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Argentina's rebuff to the IMF panics bankers

by Vin Berg

On June 15, the U.S. Treasury refused to extend its guarantee of $300 million in loans to Argentina by other Ibero-American debtors because Argentina has refused to sign commitments to wrenching austerity with the International Monetary Fund. On June 21-22 in Cartagena, Colombia, Argentina with those debtor nations and others will convene the first ministerial level meeting of their debtors' cartel. The Treasury's action makes June 30 the date of a confrontation between debtors and creditors, and a major financial crisis if neither backs down.

Argentina, for one, certainly will not. "The debt of Argentina and of other Latin American nations is the product of perverse mechanisms that lend us money in order that we do not develop ourselves. . . ." Those were the words of Argentine President Raul Alfonsín, who arrived in Spain on June 11 on an official visit, delivering a stirring speech the next day before the Spanish Parliament *(Cortes Españoles)* on his country's decision to defy the International Monetary Fund and take the lead of the emerging debtors' cartel.

"The Argentine debt is equivalent to two-thirds of Argentina's Gross National Product. The distortion of the international financial system has signified for my country and for all Latin American countries the paradox of the underdeveloped sector being bled, shipping out its resources in order to feed the financial accumulation in the developed world.

"We are transforming ourselves into actors of an historic epoch in the unity of Latin American peoples, in which each of our peoples individually affirms national unity."

The speech was the strongest public statement made yet by the head of a major debtor nation, a "debtors' club" nation. It is symptomatic of the debtors' fighting mood in the wake of the London summit of creditor nations June 7-9, which gave no hint of debt relief.

Alfonsín signed a "Madrid Declaration" with Spanish Premier Felipe González, in which Spain pledged to support Argentina's defiance of the IMF and called on the rest of Europe to do the same. Alfonsín also gave an interview to the Mexican daily *El Día*'s correspondent in Madrid, saying: "We are not going to pay our debt by making our people hungry." Back in Buenos Aires, Argentine Foreign Minister Dante Caputo told an interviewer: "We Latin American countries are victims of an inverse Marshall Plan, given the fact that we are giving up $150 billion to save the disintegrating United States economy."

Who'll buckle under?

As recently as the end of May, most financial analysts were complacently asking themselves when Argentina would buckle under to the IMF, signing a letter of intent so that its creditors could roll over the roughly $500 million in interest payments due June 30, and the U.S. Treasury could maintain its guarantee of the $300 million in loans to the country by Brazil, Mexico, Venezuela, and Colombia, to permit Argentina to meet its March 31 payments.

Now, analysts are asking themselves if and when the creditors will buckle under to Argentina, which is not only flatly refusing to sign anything remotely acceptable to the IMF—"making our people hungry"—but has submitted its own, independently drafted program to the Fund on a take-it-or-leave-it basis.

The ball was thus thrown back to the Treasury and the creditors "real hard," as one bank economist commented—

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"harder than anybody thought," said another. The Treasury's withdrawal of the guarantee puts the U.S. banks in a position of either rolling-over the Argentine debt June 30 or facing a crisis in the U.S. banking system.

If the banks and IMF do not give in and lend Argentina some $500 million in June, Argentina will be over 90 days past due on $500 million or more in interest payments to foreign banks. U.S. money center banks would have to absorb over $300 million of that loss directly in a drop of their second quarter profits. Federal Reserve Chairman Paul Volcker madly told the Senate Banking Committee June 14 that losing such "fairly limited interest payments" is "not terribly significant."

European depositors, however, are already primed to execute a mass run on U.S. banks if such loss occurs. Manufacturers Hanover, already subject to a European depositor run May 24, will lose some $20 million, a full 25% of its quarter's income, and Chemical Bank, Bank of America, and Citibank a similar 20-25% of income. Such losses would "further damage U.S. bank shares," and panic depositors, the London *Financial Times* commented June 4.

Asked June 14 what the government would do faced with "many Continental Illinois bank runs at once," Treasury Secretary Donald Regan told *EIR* "that's too many ifs."

Indeed, Regan stupidly delivered an "ultimatum" on the IMF issue to Argentina June 8, believing that Argentina would have to immediately repay its neighbors the $300 million without a U.S. guarantee. But Argentina is now part of a debtors' cartel with those very neighbors.

European banking sources observed that Regan had "painted himself into a corner." Extension of the guarantee past June 15—it was already extended from June 1—in the face of Argentine defiance of the Treasury and the IMF would have discredited both as collectors for the banks; but withdrawal of the guarantee not only threatens an early crisis in the U.S. banking system, but is certain to radicalize the debtors' cartel members.

Debtor radicalization is already afoot following the London summit, which pledged no change in support for the IMF's brutal austerity policies and a case-by-case approach to forcing debt repayment out of Ibero-America, promising only to "reward" with longer payment schedules those debtor nations which accept the IMF boot—"concessions" designed only to split key nations out of the cartel.

Colombian Foreign Minister Lloreda Caicedo called the summit a "disappointment," and observed angrily that it did not even mention the letter sent to the summit by seven Ibero-American heads of state, proposing that "international agencies" like the IMF be replaced by nation-to-nation dialogue on the debt problem.

