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U.S. administration begins to look at new options for meeting debt crisis

by David Goldman

At a press conference following his speech before the National Foreign Trade Council June 8, Treasury Secretary Donald Regan told this publication that it was impossible for Ibero-American nations to form a debtors' cartel. "They would never be able to get credit from any source ever again," the Treasury Secretary said. Regan, who has argued consistently that the recovery will by itself take care of the world debt crisis, and that the United States need do nothing more than support the existing International Monetary Fund framework, may already have lost much of his influence over American international economic policy.

Until the emergence of the present Brazilian crisis, the viewpoint defended inside the administration by Secretary of State George Shultz and Secretary Regan, i.e., that the recovery would automatically cure the debt crisis, remained the conventional wisdom. In different ways, many other departments of the administration argued that Shultz and Regan were leading American policy into a trap; objections were raised, from conflicting standpoints, at the Commerce Department, the Central Intelligence Agency, the Special Trade Representative's Office, the National Security Council, and the Council of Economic Advisers.

IMF discredited

According to officials who believe that the Shultz-Regan policy is potentially disastrous, the Brazil crisis has opened the first prospects of a change in the administration viewpoint, creating circumstances where those who have long argued that the debt crisis must be approached on a global basis and delt with as a crisis of the monetary system will be heard. One possible sign of the times is the soon-to-be-announced departure of the National Security Council chief international economist, Dr. Henry Nau. In a discussion with *EIR* during the Williamsburg summit, Dr. Nau argued that the existing mechanisms, including the IMF, were more than capable of containing the debt crisis, and that the Brazilian situation represented no cause for policy change of any important kind.

George Shultz had concentrated his efforts on a proposal to expand the IMF into a super-agency incorporating the functions of the General Agreement on Trade and Tariffs (GATT). The Shultz argument was that developing countries must be compelled to further open their markets to Western goods, as well as financial institutions in the home financial market, in such fashion as to permit creditors to restore now-suspended credit lines with confidence. However, the Brazilian crisis has pre-empted the proposal to expand the powers of the IMF by discrediting that institution. Proposals to enhance its powers will go back into the State Department refrigerator.

At the IMF's Washington headquarters, the catch-phrase for fear of what the American administration might do once the Shultz-Regan approach were abandoned is "bilateralism." Under this rubric, IMF officials perceive an American propensity to abandon the Fund, with which the administration has already sparred over the U.S. budget deficit and U.S. military spending, in favor of a direct approach on behalf of American interests. For the first time, option papers are being prepared for possible negotiations between the United States and an Ibero-American debtors' cartel.

No room for error

The President's big problem is that he will have to act very quickly when the crisis breaks. Many observers do not consider this administration capable of making fast decisions under conditions of internal strife should a crisis break out. At the point where it should be moving a plan into place to prevent the collapse of the Brazilian debt from bringing down the American banking system, the administration is only beginning to discuss possible courses of action. Under these circumstances, President Reagan will need to move decisively, with practically no margin for error, to avoid consequences which may be difficult to reverse.

Senior administration officials believe that the first response of the United States to a Brazilian debt moratorium would be to throw additional money at the problem. Previously the United States has made short-term bridge loans to both Mexico and Brazil, in order to avoid default, in the Mexican case in September of last year, and in the Brazilian case in December of last year. The problem, administration officials add, is where the money may come from. The administration is already having great difficulty persuading the House of Representatives to approve $8.4 billion in quota increases for the IMF, although the Senate appears to agree to the quota increase. The administration does have discretionary funds in the Treasury's Exchange Stabilization Fund,

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although the Exchange Stabilization Fund was never envisioned as a source of loans to developing nations who are unable to meet their debt payments.

It is not legally possible for the Federal Reserve to provide funds directly to the Brazilians, because the Brazilians have no existing swap lines with the Fed; the only nation in Ibero-America with swap lines available from the Fed is Mexico, which has drawn the full $700 million available to it already.

Congressional leaders have already warned the White House that Capitol Hill would view the use of Exchange Stabilization Fund resources as a violation of the purposes of the fund, and that such action would endanger the passage of the IMF quota increase in the House. According to some inside estimates, Secretary Regan is likely, on past profile, to make a loan in an emergency situation without taking into account political reactions to such a decision. In any case, emergency loans will not remedy the essential situation.

A major question mark is the role of Paul Volcker. Administration sources emphasize that he has practically no chances of remaining in his job.

Volcker was the official who stampeded the other administration departments into assembling the bailout package for Mexico last September. In a speech before the New York University graduating class at commencement June 3, Volcker warned that failure to deal with the international debt crisis could have deadly repercussions to the United States.

Privately, Volcker thinks largely along the same lines as Lazard Frères partner Felix Rohatyn or Princeton University Professor Peter Kenan, who have proposed to turn the IMF into a super-agency, with powers to absorb the debt owed by developing nations to commercial banks, decentralizing the debt and bailing out the banks in the same action. The unpopularity of this viewpoint in the administration has left Volcker somewhat isolated, and Volcker's open collaboration with IMF staff in lobbying for a decrease in the federal defense budget is a major factor in the White House's reluctance to reappoint him.

The present hostility of the administration and most of the Congress to enhancement of the IMF's scope of action already represents a major obstacle to the reorganization plans favored in London, and, to some extent, at the Council of Economic Advisers and the Commerce Department. Volcker's absence in deliberations over the Brazilian debt crisis would take out of the picture the most important agent of influence that proponents of the Rohatyn approach have in the U.S. government.

The United States and Operation Juárez

The administration is effectively left with two options. One is to accept an international banking crisis. The other is to fulfill the worst fears of the IMF, and adopt a bilateral approach with respect to the developing nations, and Ibero-America in particular. Under such an approach, the United States would agree to a long-term debt stretch-out of obligations of the developing sector nations, in order to immediately lower the debt service ratios of those nations to the point that they could meet some part of current debt service with a reasonable portion of their existing export earnings. To be put into effect, this form of Chapter 11 reorganization of the Ibero-American debt would have to be accompanied by the *provision of new trade credits*, enabling those nations to import the capital goods required to enhance productivity and continue their process of industrialization.

This is the approach launched by *EIR* founder Lyndon H. LaRouche, Jr. in 1975 with his International Development Bank proposal, an approach ramified in his "Operation Juárez" policy document circulated throughout Ibero-America for the past 10 months, and reflected in the Mitsubishi Research Institute's blueprint circulated for the past five years under the title, "Global Infrastructure Fund." Under this approach the United States and other industrialized nations who wish to cooperate would fund major water, canal, transportation, electrification and other projects in the developing sector, such as to accelerate its industrialization and make the existing volume of debt service seem trivial by comparison to the size of developing economies several years hence. Ibero-America is hatching "Operation Juárez." That is the fact of life the United States must now contend with. It is past time that Washington, D.C. understands this method of overcoming the crisis, and understands that it is the only way to secure the national sovereignty and economic integrity of the United States and its hemispheric partners from the financial strategists who would welcome a Second Great Depression.

The President will have to act very quickly when the crisis breaks. The present hostility of the administration to enhancement of the IMF's scope of action is justified. Mr. Reagan is left with two options: to accept an international banking crisis, or to undertake negotiations with the developing nations in pursuit of new trade and investment on a scale far more than sufficient to make good the old obligations.