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The world's biggest debtor against the wall

by David Goldman

There is no question that America's creditors will put Treasury Secretary James Baker III against the wall at the International Monetary Fund's Annual Meeting the first week of October. There is some question as to how they will do this, however. On the face of things, the foreign central banks who have, virtually alone, paid America's bills for most of the past year, will announce their decision to stop doing so, and dive into their own monetary storm-cellars. The result will be a regime of *monetary austerity* not much different from the one former Federal Reserve chairman Paul Volcker imposed upon his return from the 1979 IMF meeting in Belgrade, Yugoslavia. The regime will combine ratchet-devaluations of the U.S. dollar with a multi-stage rise in U.S. interest rates.

As such, the IMF Annual Meeting will set its course straight for the rocks. The faintest hint of an alternative appeared Sept. 14, however, in remarks by Japanese Finance Minister Miyazawa, which sent a mild shock through Washington. Japan, he said, might consider leading a new global initiative on Third World debt, given America's paralysis on that matter; it would require a new sense of responsibility on the part of the Japanese people, he added, who are not accustomed to a world-leadership role. The sole point of substance in Miyazawa's remarks made friendly reference to the Brazilian debt-reorganization plan offered the previous week by Finance Minister Bresser Pereira, which Baker had rejected without ceremony.

High-level Washington sources say that Baker and the bankers objected not so much to the specific content of the Brazilian plan, which offered them (on paper) sufficient interest payments to avoid big losses on their $25 billion exposure to that country, but to the simple fact that Brazil proposed to write its own debt-reorganization plan. "It is not for the debtors to propose debt reorganization. It is for them to offer economic reforms," i.e., offer to sell their national assets to creditors "on the cheap," one senior Senate aide said. "It is for the creditors to look at such reforms, and say, 'I'll pay for that.' " The secondary-market price of Brazil's debt-paper fell from 49% to 41% of face value after Bresser offered the plan.

But "the Japanese were astounded that Baker didn't rush to embrace the Brazilian plan," a Washington specialist argued. The Japanese banks are concerned with what interest they receive, and, much more, their future trade prospects with the one Ibero-American nation in which Japan has a strong presence. Control of the political side of debt reorganization, the central concern of the American banks and Treasury, means nothing to Japan, which has had little to say about any of it.

All that Miyazawa has offered, thus far, is *political* difference with the U.S. Treasury; there is still no concrete Japanese plan on the table. However, Japan has never had the temerity to interfere with America's imperial doings in the Western Hemisphere before.

End of the imperial economic policy

What the European and Japanese central banks have in store for the United States, however, has already registered, in the form of a 200-point drop in the Dow-Jones average since the August peak, as well as 10% collapse of long-term U.S. Treasury bond prices, and a 1% rise in short-term Eurodollar interest rates, during the same period.

The central banks printed $78 billion of their own currencies between January and June of this year, to purchase un-

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wanted dollars off the floor of the foreign exchange market, and they reinvested these dollars in U.S. Treasury securities. That is, the entire U.S. current-account deficit during this period, and most of the Treasury's borrowing requirements, were financed on the printing presses of the Bank of Japan, the German Bundesbank, and the Bank of England. During the same period, America's trade deficit rose from a $160 billion annual rate to a nearly $200 billion annual rate. No nation in the history of civilization has exacted a greater subsidy from its trading partners, excepting Imperial Rome in the heyday of its colonial tribute.

America's foreign economic policy has been reduced to a temper tantrum thrown by James Baker against West Germany, for refusing to continue printing money. Speaking at the Institute for International Economics Sept. 14, Baker demanded that Germany reflate, under the terms of the Group of Seven's so-called "surveillance" arrangements. He said that the IMF's new surveillance "indicators" "did pick up the decline in German economic growth," a statement that the United States will use the forthcoming IMF meeting to pressure the Germans to reflate. Second-quarter West German GNP rose 1.5% per annum from the previous quarter, and 0.8% from the same period the previous year; and Baker pouted that the German government in May promised stimulative action if the economy showed growth of less than 2%.

