Click here for Full Issue of EIR Volume 10, Number 47, December 6, 1983

Leutwiler calls for the 'hard path'

by Richard Freeman

Hardly had the ink dried on the United States Congress approval of an $8.4 billion U.S. Treasury Department donation to the International Monetary Fund, when the IMF turned toward imposing harsh terms on Italy, a prelude perhaps toward a crackdown on other advanced sector nations. The IMF seems to have drawn the conclusion that it now has the funds and backing of the United States to act as viciously as it pleases. The IMF had scored a "double victory" of sorts, in that the Brazilian Congress approved the IMF's bitter austerity terms Nov. 9 and, eight days later, the U.S. Congress vote for IMF funding increases came through.

The marching orders for the IMF's nasty policy were issued by Fritz Leutwiler, head of the Basel, Switzerland-based Bank for International Settlements, the same institution that in the 1940s conduited the gold which had been removed from concentration camp victims' teeth into its vaults. In a speech delivered Nov. 16 before the Swiss Institute for Foreign Research, Leutwiler proposed "two theses" on the future of the world monetary system, and opted for one of the theses. The Leutwiller speech was given to a predominantly Swiss audience and not covered in any American press, but only in the Swiss *Neue Zürcher Zeitung* newspaper. The first thesis, Leutwiler said, is the bail-out or "soft" version. This thesis holds that the world debt crisis can be controlled and that the world monetary system is sustainable if governments and agencies like the IMF simply continue to provide emergency funds to back up loans that aren't being repaid.

But the "soft" thesis is not acceptable to the BIS. "The hard thesis deserves more and more attention," Leutwiler said. That means a "gradual withdrawal of official injections of funds" into the world monetary system. Leutwiler warned against, "an ever smaller number of financially strong supporting an ever larger majority of financially weak." The Swiss central banker demanded that both developing and industrial nations face the fact that the kind of problems which the IMF is facing in scraping together liquidity are "exemplary of the growing shortage of financial resources" all over the world.

Criticizing the "euphoria" of bank lending to the Third World of the 1970s, Leutwiler said that should a "larger country" unilaterally default on its debt "against expectation," he fears a shock would erupt on the interbank market which could put "all banks on the firing line." While a funds restriction, as he proposes, still runs the risk of a "domino effect" of underdeveloped-sector defaults, this, he implies, is a necessary risk.

In mid-November, Leutwiler gathered together 18 central banks which declared themselves ready to ameliorate the IMF's illiquidity through the end of 1983, by offering the Fund a central bank "bridge loan." This was made contingent, however, on the U.S. Congress passing the IMF $8.4 billion quota increase and the expansion of the Group of Ten industrial nations General Agreement to Borrow (GAB) checking account.

By arranging matters this way, Leutwiler achieved the objective of forcing President Reagan to fight for the IMF quota bill, which was in trouble in Congress, as his own bill. Without such a bill, the central banks would withhold funds from the IMF, and a world liquidity crisis, and hence an American banking crisis, would erupt the fourth quarter of this year. With President Reagan blackmailed by Leutwiler,

© 1983 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

and the connivance of witting elements in the Democratic Party in the Democratic-controlled House, the IMF quota increase bill squeaked through the House of Representatives Nov. 18 by 226-to-196 vote.

The IMF had already secured the endorsement of the Brazilian Congress Nov. 9 of Decree Law 2045, a wage reduction law, which was the sticking point holding up the Brazilians' signing of an IMF letter of intent. Without this draconian wage law the IMF would not consider giving the Brazilians a penny.

Now, Leutwiler could use the IMF funds as a "pot of gold," but the IMF quota increase would not be a step toward reflating the world economy. Rather, it would probably be the last increase of IMF funds ever to occur. In a world starved for credit, Leutwiler could bargain with the only pool of funds likely to be available for a while. He could tell countries, in effect, "either meet my terms, or your country won't see any of this money."

