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Policy failure at IMF meeting crashes markets

by David Goldman

The U.S. dollar fell to its lowest level of the postwar period, and Treasury long-term bonds fell to a point nearly 10% below their level of April 1, as Western nations agreed to nothing at the International Monetary Fund meeting concluded April 10.

The U.S. dollar stood at 143.1 midday in Tokyo, 2 yen below the early level of April 9, and long-term Treasury bonds lost 2% April 9 and an additional 1% on April 10.

The Reuter wire service reported April 10, under the headline, "Volcker's nightmare," "... the financial markets [have] suddenly come to share Fed Chairman Paul Volcker's often-repeated warnings about the risks of a dollar collapse. 'Volcker's been saying for a long time that a dollar freefall would be extremely dangerous—now he's got it,' said David Jones, economist at Aubrey Langston and Co."

The combined freefall of the dollar and U.S. securities markets suggest that the turning point has been reached, at which Japanese and other foreign investors will cease to fund America's $150 billion per annum payments deficit. London sources warn that a pullout of foreign funds would drive U.S. interest rates up to 20-25%.

The next point of reckoning will be April 17, the day on which the United States is scheduled to impose the first retaliatory trade sanctions against Japan of the entire postwar period. At last report, talks between Japanese trade representatives and the Reagan Administration had produced no agreement to call off the sanctions, imposed allegedly because of Japanese violation of the September agreement on semiconductors.

Brazil has the last word

Although the details of the discord between the United States and its trading partners are relevant, the last word went to Brazil's finance minister, Dilson Funaro, who told a post-meeting press conference that Brazil's new democracy could not tolerate IMF conditionalities. Funaro, the architect of Brazil's debt moratorium declared Feb. 20, detailed his country's ambitious growth plans, before a stunned press corps, which only the day before had (inaccurately) predicted his near-term dismissal.

EIR has emphasized that Brazil's debt moratorium, announced the same day that the big five industrial nations last met to try to patch up the foreign exchange markets, broke up the fragile political agreements among the Western nations. French Prime Minister Chirac has virtually endorsed the Brazilian position, under pressure from the Vatican; the Japanese are writing off their entire Ibero-American debt portfolio; the Swiss banks are recommending a 30-year, 2% reorganization of the Third World debt; and U.S. Treasury Secretary James Baker III is left alone, like Admiral Doenitz in April 1945, to fight on for Wall Street's thousand-year empire.

Comments attributed to Italian Finance Minister Giovanni Goria in wire reports on April 9 triggered the dollar and related market collapse; reportedly, he said that foreign exchange markets had asked the Group of Seven (the U.S., Germany, France, Britain, Japan, Italy, and Canada) what they would do to protect the dollar, and "found the answer weak. In terms of imbalances in exchange rates, things haven't improved" since the Feb. 22 meeting of the same nations at the Louvre.

The United States, as usual, demanded that the West Germans and Japanese reflate their economies, supposedly to absorb more American imports, but, more to the point, to dump more liquidity into the crisis-wracked international markets. As usual, the Japanese offered a domestic spending

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program, and the West Germans offered nothing. At previous such meetings, the credibility of the bland press releases on international cooperation lasted at least a week or two; this time, the dollar had collapsed before they were photocopied.

Banking crash

There was really only one item on the IMF's agenda, and it was not addressed: This is the debt-moratorium movement inaugurated two years ago by Peruvian President Alan García, joined by Brazil in February, guided by the moral influence of the Vatican, and informed by the economic program of economist and presidential candidate Lyndon H. LaRouche, Jr. The International Monetary Fund, in its capacity as enforcer for the banks, had nothing to say to the Brazilians, and the U.S. Treasury, still guided by Citibank's hard line against the debtors, had even less to say.

The suspension of payments on a large part of the $1 trillion Third World debt bubble, and threat of a general suspension, has already shut down trading of hundreds of billions of dollars of banks' long-term paper on the offshore market, and produced persistent rumors that some of the large U.S. banks are having difficulty persuading depositors to roll over their money. However, the Third World debt is merely one of several potential detonators for a world debt bubble in the range of $25 trillion, of which half may collapse in a general crisis of the financial markets.

The most secret meetings of finance ministers and central bankers appear to have ended in disarray, and it is likely that the only discussion of the pressing issues occurred when *EIR*'s Washington correspondent, Nicholas Benton, asked West Germany's central bank governor about the prospects for a global crash, during a Johns Hopkins University seminar April 7.

With both Federal Reserve Chairman Paul Volcker and Secretary of State George Shultz present, Bundesbank President Karl-Otto Poehl was asked to comment on French Prime Minister Jacques Chirac's proposal for the "Marshall Plan" for the Third World, and on the March 18 statement of Swiss Bankers Association official Hans-Georg Rudloff, "We are on the verge of the worst financial crash in history."

Poehl answered, "I know Rudloff; he is a very smart and successful banker, and this is his position. It is possible he is taking protective measures himself, as an individual banker, and there are increasing numbers who are now thinking like this. However, I cannot act on such assumptions, even though there are serious international debt problems and the potential for economic growth to stagnate in the advanced countries. It is not reasonable for me to speculate on the probability of a great crash. After all, we central bankers are paid to avoid it."

To the extent of *EIR*'s records, that is the first admission by a central banker of one of the leading industrial nations that a crash is indeed possible.

Regarding the Chirac plan, the West German central banker added, "This would work only as a temporary measure. In the long term, we must not only transfer agricultural surpluses to hungry nations, but make them able to produce themselves."

Among the adherents of Rudloff's views is West Germany's largest financial institution, the Deutsche Bank, which has built up a crash reserve of $5.5 billion. According to an internal "risk study," the leading German bank has been putting money away to cover sudden holes in case of default. The reserves are $0.5 billion for Mexico and Brazil each, $360 million for Argentina, and $920 million for other "critical debtors in Latin-America." The internal study, reported in the new issue of the West German weekly, *Der Spiegel,* describes the Third World debt situation as gloomy, or, as Deutsche Bank's president Wilhelm Christians put it, "the red light is turned on."

Baker blasted

The collapse of Treasury Secretary Baker's credibility among his colleagues is not surprising, given the developing nations' brusque rejection of the so-called "Baker plan" for Third World debt. After the collapse of a lenders' consortium that promised to provide Mexico with $7 billion in new credits, but couldn't, Baker's proposal that new loans will come forth in response to economic concessions (i.e., austerity and the auction of national assets) is last year's news.

The developing nations' caucus at the IMF, the Group of 24, issued a working paper April 6 denouncing the Baker plan: "The initial approach to the international debt crisis, instead of providing debtor countries with adequate resources to allow them to strengthen and restructure their productive capacities, has required the economies of debtor countries to generate outward transfers of resources. . . . The supply of new finance has sufficed only to keep debtor countries current on new interest payments, allowing little or no margin for investment. . . . [The Baker plan] overestimated the extent and speed of the benefits that could result from the structural policy reforms advocated . . . [and] failed to assure an adequate supply of resources private or public."

In a communiqué, the G-24 warned, "The debt crisis is entering a new and dangerous phase in which an increasing number of developing countries are not in a position to meet their debt obligations or to reconcile debt servicing with sustainable growth. . . . We affirm that existing strategy offers no prospect for a lasting solution to the debt problem and insist that a new attitude and approach in respect of the existing stock of debt, current flows and future credits be examined by governments, [and] multilateral and banking institutions."

In short, the entire Third World is looking to Brazil and Peru for leadership, and the IMF has nothing more to say to the debtors. That recognition has destroyed the credibility of the industrial nations' economic policy, and above all, the credibility of the American securities bubble.