Who will pay for the June debt crisis?

by David Goldman

Only a few weeks ago it appeared that the International Monetary Fund and the consortia of major international commercial banks were in a position to dictate financial terms to the rest of the world.

Following the acquiescence of both Mexico and Brazil, the world's two largest debtors, to programs of IMF austerity in return for debt-rescheduling operations by the commercial banks, the prospect of political resistance to the IMF looked slim to most of the parties and observers involved. The formation earlier this year of the Ditchley Group of commercial-bank creditors appeared to have consolidated a dictatorship over world finance against which no political force could safely move. Secretary of State George Shultz could say, with credibility in many quarters, that the world "recovery" would solve the debt problem "in time," and that the ferocious "adjustment" measures required of the developing nations were the price they had to pay to ensure good terms with their creditors over the years ahead.

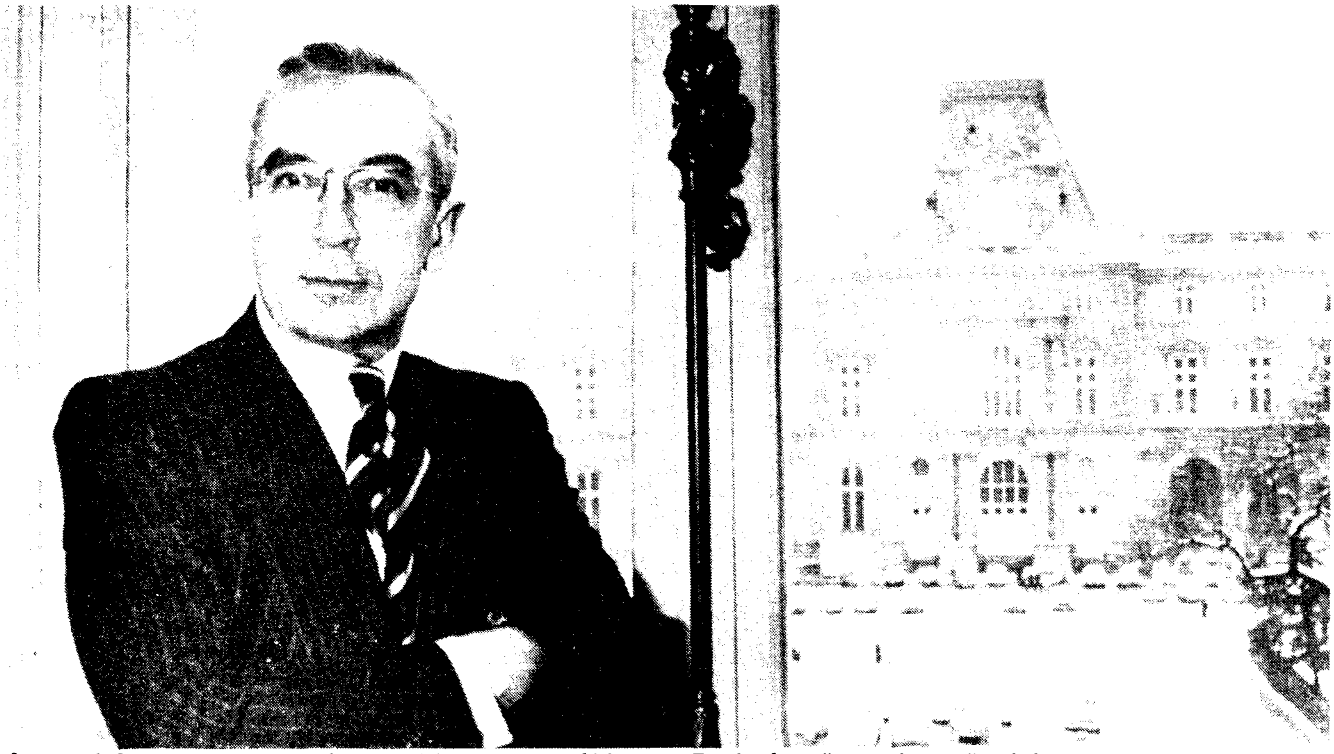
Since the beginning of June, however, it has begun to dawn upon the commercial banks and the International Monetary Fund that their public and private estimates of only a month ago could not have been more misleading and more dangerous. These institutions miscalculated terribly, to the extent that the institutional power of neither group may survive the month of June in penalty for this miscalculation.