Sebastian Allegrett, the head of the Latin American Economic System (SELA), stated flatly that "to negotiate on a case-by-case basis would neutralize our collective actions," and called the talk of "rewards" for submissive debtors "colonialist language."

The effect of Argentina's defiance, wrote the June 15 *Wall Street Journal,* has been to "single-handedly gut the reward strategy before it barely got off the ground." Who will take IMF "medicine" in return for "rewards" if the IMF can be successfully repudiated altogether? The *Journal* had to admit that Argentina is now threatening to destroy the very system which "called for IMF austerity programs paving the way for more bank loans, which countries used to make bank interest payments and keep the global banking network intact."

In conclusion, wrote the *Journal,* the banks will just have to roll over Argentina's debt, regardless of its domestic economic policies, or see some of the largest U.S. institutions badly shaken at very least; then they will face the same from other debtors. "Most agree with Johns Hopkins's Mr. Roett that the least likely player to blink in this game is Argentina. Argentina's public war with the IMF, he says, has left 'little room for . . . Alfonsín to back down.'"

That Argentina and its neighbors suddenly hold the cards is the singular development in the world financial picture since May 19, the date of the four Presidents' communiqué (Argentina, Mexico, Brazil, and Colombia). It signaled that the cartel formed in late March "to pay, not not to pay" Argentina's debt service, had shifted purpose. All at once, the political fiction surrounding the world debt crisis, that the creditors have all the power, is exploded. If the debtors collectively default, the creditors are bankrupt, and the weapon created by the creditors' usury is suddenly the debtors' to wield.

Alfonsín's Madrid speech implied what Foreign Minister Caputo asserted outright: Argentina, Brazil, et al. are not bankrupt, but their creditors are and have been papering over the fact with subsidies from their Ibero-American debtors. The formation of a debtors' cartel capable of calling a halt to those subsidies—called "debt service" on Wall Street—affected markets already shaken by the May 11 collapse of Continental Illinois, and was sufficient to produce a near-collapse of Manufacturers Hanover, rumors about Chase Manhattan and Bank of America and crashing stock markets all over the world, and equally exposed British banks scrambling to place their certificates of deposit at rates well above the normal—precisely what started the collapse of Conti.

Donald Regan could not be more ridiculous. He astonished the entire New York press corps during a June 14 briefing, when, under questioning from *EIR,* he said that relief to the debtor nations was "illegal." In that case, so is reality: It is clear that the bankers won't get the amount of debt service they expect from the Ibero-American nations over the June 30 and Sept. 30 payments periods—because payment is a physical impossibility. Panic and a crash of the entire system because these debts are actually non-performing, whatever sleight of hand might be devised by the regu-

lators, could erupt at any time over that period.

In that case, reported a senior U.S. official, "the decision has already been made. The Federal Reserve will float the banks off into the sunset on a sea of liquidity." But that, of course, means a crashing U.S. dollar, rising interest rates on inflationary expectations, and, its ultimate logic, Weimar Germany hyperinflation 1922-23 style.

Documentation

A 'revolutionary' move

Le Monde, *Paris, June 12:*

The doctrine laid down in London was called into question as soon as issued, by one of Latin America's leading debtors. . . . The initiative taken in Buenos Aires is interesting in many respects: It breaks dramatically with the orthodoxy requiring that economic improvement be obtained through a ferocious adjustment policy. . . . It places the IMF in a delicate position . . . and might cause new trouble for the U.S. banking system. . . . Mr. Alfonsín's move will strengthen Latin-American solidarity. . . . The Argentine government has said loudly what many others thought. His initiative is revolutionary. This brings us far from the London summit's conclusions, and the awakening might be hard.

The Daily Telegraph, *London, June 12:*

Argentina threw down the gauntlet yesterday in what could be the most serious development yet in the Third World debt crisis. . . . Argentina has decided to challenge the authority of the IMF. . . . The Letter [of Intent] is a slap in the face to IMF officials. . . . Argentina has in effect decided on its own terms. . . . Worse still, Argentina is prepared to blackmail its international creditors by considering a siege economy.

The problem for the rest of the world is how to deal with Argentina if it proceeds to renege on its international obligations. The key consideration will be to prevent Argentina's default contaminating other debtor countries. . . . Indeed, Western Governments may have little choice now other than to call Argentina's bluff, however harsh the consequences for their domestic banks.

The Washington Post, *June 12:*

If Argentina pushes too hard and actually propels itself into default, the economic consequences for the country will be severe. It would mean an abrupt end of trade with most of the world. Argentines wouldn't starve, but their incomes would drop radically.

The Times, *London, June 12:*

The continuing drain of commercial deposits from the Continental Illinois Bank must be evoking some wry smiles of satisfaction in Buenos Aires where Pres. Alfonsín is playing a game of brinkmanship with the IMF. . . . U.S. banks could look sick if Argentina fails to make payments due. . . . Unless IMF negotiators suddenly start going soft, the creditor nations may find they have painted themselves into a corner.

