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EIR Economics

Regan's 'modest proposal' for the Third World

by David Goldman, Economics Editor

Treasury Secretary Donald Regan's Sept. 23 press conference in advance of this week's International Monetary Fund annual meeting in Washington would be called in military terms a *flight forward*, that is, a recognition that existing options have failed in the form of a suicidal lunge at the opposition. Nothing less is threatened by the administration's outburst than a 10 percent reduction of world trade over the next quarter or two.

Regan announced that "there is already too much liquidity sloshing around in the international markets," and too much lent to the developing countries in particular, and that his "answer is 'No!' " to the proposition of providing more funds to the International Monetary Fund itself. In particular, Regan announced that the United States would oppose the recently negotiated $5.8 billion loan proposal for India as "extravagant," and attempt to force middle-income countries out of International Monetary Fund and World Bank lending programs altogether.

And, in response to a question from *EIR* correspondent Stanley Ezrol, the Treasury secretary said that the United States supported making reduction of population growth a condition for obtaining funds from the IMF, a policy outlined two months ago by IMF Managing Director Jacques de Larosière. Although American officials have expressed such support in private, Regan's affirmative answer Sept. 23 is the first such on-record admission from the administration's chief economic policy spokesman, and a bombshell for the end-October World Development Summit meeting at the Mexican resort of Cancún.

Population club

In effect, Regan has announced a Swiftian proposal by which the developing nations would cover their estimated $96 billion current account payments deficit for 1981 by eliminating large sections of their populations. Finally, the "link between monetary and population policy" described in an interview this publication released from former Treasury Secretary Henry Fowler is on the official agenda. For the rest of us, as well as for the developing sector, the results could be horrifying. The declaration is not surprising coming from Mr. Regan, whose main activity as an officer of the Charles A. Merrill Foundation for the past twenty years consisted of funding population control programs, but it jars with the objectives President Reagan stated upon taking office.

The monetary aspects of the problem were treated exhaustively in this publication's Aug. 11, 1981 cover story, "From Dollar Crisis to Economic Collapse," which examined the global flow of funds and concluded

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that the $96 billion deficit-financing requirement of the developing countries is unsustainable. Most of this represents debt service; on balance no more than $30 billion this year consists of merchandise trade deficits, including oil imports. Every 1 percent rise in dollar interest rates has added roughly $3 billion to the annual debt-service charges of the Third World; as Morgan Guaranty Trust points out, a 1 percent rise in interest costs is more deleterious to Third World country balance sheets than an identical rise in the oil price.

Even the $96 billion figure admitted by the International Monetary Fund ignores perhaps $30 billion in interest charges on these countries' short-term debt. In all, the impact of the "Volcker shock" to the international markets has forced a 35 percent p.a. rate of increase in total Third World indebtedness, about the same as the rate of increase of corporate indebtedness in the United States. The difference is that loans to U.S. corporations represent viable credits relative to high-interest debt-refinancing loans to the Third World, which have no hope of repayment.

Even to make such loans, the commercial banks are forced to create fictitious "book money" on the Eurodollar market, whose absence of reserve requirements permits banks to multiply a given deposit base into a limitless amount of book loans. Particularly since the Arabs shifted perhaps $60 billion of funds from U.S. banks abroad to their own and to European and Japanese banks following the November 1979 Iran assets freeze, American banks have had to stretch themselves thin on the interbank lending market to raise funds necessary to make such loans.

So, as Treasury officials reported in interviews, the banks and Treasury got together to demand that the developing countries take the difference out of their imports.

What this means is evident from statistical material summarized in the International Monetary Fund's July 19 "World Economic Outlook for 1981." Less than one-quarter, or $24.1 billion, of the non-oil developing countries' current account payments deficit this year will appear on the account of merchandise trade; the rest is shipping, insurance, and, above all, debt service. For example, Latin America—the major target of the proposed lending cutoff—has a current account deficit for this year of $39.9 billion, the IMF estimates, but a trade deficit of only $9.2 billion.

From the standpoint of the industrial nations' trading interest, the relatively small trade deficit of the developing countries represents the results of seven years of *import austerity* due to high oil prices. As a percentage of total import costs to the Third World, fuels have risen from 9 percent in 1960 to 20 percent in 1969. In the case of Brazil, the single largest developing-country borrower and the victim par excellence of the new Treasury policy, fuels account for 33 percent of imports.

There is little fat to cut from these countries' imports, even if all "luxury goods" (automobiles, consumer durables, and so forth) were eliminated. To cut any significant amount from the current account deficit, e.g., the 20 percent in real terms over the next year the Treasury is talking about, would mean the *political dissolution* of most Third World governments, and a sharp reduction of living standards in countries where much of the population now lives at the survival level. Whether or not the IMF put in place birth-control programs as a condition for lending, it would accomplish the reduction of population through the Apocalyptic Horsemen.

Since Brazil, Argentina, and other major debtors depend on a growing export volume to meet their debt service obligations, the shock to their economies would result in massive defaults within a year of this policy's introduction, even if all the import adjustments were to be made according to the bankers' specifications.

