EIR Economics

Has the Group of Five given the dollar a death sentence?

by David Goldman, Economics Editor

Senior officials of the international financial organizations do not expect the Dec. 9 meeting of the Group of Five finance ministers near Frankfurt to secure a bailout of the world banking system.

From preliminary briefings, it appears that the ministers will agree to a 50 percent increase in the present resources of the International Monetary Fund (now $60 billion, but only about half in currencies acceptable in international payment), and to the expansion of the industrial nations' emergency kitty, the General Agreement to Borrow (GAB). In any event the International Monetary Fund's increase in quotas from members will not make funds available until some time during 1984, even under the very best of circumstances, and has no relevance to the present crisis, as well-informed officials are quick to admit. The General Agreement to Borrow presently stands at $8 billion, and may be expanded to $15 billion.

International payments crisis

Meanwhile, after the $1 billion-plus American loans to Brazil and Mexico, a $1 billion Yugoslav loan from the Federal Reserve is under discussion, while Argentina has made applications for a $750 million facility from the Bank for International Settlements.

All this has a great deal to do with the dollar's 12 percent fall against the yen, and 7 percent fall against the German mark, as well as the rise in the price of gold to about $458, during the past three weeks, for reasons to be explained below.

Clearly, the pre-circulated agenda of the finance ministers of the largest industrial countries falls short of a solution to the worst international payments crisis since 1931 (and in terms of the ratio of debt to trade, of all time). World trade is now declining at an annual rate of 25 percent per annum, according to the respected Japanese economist T. Nakamae of Daiwa Securities, London. The collapse of world trade volume has been accompanied by a breathtaking decline in the terms of trade of the major debtor countries, in the form of a 30 percent decline in raw materials prices during the past 18 months. British analysis, contemplating the free fall of the pound sterling during the past several weeks, now warn that after the winter's peak, the OPEC production level will fall from the present low level of 18 million barrels a day to only 10; and that, as a consequence, the present softening trend of oil prices will turn into a rout, with the price of oil ending the first quarter of 1983 between $20 and $25 per barrel, against the present $32 benchmark. They further agree that the oil price drop will inaugurate a new round of price declines among the major industrial and agricultural commodities, further worsening the payments terms of the developing nations.

How thin the safety net that the Group of Five has stretched out turns out to be is not certain; but the difficulties are best illustrated by the case of Brazil. Brazil had received, and spent, the entire $1.2 billion American loan announced by President Reagan during his trip to that country Nov. 27; the first installment had come a month earlier, the balance several days before Reagan arrived. The American government hastened to make clear that the Brazil loan was only a short-term bridging facility, to be paid back out of the proceeds of Brazil's condition-free borrowing from the International Monetary Fund, through the Compensatory Financing Facil-

© 1982 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

ity. It appears that a $5.8 billion IMF package for Brazil (the figure is disputed in any event by IMF officials who look for a somewhat lower figure), plus a $1.2 billion IMF loan, turns into barely enough to meet Brazil's $4 billion payments requirements until year's end. Brazil has, in any event, been flat out of funds since early October, and has been living hand to mouth through short-term credits. (Although the entire IMF loan will not be made available immediately, but rather over three years, it is expected that Brazil will be able to borrow elsewhere against its eventual disbursement.)

Where will the money come from afterward? The IMF can neither legally give more, nor physically find the wherewithal to do so. The private banks are out to lunch, particularly after the European members of the Brazilian lending consortia delivered a flat "no" to Mr. Delfim Netto, Brazil's Economics Minister, during his trip to Europe in October. During the first week of December Brazil took the extraordinary step of sending a telex message to its bankers informing them how much would be expected from each of them; the contents of the replies are not known.

Apart from Brazil, the Argentine situation remains blocked, not least by a 6-million-person general strike against the International Monetary Fund by Argentine unionists on Dec. 7, whose illegality under the military regime did not appear to trouble the Argentine government (see article, page 34). Argentina has in any event been persona non grata at the Bank for International Settlements in Basel, where its requested $750 million emergency credit line is under discussion, since it unilaterally issued $5.5 billion in five-year paper in exchange for defaulting private, government-guaranteed debt in late October. Venezuela's once rock-steady bolivar has collapsed in imitation of the Mexican peso in late summer (following the precise timing *EIR* projected in September). Chile's government, unable to obtain foreign currency, has desperately asked its private companies to go out and obtain foreign credits, with little hope of success; and it appears likely that the second economics plenipotentiary within three months will be fired.

Debt and the U.S. currency

How long the Federal Reserve can continue its largesse is uncertain; after all, it is difficult for Volcker or the administration to go before Congress and justify multi-billion-dollar loans to bankrupt developing nations, on behalf of the bankers, while the federal budget is subjected to unheard-of austerity and the economy remains in depression. Nonetheless, analysts at some large New York commercial banks believe that the stunning fall of the dollar during the past three weeks was a reflex response to the possibility that the Federal Reserve might try to deal with the problem through a general reflation—that is, by *transferring the bad debts of the banks to the account of the United States itself.*

The dollar's present fall, which is not necessarily irreversible—although the dollar must fall sharply some time in the near future—indicates that the credit of the United States is no longer good enough to absorb the bad debts of the banking system. If the United States had not already had to borrow in the fiscal year ended Sept. 30 approximately the total of domestic savings, $217 billion net, matters might be different; there might be more room for maneuver. However, the enormous dependence of the United States Treasury on foreign capital inflows makes the entire American interest rate structure, and therefore the world economy, hair-trigger sensitive to the value of American government obligations (i.e., the dollar) on the international markets.

During the coming fiscal year, according to official estimates, the Treasury deficit will be in the range of $150 to $200 billion; that assumes a strong or weak recovery, respectively. Assuming no recovery, and a continued downturn, as *EIR* projects, the deficit will be even worse. Add about another $100 billion for the various "off-budget" forms of federal borrowing, and the total borrowing bill may be in excess of $300 billion, or half again as much as total domestic savings!

Should Volcker attempt to throw newly created money at the problem, which some analysts at the German Bundesbank expect he will, the foreign fund managers who put perhaps $40 billion into U.S. government securities during the course of the past year will run for cover. In effect, Volcker would have told them that he is devaluing their claims in order to compensate for the absence of paying income on other dollar-denominated claims, those of the large American banks.

There should also be no illusions concerning "international cooperation" or "coordinated reflation"; since the overwhelming majority of the bad debts are in dollars, the bill will come back to the Federal Reserve. This point has been made with some emphasis by the chief economist of the General Agreement on Trade and Tariffs, Jan Tumlir, in recent public discussion.

A barren agenda

Of course, once the dollar fell out of control—and the past three weeks demonstrate its vulnerability to free fall—interest rates in the long-term markets in the United States would necessarily rise. Foreign investors who moved in for safety would flee for fear of capital depreciation. The situation of the British markets, now characterized both by rising interest rates and a falling pound, may well prefigure the American markets' situation during the next several months, as the sterling crises of the 1960s and 1970s provided the precedent for dollar crises that followed.

The Federal Reserve's policy has run out; it can offer nothing but "loose money" or "tight money," neither of which work in an environment of rapidly shrinking world trade. Nothing will help short of a general reorganization of the developing sector's debt at low interest rates, and the restriction of new official credits to purposes which actually expand the physical volume of goods produced and shipped. Tragically, the Group of Five agenda does not include anything of the sort.