Their judgment failed on two counts.

First, they assumed that the nations of Ibero-America would behave like imperial subjects, rather than as sovereign nation-states committed to defending their most basic interests.

Second, they assumed that the leading Swiss and other central European financial institutions would collaborate with the process of debt rescheduling, despite evident grumblings of disagreement over the past several months.

The bankers had put themselves in the position of that farmer who decided to train his horse to live on fewer and fewer oats, and was horrified when the animal



Jacques de Larosière, managing director of the International Monetary Fund, whose "aura of power" is fading.

died just before completing its course of training.

How the situation has changed

Now, as reported elsewhere in this issue, leading sections of the Brazilian nationalist establishment have decided that they cannot be responsible for the internal security of their country, much less for its future development, under the terms dictated by the International Monetary Fund. In these circumstances the IMF cannot go forward against Brazil, i.e., enforce the austerity conditions demanded under the terms of the February loan agreement between Brazil and the IMF.

Neither can the IMF go back. Even the pundits of the financial press have now perceived this dilemma. Although considerable sections of the Anglo-American banking community are now clamoring for a "waiver" of the Brazilian IMF conditions, the decision of the "German-speaking central banks," as the grouping is described in London, to enforce the conditions at all costs, prevents a retreat on the part of the IMF. Unable to go forward or backward, the International Monetary Fund "will be totally discredited whatever the outcome," in the view of a Latin American specialist at the Schroeder's Bank in London. The International Monetary Fund's mission to Brasilia is expected to demand that the government not merely adopt additional austerity measures for the future, but also make up for several months of deviation from IMF "targets" in regard to government spending. Although the Brazilians may be prepared to sacrifice some important government subsidies on basic food and other products—in principle—it appears impossible that they will sacrifice such subsidies—in practice—within the time frame demanded by the International Monetary Fund. Under these circumstances, despite bankers' demands for clemency for their debtor, the IMF will refuse to grant additional tranches of Brazil's previously negotiated loan.

According to a European executive director of the IMF, the creditor nations will not be able to swing the Fund into the position of waiving conditionalities for Brazil. The Swiss, Dutch, Germans, Austrians, and Belgians, representing a continental bloc that prefers to see a crisis now, will argue strongly against any suspension of conditionalities in Brazil's case or any other. Under these circumstances, the European executive director argued persuasively, it will be impossible for the U.S. Treasury to make a 180-degree turn and support a loan for Brazil free from conditionalities. As the Europeans emphasized, since the United States has taken the toughest stand on conditionalities in the past, largely because of American hostility to providing any funds for the IMF at all, under normal diplomatic circumstances the United States can hardly change its position so radically within the short period in which the decision must be made.

Rumblings from the Fourth Reich

Careful observation of the process of ratification of the proposed $8.4 billion American contribution to the International Monetary Fund under the current round of quota increases would have demonstrated to senior American bank management that something was radically wrong within the ranks of the banking sector itself.

Swiss National Bank consultant Karl Brunner, doyen of the so-called Shadow Open Market Committee and professor at the University of Rochester, led a group of right-wing economists formed earlier this year to oppose giving additional funds to the IMF. Brunner's operation represented a dirty-tricks campaign on the part of the Swiss National Bank to make life difficult for the International Monetary Fund in its capacity as manager of the present round of reschedulings. In public, Swiss National Bank President Fritz Leutwiler expressed doubts concerning the possibility of rescheduling Brazil's and other nations' outstanding debt without a major and catastrophic crisis. He made these statements first in a March interview with this publication, and later in public statements before other groups.