Superficially, the banks would appear to have the upper hand: After all, where would Brazil, Argentina, and Mexico go for credits if they failed to accept the conditions? The reality is different: The banks are acting out of their own desperate, underlying weakness.

The major international source of liquidity, the OPEC nations and Saudi Arabia in particular, have no interest in this program. The two largest exporting nations, Germany and Japan (who together account for almost 30 percent of world exports) have no interest in it. Neither, for that matter, does the Soviet Union. The major developing country importers, e.g., Brazil, Mexico, Argentina, India, Indonesia, the Philippines, and Nigeria, have some interesting negotiating partners.

Technically, all the above list of nations need do is monetize their gold reserves and issue long-term, low-interest gold-backed credits to maintain and enhance their export flows. Jerry-rigged political arrangements are already at work to this effect; for example, Japan's $20 billion increase in exports this year has a great deal to do with the placement of Arab deposits in foreign branches of Japanese banks, whose external assets grew from $60 billion 18 months ago to $110 billion at the end of the first quarter of 1981.

Unless the rest of the world is prepared to tolerate the steepest drop in international trade since the Second World War, comparable to the worst trading years of the early 1930s, we will see arrangements of this kind proliferate around the boundaries of America's declining influence in world economic matters. Moreover, these decisions will be made rapidly: $40 billion of the Third World deficit is still to be financed in the last quarter of this year, and the crisis of decision will emerge within weeks.

Treasury: 'take away the credit punchbowl'

From an interview with Charles Dallara, executive assistant to Marc Leland, assistant secretary of the Treasury for international affairs, provided to EIR *by banking sources.*

Q: Doesn't Treasury Secretary Regan's call for a cut in world liquidity tend to destabilize current delicate LDC debt negotiations, and might it not endanger U.S. bank creditors?
A: Certainly not. But the banks approve of what we say.

Q: But commercial bankers from David Rockefeller to Walter Wriston have warned all year that the private banks can no longer continue huge international lending, and have asked more, not less, government lending.
A: True, but not at all inconsistent with what we're saying. Your mistake is to assume that there is a fixed financial Third World requirement for credit. The fact is, they are going to have to bring down their demands for net credit. The secretary has discussed this with the banks, and he is saying, in concert with the banks, that what is needed overall is for the Third World to reduce its borrowing requirements. If we get an overall such reduction, the percentage of government finance, such as the IMF loans, may even increase in total, relative to private finance—but the amount will fall.

The banks understand this. They much prefer this, because they believe there is a worldwide problem of too much deficit spending. The U.S. and European governments are running up big deficits, and the Third World is running up too big a deficit. The deficits must be reduced to stabilize the system. So the Third World will have to make adjustments. They will have to import less. They will have to spend less.

We're using the muscle of the U.S. government to do what the banks would like to see anyway.

Q: I can't believe that you can succeed politically with the LDC governments. How can they reduce their world borrowing; they'll have riots in the streets.
A: We believe it can be done, because it must be done, and contrary to what you say, we already see a lot of cooperation from LDCs at the IMF. India will have to be more cooperative.

Q: You mean you can reduce the $90 billion LDC borrowing figure for 1981 in absolute terms?
A: We think so.

Q: Many countries have not even borrowed most of their 1981 needs yet, they're waiting for interest rates to fall.
A: That's true enough.

Q: I've heard estimates that out of $90 billion, maybe $40 billion still remains to be borrowed in the fourth quarter alone—how can that sort of bunching up possibly be cut?
A: Turn that on its head. That's our leverage—now they're stuck trying to borrow all that at once. So turn it on its head—because they simply can't borrow all that at once. We're using this situation, we're using it to say that they will just have to borrow less, they'll have to cut that request by $10 or $20 billion, or whatever.

From an interview with Marshall Case, executive assistant to Meyer Rashish, undersecretary of state for economic affairs, provided to EIR *by a journalist.*

Q: Isn't Reagan going to cause problems for the banks?
A: We're just doing what the Fed did here at home: we're taking the punch bowl away before the party gets too merry. We're helping the banks to impose discipline. We're creating a situation where the banks can't lend—and they don't want to.

Our view first of all is that oil consumption, and so oil import bills, are going to be a lot smaller. The OPEC surplus is going to fall to $50 billion or under next year [from over $80 billion this year—ed.]. We're going to create a situation where we force countries simply not to undertake the debt. We already have test cases, like Turkey, where these countries are starting to cut their imports.

Our aim, for next year, is to actually reduce that LDC current-account deficit in absolute terms for the first time in history. We don't care if it falls [from $90 billion] to only $80 billion, the point is to break the pattern.

Q: And you hope to do this by import cuts?
A: Right. They'll have to undergo domestic adjustment.

Q: But I can't believe you can get those kinds of cuts out of Costa Rica, Bolivia, or whatever.
A: Right, nor out of Poland. Those are the basket cases, and they just serve us in their debt-rescheduling negotiations, as useful examples for others. The big dollars will have to be taken out of the big spenders—Brazil, Argentina, Mexico.

Q: What about that big loan the IMF gave India?
A: That's another good example. The IMF staff recommended it, but the U.S. hasn't had a chance to take it apart yet. We just can't have those levels of borrowing and spending going on.