

Banking by David Goldman and William Engdahl

Slim prospects for a bailout

Is Citibank gambling on federal guarantees for "secondary market" Third World paper?

New York's Citicorp has been telling European bankers that its \$3 billion addition to reserves against losses hinged on a deal with the U.S. government to offer some form of federal guarantee to secondary-market trading of Third World loan paper.

On May 21, Citicorp chairman John Reed said he planned to reduce the bank's Third World loan portfolio by a third, or about \$5 billion, over the next five years, via debt-for-equity swaps, loan sales, and so forth.

He estimated that \$1 billion would be swapped for equity in debtor countries—assuming the countries are willing to sell Citibank anything it wants.

The debt-for-equity scheme has been around for a long time, and debtor countries' willingness or ability to play along with it has diminished, if anything, since Henry Kissinger first floated it five years ago. Even less promising, as matters stand, is the so-called secondary market in Third World debt, where regional banks now trade a few million dollars of Third World debt paper at a time.

The present "secondary market permits smaller regional banks to a) get out of such paper entirely, b) diversify risks, or c) consolidate risks, in order to eliminate certain countries entirely from portfolio, and save on the expense of participation in creditors' committees; this they do by barttering loans. It couldn't absorb \$1 billion of Citibank or anyone else's paper.

However, some European banking sources envision a massive expansion of the market, based on federal guarantees. "We have information that a deal has been worked out" to offer official guarantees for heavily discounted Third World loan paper, said a spokesman for one of West Germany's largest banks. "We are very happy with the Citibank move. It will now allow the creditor banks to be more tough with debtors like Brazil."

A well-informed British banker was more cautious. "The scheme is highly risky," he said. "It may well be beyond the time that President Reagan can deliver on anything," especially something as politically hot as a bailout of the big New York money center banks during a pre-election period.

There are two major, possibly insurmountable, obstacles. First, Congress must approve the scheme. Second, as some European bankers argue, Washington must persuade Japanese and European finance ministries to pick up some of the burden.

"But Germany is not about to go for this bailout. It's completely without historical precedent for the U.S. government to bear such responsibility for private bank debt, not even during the 1930s," one banker said. The Continental Europeans and Japanese have already written off most of their developing-sector loans, in contrast to the British and Americans.

In essence, the scheme under discussion revives the March 1983 proposal of Princeton University's Peter

Kenen, an adviser to the International Monetary Fund, and co-founder of the "Group of 30." He argued that an official institution backed by industrial countries should offer its paper to banks in exchange for Third World loans, paying them 80¢ (he now suggests 60¢) on the dollar. The official institution would then try to collect a fraction more than that from the debtors.

John Makin of the American Enterprise Institute promoted a similar scheme in the March *Times*.

But Professor Kenen warned recently that implementation of any such plan would have to wait for the next administration, given the present state of affairs in Washington.

In the short run, the World Bank is the only available candidate to make a market for "secondary trading" in Third World debt, Kenen suggested. Citibank's intention to off-load Third World debt at a discount on the secondary market is unworkable without the participation of some official institution, since the present market trades \$5 or \$10 million at a time. Given the present budget crisis, the U.S. Congress will not vote up U.S. government guarantees for such paper, or funding for an agency to buy it. The only institution capable of doing this now is the World Bank, which might put in a few hundred million dollars of "seed money" to make a market in such paper, encouraging large banks to come in at the billion-dollar level by its simple presence, he adds.

Fierce objections from the Japanese, who want the World Bank to lend for development, and from debtor nations themselves, make the World Bank's role a politically explosive one. Should it trade in discounted Third World paper, it might end up persuading major debtors to immediately reduce their payments of debt service.

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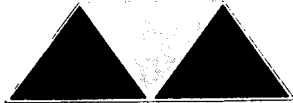
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