The Italian solution

In a 12-page letter by the IMF's European Department head Alan Whittome to Italian Treasury Minister Giovanni Goria, released Nov. 21, three days after the U.S. Congress IMF vote, the IMF warned Italy that it will have to take on its trade unions, reducing "wage indexation," as well as adopting "a substantial package of additional [austerity] measures to be introduced at the beginning of 1984." The "or else" was not specified in the IMF letter, but it was generally understood that Italy, which is in need of international credits, would not get any if it did not comply. The Nov 22 *Financial Times* termed the letter an "unusually hard-hitting critique," adding that Italy can expect, "potentially disastrous consequences" if it does not comply.

Private bankers, as well as the IMF and BIS, have the Scandanavian countries, Portugal, Spain and France under scrutiny for the same treatment. The U.S. congressional vote for the IMF increase also approved an additional clause that allows the IMF to create new issues of its Special Drawing Rights without a U.S. veto right that previously existed. Since the dollar is the largest component of the basket of currencies that make up the SDR, the United States has thus sacrificed a large part of its sovereignty.

Writing down bad loans

Leutwiler also raised in his Nov. 16 speech the prospect that banks will now have to "consider write-offs on interest payments." This is the first time Leutwiler has raised this proposal publicly in that direct form.

A proposal by an administration source close to Federal Reserve Board chairman Paul Volcker on Nov. 10 goes to the heart of the Leutwiler "interest write-off" suggestion. This plan, which is endorsed by the Bank of America and Security Pacific, two of the United States' largest banks, has two parts. The first is to have a debtor country, like Brazil, pay half its annual interest payments into a "blocked account" that would be denominated in that country's local currency, i.e., cruzeiros. The "blocked account" would not allow these cruzeiros to be used for any other purpose but debt repayment. The accounts would be held at the Brazilian central bank (see *EIR*, Nov. 29).

While such a proposal would not lessen the amount of debt that a Third World country had to pay, it would lessen by half the amount of dollar foreign exchange it had to earn. It would also supposedly help the U.S. creditors, because banks could avoid classing those loans in the blocked account which do not pay interest as non-performing. The alleged reason: only dollar-denominated loans can be classified as non-performing. Currently, the 18 largest U.S. commercial banks have at least $70 billion in foreign loans which are non-performing, according to a private estimate (see International Credit, page 15). If these loans were officially counted as non-performing—which legally they should be—they would have to be written off. Such large official write-offs would exceed the banks' paid-in capital and they would therefore technically be bankrupt. The "solution" offered here, which has been proposed by other sources, offers the cosmetic appearance of solving that problem, although whether such a gimmick would be acceptable to congressmen and bank auditors is another question.

The second part of the plan is that once such "blocked accounts" in local currencies are established, the banks may find ways to use the funds in the "blocked accounts" to cheaply buy up assets in the country of those accounts.

In short, the "debt write-off" plan is an attempt to have the best of both worlds: maintain non-performing principal balances which are perpetually not repaid but not classified as non-paying, and second, prohibit the use of these blocked accounts for any purposes other than a "fire sale" of the indebted country.

But, by attempting to impose credit restrictions on advanced-sector nations as well as the Third World, as the IMF signaled with its latest assault on Italy, the likelihood of corporate bankruptcies in the OECD sector is enhanced. A contracting world economy will blow up the world debt structure, no matter what accounting schemes are introduced.

A slavish adoption of Leutwiler's call for credit restriction is portended for the United States itself. Whereas U.S. domestic money supply (M-1) grew at a 13.2 percent rate during the summer, for the last 13 weeks it has only increased at a 3.2 percent rate. All the new money is being gobbled up by U.S. corporate debt service financing. On Nov. 20 the Reagan administration commented that it thought that the U.S. Federal Reserve was tightening too deeply. The administration is worried that the the small upticks in the housing and auto sectors which have been mislabeled a "recovery" will evaporate if credit remains tight. A worried *Wall Street Journal* wrote Nov. 21 that the "Federal Reserve System may be hitting its credit brakes despite last week's plea by the Reagan administration to boost the growth of the nation's money supply." Under conditions of global illiquidity all bank debt is worthless. Mr. Reagan may get a very nasty Christmas gift from Paul Volcker.