Choice facing Washington: SDRs or national defense

by Kathy Burdman

Financial circles close to Britain's Lord Peter Carrington the first week of December openly announced that unless President Reagan agrees to cut the U.S. military budget and forego large expenditures for a crash beam weapons defense program, a world financial crisis will erupt. Lord Carrington is the leading opponent of beam weapons in Europe, the Neville Chamberlain who seeks to appease the Soviets by promising never to build such defense systems.

If Reagan goes with a crash beam program, "the markets will react very, very negatively. . . . There would be a major rise in interest rates, and it would be the end of the 'Reagan Recovery.'. . . The Reagan deficit has already added 2-3 percent to the U.S. long-term bond interest rates. If Reagan makes another major defense initiative now, rates will definitely go way up," and the President's re-election campaign is over, an aide to Lehman Brothers Kuhn, Loeb Chairman Peter Peterson stated on Dec. 5.

This is no mere traders' threat. Peterson heads the Bipartisan Budget Appeal group of former Cabinet secretaries which includes Carrington's leading U.S. peacenik allies, such as former Defense Secretary Robert McNamara and former Treasury Secretaries Henry Fowler, Micheal Blumenthal, and C. Douglas Dillon—all of whom are now business executives with big clout on Wall Street. The Peterson "Gang of Five" has put out the word on Capitol Hill that the markets will "blow out" if Congress passes Reagan's request, the aide said.

Instead, Carrington's friends are insisting that President Reagan put all available cash into their plan, contained in the recently passed U.S. IMF quota bill (see *EIR* Nov. 29), to set up a huge new Special Drawing Rights fund at the IMF. The SDR fund is meant to back up their schemes for a "new Bretton Woods" reorganization of Third World debt and world currencies.

"If the timing of the defense budget coincides with another blowup of the debt crisis, then Reagan has a contradiction on his hands," Peterson's aide concluded.

Beam weapons *Nyet*. . .

Within the past week, calls for cuts in the U.S. defense budget threatening President Reagan with a blowup on various markets has included every leading spokesman for the International Monetary Fund. Almost all of them are on record demanding the new Bretton Woods scheme.

Topping the list was IMF Managing Director Jacques de Larosière, who on Dec. 5 told the American Enterprise Institute that President Reagan's budget is responsible for the world debt crisis. High U.S. interest rates—allegedly a result of the budget deficit—were, he said, responsible for "almost a fifth of the total current account deficit of non-oil developing countries."

Therefore the U.S. budget must be slashed. "It will come as no surprise that we in the Fund strongly favor early and substantial action to achieve a credible reduction in fiscal deficits over the medium term in a number of countries, particularly in the United States. This could do more than any other single policy action to bring down interest rates and reduce uncertainty."

De Larosière went on to demand stricter IMF political power of "surveillance" over the U.S. budget and economy, and threatened a world collapse were this not done. "The institutional framework," he said, "already exists in embryo, in the surveillance responsibilities of the IMF. It is of the utmost importance that these techniques of collaboration are developed and refined. If they are rejected in favor of autarkic solutions, then the foundations of our present international economic system will be swept aside to the detriment of all."

BIS Chairman Fritz Leutwiler sounded the same theme the next day in Philadelphia, at a conference sponsored by former IMF director Johannes Witeveen's Group of Thirty and the Global Interdependence Center. "Industrial countries," i.e., the United States "have a responsiblity to provide sound fiscal and monetary policies. . . . Budget deficits are larger than ever," he warned.

And on Dec. 6, New York Federal Reserve President Anthony Solomon threatened directly at the same conference that if the budget is not cut now, the Fed will drive up interest rates immediately. Solomon denounced Reagan's "loose fiscal policy" saying that it necessitated a "tight monetary policy." His speech caused the U.S. Treasury bond market to collapse 1 percent the next day.

