

evidence, albeit conclusive evidence,” that the country’s new President was on the take.

This is also not the first time that the DEA has honed in on the narco-economic “reforms” embraced by Gaviria and his successor, and mentored by Liberal Party honcho and former President Alfonso López Michelsen. In late 1991, the head of the DEA’s financial investigations division, Greg Passic, gave a presentation to an Ibero-American conference on banking security held in Bogotá, at which he warned that the exchange and tax amnesties, the bank deregulation, the lifting of restrictions on foreign investment, and other reforms contemplated under the *apertura* “are creating a scenario propitious to the legalization of capital obtained from the drug trade.”

Pressures from the IMF

What Passic did not say at the time, and what only *EIR* has been saying for years, is that these free-market “reforms” are the direct result of pressure from the International Monetary Fund, World Bank, and other elements of the international financial community to turn Colombia’s economy into a vast drug-money laundry to help keep their decaying world monetary system afloat. In fact, at a May 9, 1991 conference in Bogotá on George Bush’s Enterprise for the Americas initiative, Alejandro Scopelli from the Inter-American Development Bank insisted that Bogotá be turned “into an international financial center, like Montevideo is today.” Montevideo, the capital city of Uruguay, was then universally known as the “hot-money” laundry for all of Ibero-America.

At that conference, then-U.S. Ambassador to Colombia Thomas McNamara praised Gaviria’s “economic and structural adjustment reforms,” saying they had created an investment climate in Colombia that “at the present time is one of the best in Latin America. And this has improved even further due to the recent reforms of the exchange statute of taxes, of investment and of the labor code.” That conference was sponsored by, among others, President Gaviria’s Development Ministry, which at the time was run by none other than Ernesto Samper Pizano.

In a Dec. 31, 1991 article on the flood of drug dollars pouring into Colombia, even the *Washington Post* couldn’t help but observe, “This repatriation of drug profits is being facilitated—in a dash of market-economics irony—by the affirmative response of Colombia to U.S. urgings to open up the economy here.”

It certainly gives one pause, in view of the fact that President Samper—a 20-year lobbyist for drug legalization—is currently sponsoring a 20-nation conference on drug-money laundering in Bogotá, which is supposed to hammer out hemispheric guidelines for preventing and punishing the laundering of illicit capital. Included alongside the list of Ibero-American countries in attendance is, of course, the United States.

India moves against weak national banks

by Ramtanu Maitra and Susan Maitra

It has been almost four years since the World Bank, in its 1990 study on India’s financial sector, called for the reform of India’s “inefficient” nationalized commercial banks, and three years since the government-sponsored Narasimham Committee report urged consolidation of the nationalized commercial banks. Finally, on Oct. 17, the Reserve Bank of India (RBI), India’s central bank, announced the deregulation of lending rates for loans above 200,000 rupees. The ostensible purpose of the move is to make money cheaper for investors and at the same time make the banks more efficient.

The RBI announcement to abolish the minimum lending rate was welcomed by trade and industry, and a similar signal was conveyed by all major stock markets in the country. The captains of Indian industry hailed the new policy, because it would enable professionally managed companies to borrow money at cheaper rates of interest. But the bankers are rattled.

The old days

In the old regime of high lending rates, the RBI set a minimum lending rate for the commercial banks, setting the cost of credit unbelievably high. Backed by reasonings such as that the high interest rate is an automatic control over the money supply, and that it encourages higher savings, the high-lending-rate regime served primarily the interest of the government. A large percentage of bank funds was reserved for the government to borrow at a lower rate, whenever necessary.

But there was more to it. To “alleviate poverty,” and to provide incentives to agriculturalists and small-scale industrialists, the government had created a priority-sector lending regime of lower interest rates. What could only have been achieved through the upgrading of technology was attempted by the government through the banking system. The result: The banks were greatly weakened and the government’s populist objectives remain unmet.

In addition, through a very high statutory liquidity ratio, the government has kept almost 75% of the bank money under its control for priority-sector lending, buying of treasury bills, and payments for vote-banks (campaign slush-funds). This regime kept the lending rate astronomically high and starved entrepreneurs of cash. The process turned the banks into non-accountable behemoths where introduction of technology for efficiency became impossible. This arrangement was comfortable for the bankers: It provided a protected environment where no accountability was demand-

ed. The only requirement for the bankers was to produce the money for the government whenever and wherever the ruling authority wanted.

Collapse of the old system

Beginning in the mid-1980s, a perceptible change was brought about by the economic liberalization process introduced by the late Indian Prime Minister Rajiv Gandhi. The development of the capital market allowed dynamic entrepreneurs to shift their dependency for cash away from the banks and raise capital through public issues. The idea caught on quickly, because it provided entrepreneurs with cheaper money, and soon the banks began to feel the pinch. Though sitting on a pile of money, the commercial banks continued to lose money at an accelerating pace. The squeeze brought about the great securities scam of the early 1990s, in which the commercial banks illegally deployed money into the stock market to generate profit.

In 1991, soon after the Narasimha Rao government came to power and the wind of economic reform was blowing across the financial sector, the Narasimham Committee, headed by former RBI Governor M. Narasimham, produced a report which called for an overhauling of the financial sector. The report included measures to consolidate the stronger commercial banks and encourage the growth of private ones. The days of ad hoc banking by the commercial banks were coming to an end. Although it accepted the Narasimham Committee recommendations, the Rao government was unsure of their political ramifications and began implementing them at a much slower pace than was expected.

Impact of the new regime

The Oct. 17 announcement, which also included lowering of the statutory liquidity ratio, delinking of commercial paper from cash credit limits, introduction of cash credit to agricultural advances, among other items, caught the bankers by surprise.

The most immediate problem is that the smaller commercial banks, which could afford to be highly inefficient and irregular because of the blessings of the government, have feet of clay. Unprepared as they are, they will have to go out and entice lenders to borrow at a rate which is acceptable to the borrower and also profitable for the banks. An added problem is that these banks have large overheads and almost zero computerization. It is almost certain that most of these institutions will have to be closed down or merged with stronger ones. The word is around that those banks which cannot turn a profit by the beginning of the 1996 fiscal year will be liquidated.

The second problem for the Indian banks will be to compete with the foreign banks already in place in India. For instance, following the announcement of the deregulation of lending rates, the State Bank of India, the largest of the Indian commercial banks and surely the leader at this point in time,

announced a 14% prime lending rate. The same day, Standard and Chartered stepped in with a 13.5% rate. Standard and Chartered picked up a number of blue chip customers by that single move. Since banks like Standard and Chartered, Citibank, and Deutsche Bank are big enough to undercut the smaller Indian banks, the foreign banks will pick up more business.

The problem that the banks will face now is reflected in the stock market, where the State Bank of India lost about 15% right away, to settle at a historic low.

In addition to these two threats, there is unanimity that with the interest rate on deposits remaining constant, spreads will be narrower and hence the profitability of the banks and financial institutions will be lower. The only way the banks can get a decent profit is through volume. However, with inflation hovering around 10% and showing no sign of retreating significantly, it is unlikely that the volume of lending will grow substantially. This may pose a serious threat to the banks in general, whether they are efficient or inefficient.

The securities scam showed the limitation of the RBI's supervising capabilities. The banks, with the expectation of making greater profits, may indulge in investing in prime risk areas and even in areas in violation of the banking code. The RBI failed earlier to act in time to prevent the securities scam, and the new deregulation will definitely require more efficient policing.

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