The Neue Zürcher Zeitung, *Switzerland, June 8:*

[The situation] might go in the direction of the widely propagandized debtors' cartel . . . which would bring the debtor countries more damage than benefit, because it would shut down totally any access to the international capital markets and thus to trade credits, and would also push the creditor countries into a banking crisis.

World's bankers at a loss

"The Role of the Commercial Banks in the Prospective World Environment" was the title of a "prestigious" gathering of international bankers at the International Monetary Conference in Philadelphia, Pennslyvania June 3-6. The Conference was confronted with the recent formation of an Ibero-American debtors' cartel in which Ibero-America's leading debtors pledged to set the terms under which they can continue to pay at all on their millions of dollars of foreign debt. In the face of this reality, virtually the only policy the assembled bankers could agree on was their desire to stay afloat.

The international banking community generally divides three ways on the approach to solving the international financial crisis looming over their heads in the form of unpayable Third World debt:

1) Stick to the "tried and true" methods of trying to bully its way into getting payment, by using the IMF and equity grabs;

2) Concoct a rescheduling scheme that will both stretch out the payments and write off a portion of the unpayable debt, the latter at the expense of the banks;

3) Organize a massive bailout operation through the international central banks, particularly the U.S. Federal Reserve Bank.

The "consensus" reached at the London Summit of Western heads of state reflected the first point of view, one also enunciated by IMF director Jacques de Larosière at the Philadelphia conference. Sample excerpts from the speeches of participants at the Philadelphia conference, reprinted below, indicate that such a "consensus" is in fact born of total ignorance by the bankers of what approach to take. They have chosen to apply the very same principles of austerity and looting that created the problem.

Not reflected in these excerpts is the extensive technical discussion of "banking reform" which occurred at the conference. These papers will be reviewed for EIR *by Kathy Burdman in her upcoming columns.*

Walter B. Wriston, chairman, Citibank/Citicorp:

No one has to tell this group that we have just passed through [sic] the worst economic conditions since the 1930s. Whenever there is a worldwide recession, loans to individuals and to companies that appeared sound when they were made drift into trouble. To quote an old Wall Street adage, "Whenever the tide goes out there are always a few dead cows on the beach.". . .

The technical lending problem that surfaced in many less developed countries was the lack of equity. Too much was financed by debt and too little by equity. In many countries, this state of affairs was as much a political decision as an economic one, brought on by national policies that tended to equate foreign capital with exploitation. . . .

We all know that if the OPEC nations would drop the price of oil by $10 a barrel, or if countries selling manufactured goods would cut their prices and stretch out their terms, or if industrialized nations would mount massive aid programs, then no doubt things would improve for the developing countries in the short run. But in the longer run, all these measures would tend to relieve the pressure to build solid economic growth. . . .

And so, too, would measures such as capitalizing interest on LDC debt. Whether you capitalize all future interest, or only that portion of it which exceeds a "reasonable rate," you do not cure the problem. You only hide it. The global marketplace will not be fooled. If the market perceives that a particular country prefers to issue an unlimited amount of its own interest capitalization notes, rather than do what it, and only it, can do to regain its strength and discipline, then the market will shun this paper, no matter what its rate or tenor.

Wilfried Guth, managing director, Deutsche Bank A.G.:

I think it is crucial under such circumstances [tensions in the interbank market] that we commercial bankers, as well as central bankers and government officials, do not succumb to any panicky mood or reactions but consider the problem cooly. But at the same time, it would seem to me more important than ever to continue and, wherever necessary, intensify the cautious approach with respect to the debt problem of making adequate provisions and securing a solid capital base which most of us have adopted. It is consequently essential that supervisory authorities in all lending countries induce banks to take these precautions and fiscal authorites allow them to do so without tax penalties.

None of us can say when and how our worries about overindebtedness will come to an end and I would, therefore, consider it a sheer waste of time to quarrel about the likelihood of more optimistic or more pessimistic forecasts. Personally, I think I would have to classify myself as an optimist by nature, but by profession I am a banker and I have learned from experience that it is preferable to be always prepared for a "worse case scenario.". . .

In my view, the focus of our attention in these cases must be on the development of the countries' *repayment capacity* [emphasis in original].

Broadly speaking, an improvement of the repayment capacity can be said to be underway, if the financing gap which has to be covered by fresh money in whatever form shows a definitely narrowing trend. If this could not be achieved and if the underlying discrepancy between a country's debt service obligations and its economic performance, particularly its foreign-exchange earning power, were to increase rather than decrease over time, the therapy would have to be changed. In such a case the banks and all other creditors would, in my view, have to face the fact that the problem can no longer be solved by the method of rescheduling and new financing as practiced up to this time; other—certainly more painful—ways of restoring the country's financial and economic viability would then have to be considered, not least from a political point of view."

C. Fred Bergsten, director, Institute for International Economics:

. . . F. Conclusions

1) Probably need package approach: some of each.

2) Must recognize continuing nature of problem; may need supplementary sources of finance for many years, so prepare now.

3) Especially requires serious/sustained support for public international institutions—and possibly some changes in the policies and operating procedures of the institutions themselves (including much closer IMF-IBRD coordination).

4) Also need clarification of accounting/regulatory/ etc. implications of several of the proposals, especially regarding bank loans.