Another meeting participant, former German economics minister Count Otto Lambsdorff, rose from the floor to say that "the indicators don't seem to be very helpful. As far as I can see, these political decisions [to reflate] will not be taken."

Baker shot back, "We need a little more discipline in the [surveillance] system. We don't get there overnight, and we are a heck of a lot better off today than we were a year and a half or two ago, when—I can promise you—we didn't have meaningful meetings. We had a little *tour de table* everybody recited what their economies' prospects were, but there was never any serious discussion of coordination. You're right, you need the political will, but first you need the political mechanism."

Baker is spitting into the wind. After much U.S. pressure, the weakening government of Chancellor Helmut Kohl offered a pallid tax-cut program. It cuts taxes by $24 billion by 1990, while reducing spending by $11 billion—hardly what Baker is asking for. Meanwhile, the Social Democratic opposition has denounced the plan as too expansive. In the Bundestag budget debate Sept. 9, opposition spokesman Hans Apel attacked what he called the "megalomaniacal" tax reform, which mainly benefits the rich, by way of reference to the horrible example of America, "where tax cuts did not bring about the hoped-for growth impulse, and resulted in devastating budget deficits."

Japan, as reported on page 6, has begun a managed shakeout of its own speculative financial markets, likely to force Japanese private investors to drastically reduce their holdings of U.S. securities. Nor will Japan make further concessions by way of monetary expansion. Bank of Japan governor Satoshi Sumito said Sept. 9 in Tokyo that the Japanese central bank will continue to hold its discount rate at the record low level of 2.5% even though the Federal Reserve raised its rate by 0.5 to 6% the previous Friday.

On Sept. 18, a leading Japanese daily, the *Yomiuri Shimbun,* reported that the Group of Seven countries had decided to abandon the present "target range" for support of the dollar at yen 140 to 160, and retreat to a range of 130 to 150.

Worse and worst alternatives

Among America's creditors, only certain voices in the City of London propose to keep financing America's deficit. The London *Financial Times* editorialized Sept. 15, "Failing still tighter monetary policy in the U.S., further declines in the dollar would not be surprising . . . [It] would be the price of attracting the required private financing of the external deficit . . . an adjustment process triggered by higher interest rates . . . that had the by-product of dramatically impairing the position of developing country debtors, would seem most unwelcome."

The *Financial Times* editors conclude, "Despite the evident dangers of a slow adjustment of the present pattern of deficits and surpluses, an effort to unwind more rapidly could create still more problems. A continuation of the U.S. deficit . . . is the worst possible situation for the world economy, except for all the alternatives." However, that logic has no credit at the Bank of England, let alone the Bank of Japan or the Bundesbank.

To some extent, the administration can choose its poison, e.g., permit the dollar to slide, or raise interest rates. In fact, its manuevering room is negligible, since a big drop in the dollar will chase out the foreign money that has supported the U.S. securities market, and force an increase in long-term interest rates. By choosing a major dollar devaluation, in the range of the 30% that former Carter official C. Fred Bergsten wants, the administration might, for some time, hold short-term rates down, while long-term rates soared.

Should short-term rates, now at 7.5% for one-month Eurodollars—1% above August's level—rise another 1.5%, large parts of the U.S. financial system, including about 1,000 savings banks, will collapse. It is entirely possible that Alan Greenspan, whose ideological bias resembles that of Andrew "liquidate everything" Mellon, Herbert Hoover's bloodthirsty Treasury secretary, will choose a tight-money regime, and begin a financial crash during October.

Wall Street is terrified that Greenspan will do precisely that. After the 0.5% increase in the discount rate, the Federal Reserve pushed the overnight interbank loan, or Fed funds rate into the 7¼% range. Greenspan still has 1-1.5% to go upwards before the needle hits the red mark; but that margin of safety could disappear in the few days following the IMF meeting.