Senior American and British bankers never considered seriously the possibility that the Swiss would be insane enough to carry through with their conviction that a crash was necessary. The Swiss are convinced that they will survive the worst of a banking crash, with virtually no exposure in the developing sector, and a very strong position in gold, more or less in the same fashion that cockroaches are expected to survive a nuclear war.

Well-placed British banking sources now complain that the Swiss have not only withdrawn their own funds from the Ibero-American refinancing operation, but have both persuaded Western European continental banks to do the same, and instigated a similar withdrawal of funds by Arab banks, among whom are counted some of Brazil's largest creditors.

The result of the Swiss vote of no confidence in the rescheduling procedures has been a collapse of the Brazilian rescheduling package, especially in its so-called Project Four, the section applying to interbank credits among the major commercial banks. Interbank credits, as *EIR* has reported in the past, represent the weakest flank of the American and British commercial banks.

The Bank for International Settlements will rub in the vulnerability of the American banks as well as their central banking institution, with the June 9 release of an updated version of the Basel Concordat, the gentlemen's agreement among central banks concerning division of responsibility for regulation and supervision of foreign banking offices.

Swiss central bank officials emphasize that the import of the updated version of the concordat is that the Federal Reserve must take responsibility for American-based offices of Latin American central banks, which have borrowed upwards of $40 billion from the American banking system in the last few months of refinancing scramble. Coinciding with already rising interest rates and an out-of-control budget deficit, the impact of such a bill presented at the New York Federal Reserve Bank would be virtual collapse of American money markets, even assuming that the Brazilian default did not lead to a run on deposits at major commercial banks themselves, as began after the announcement of a Mexican moratorium in September 1982.

The Swiss banks, the representatives of the old Venetian *fondi*—the private fortunes dating from the period of the Crusades—merely tolerated the International Monetary Fund. Switzerland never joined it.

In the Swiss view, the IMF was too contaminated by the voting powers of sovereign governments. Their institution of preference has been the Bank for International Settlements, the ultra-secret and quasi-private central bankers' central bank, which, among other activities, absorbed the gold bars made from concentration camp victims' gold teeth during World War II in order to aid Adolf Hitler's purchase of raw materials from abroad.

Evidently, they are willing to dispense with the offices of the International Monetary Fund, however much they may otherwise support the frankly brutal approach of the IMF in prescribing austerity conditions to the developing sector.

At the same time, they are willing to take the political risk of putting the backs of Brazil and other countries to the wall, risking the emergence of a continent-wide debtors' cartel. This may represent a fundamental element of miscaculation on the part of the Swiss.

As one senior Austrian Central Bank official put it, what the so-called German-speaking central bankers' group expects is not so much the emergence of a unified and orderly debtors' cartel, but "the complete taking over by centrifugal forces which will tear the continent apart."

What will the United States do?

Despite the threat of chaos, or perhaps because of it, the recent proposal by President Figuereido of Brazil to change the terms of negotiations from "financial" to "political" is viewed by some administration circles as an offer the United States may not be able to refuse. This is also true in Great Britain, where a press spokesman for Chancellor of the Exchequer Sir Geoffrey Howe said privately June 7 that the possibility of one day having to negotiate with a debtors' cartel in Latin America has been under priority scrutiny since the meeting of Argentine President Bignone with Brazilian President Figuereido on the Argentine border months ago.

The only means the United States has for averting a financial shock with devastating strategic implications is to adopt the "political" approach, which implies abandoning the IMF context and negotiating bilaterally with a debtors' cartel or in combination with some of America's allies. This policy was characterized as "Operation Juárez" when its detailed principles were published a year ago by *EIR* founder Lyndon H. LaRouche, Jr. A year later, Operation Juárez is perhaps only weeks away from reality as both the United States and the Ibero-American nations realize that it is the only alternative to disaster, and that their mutual enemies stand ready to take advantage of any opportunity to provoke such disasters.