Other attacks this month by Carrington's networks on the U.S. defense budget include:

- The Global Economic Action Institute, run by Carrington's ally Lord Harold Lever, former British Labour Minister, and former Treasury Secretary Robert B. Anderson. Its just released first report threatens that because the world is on a dollar standard, "the issuance of all national currencies against dollar reserves . . . poses a potential threat to international finance" unless the U.S. budget is cut. "The fiscal and monetary policies of the U.S. are central to the maintenance of a stable international economy . . . lack of commitment to this principle in the United States has led to excessive capital market borrowing."
- Fed Chairman Paul Volcker stated publicly in a Nov. 21 speech that "the President . . . was wrong" when he complained recently about tight money. Only if Reagan cuts the deficit will rates fall, he stated. The longer the deficits go on, "the greater the risks on the financial markets and on the economy generally."
- White House Chief Economic Adviser Martin Feldstein, Milton Friedman's protégé, announced Nov. 21 that the deficit is too big, and that it has been caused by "increased defense spending." He said that the entire rise in the deficit from 2.3 percent of GNP in 1980 to 4.2 percent in 1988 will be due to the Reagan defense budget.

. . .SDRs *Da!*

The same people attacking the Reagan defense budget want the money spent instead on expansion of SDRs, to turn the IMF into a world central bank. If Reagan announces a full crash-scale beam weapons budget, Volcker will walk into the Oval Office and say, "Mr. President, I need $50 billion (or more) SDRs. You will have to choose between my program for saving the U.S. banking system, and your defense budget. Give up this Star Wars spending spree, or you will be responsible for the collapse of the world banking system and lose the election."

The plot began in early November, when Lord Carrington's close associate Sir Alan Walters, monetary adviser to British Prime Minister Margaret Thatcher, warned the White House that the U.S. banking system is about to go under. In an overt political manipulation, Walters told White House Councillor Ed Meese and Reagan campaign director Sen. Paul Laxalt that if the U.S. banking system's assets were put up for auction, they would be found worthless. This has reportedly made Meese and Laxalt "hysterical on the issue of U.S. banks blowing up," insiders say.

The SDR scheme contained in the IMF bill passed on Nov. 18, officially removed the right of the U.S. Congress to veto a new SDR allocation. Sources close to Volcker said that the purpose of this unconstitutional measure was to set up a new $12 billion SDR "Interest Guaranty Fund" at the IMF. Because the plan links debt and currencies, it means the IMF is becoming a true world central bank. Under the plan, the new IMF fund would allow Third World debtors to repay their debts not in dollars, but in Brazilian cruzeiros, Mexican pesos, and other so-called "blocked accounts."

The plan was first proposed by the Lever-Anderson Global Economic Institute, the same group which has been criticizing the U.S. defense budget, in their first report. "Special domestic accounts should be used to ease debt repayment problems," they write. "A significant percentage of the debts . . . could be paid in local currencies into special domestic accounts held by central banks or a special agency created for that purpose. Eventually payment of interest could also be paid into these accounts if new borrowings would otherwise be needed to finance interest payments."

Part of the "equity" plans already implemented to "stretch out" debt in Mexico, Argentina, and Brazil, are prototype currency programs. Under a current IMF plan, the private-sector parts of Mexico's foreign dollar debt are being transformed into Mexican domestic pesos, held as "blocked accounts," owned by the creditors, at the Mexican central bank. The Mexican central bank has thus far been translating the pesos back into dollars and paying creditors.

But the blocked accounts have not yet been made permanent. If they are, they will have to be *guaranteed* by some surpranational authority.

Asked who would be the "higher guarantor" for what is already Brazilian sovereign state debt, an administration source said, "the IMF and the U.S. government. They will guarantee these cruzeiro accounts, and the U.S. bank regulators will have to change their rules to allow such as payment."

By doing this, the IMF is implicitly setting some sort of cruzeiro/dollar currency rate. The IMF is backing up private bank debt with direct guarantee, something it has never done before. Finally, since nothing stands behind the SDR but the U.S. dollar, what is really happening is that the United States is footing the bill for all of it.