoid in this way as much as possible having hard currency leave the region. Naturally the instrument of bilateral compensatory trade accords will be used more and more. Nonetheless, we must also maintain ourselves within a multilateral structure and discipline. I believe that both things are compatible. I think that thus we will take the surest path toward the ever-present objective of the regional Latin American market.

Therefore, it seems to me that this is, today, a very appropriate path for the situation Latin America is going through, which other nations are going to follow. It requires, as we stated it better in another document, a major economic and commercial understanding within Latin America, perhaps through the conference we have proposed.

Anyway, I would like to get back a bit to the question of the debt to try to summarize the point. What we have protested most strongly is the excessive and unjustified cost which refinancing is having for the countries—which means surcharges, honoraria, commissions, and other increases, which are really a scandal. My final and overall reflection on the problem of the debt is that we have to pay our debts, but we do not have to pay usury. . . .