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The debt crisis and the Swiss calculations

by David Goldman

Federal Reserve and administration officials expect that Brazil will default upon a $400 million loan repayment to the Bank for International Settlements (BIS) due June 30 after a four-week extension. To our knowledge, this would be the first such default against the world's most powerful banking institution. In the view of one senior administration economist, there is an 80 percent probability that Brazil will impose some form of payments moratorium before the end of June, although the nature of this moratorium is still far from certain.

Two weeks of armtwisting by International Monetary Fund (IMF) chief Eduardo Wiesner and team failed to bring forth the tough austerity concessions which, the IMF staff had hoped, might have permitted a resumption of IMF disbursements to Brazil. These had been suspended in retaliation for Brazilian "non-compliance" with the Fund's program, agreed upon last February, as part of a comprehensive package to prevent the collapse of $100 billion in Brazilian foreign debt. Brazil has made repayment to the BIS contingent upon receipt of a comparable sum from the IMF.

As the Ecuadoran trade and industry minister, José Augusto Bermeo, commented in an interview (see page 11), the heads of state of several Ibero-American nations may take the opportunity of their meeting in Caracas on July 24 to announce the formal existence of a debtors' bloc. Venezuela's official position was given to the UNCTAD conference in Belgrade by its foreign minister José Zambrano: "the creditors have organized themselves to coordinate their efforts; therefore, it is only logical that the debtors do what is necessary to coordinate their positions." To the profound chagrin of European bankers, who earlier expressed *Schadenfreude* over their American colleagues' Latin American predicament, Poland has directly associated its cause with that of the Ibero-American continent; Polish Deputy Prime Minister Janusz Obodowski's proposal June 13 to stretch out the Polish debt over a 20-year repayment period with eight years' grace was intended, the Polish leader said, "for all countries" (see article, page 9). Authoritative Polish sources report that the Polish government considers association of its debt problem with that of Ibero-America as the country's last chance to escape the crushing economic embrace of the Comecon.

The view from the *Alpenfestung*

One of the great dramas in postwar history has begun with this set of events, and its first act was played out at the annual meeting June 11-12 of the Bank for International Settlements, the *Alpenfestung* of world finance. The odd and contradictory formulations of the BIS's Annual Report reflect the conflicts in the mind of the BIS chairman, Dr. Fritz Leutwiler, who is also president of the Swiss National Bank. In an interview published exclusively by *EIR* last March, before its circulation to the daily press in several countries, Leutwiler predicted a financial catastrophe. Describing the world "economic recovery," usually represented as a solution to the debt crisis, as "wishful thinking," Leutwiler warned bluntly that none of the proposed solutions to prevent a world monetary collapse would work.

Nonetheless, Leutwiler's remarks to the annual meeting take the more guarded viewpoint associated with the Bank of England and the U.S. Federal Reserve Board. Warning that the world debt problem has left the monetary system in a state of "fragility," the Annual Report recommends concerted growth by the United States, Japan, West Germany, and the United Kingdom, in order to establish a "buyer of last resort" for the exports of heavily indebted Third World countries. Even more than the mid-May pronouncements of the Organization for Economic Cooperation and Development meet-

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ing in Paris, the BIS emphasizes the "need for growth" as opposed to the "fight against inflation." That by itself is a man-bites-dog story; the BIS is, after all, the zealous and uncompromising guardian of monetary stability.

In fact, the report reflects neither Swiss views nor intentions. The Central European financial group has discovered that it may have miscalculated badly regarding the likely behavior of London and Washington, not to mention Brasilia, Buenos Aires, and Caracas. As reported last issue, the Swiss consensus expected a chaotic pattern of payments default and social breakdown. This was the estimate offered by Swiss academic Jacques Freymond at a seminar at the end of April co-sponsored by Fritz Leutwiler, involving most of the leading Swiss banks and corporations. Under these circumstances, the Swiss believed that the principal weight of the world debt crisis would fall upon an American banking system ill-prepared to absorb it at a moment when the weakness of U.S. federal finances opened the possibility of devastation spinning off into all dollar credit markets. Mr. Carlo De Benedetti of the Olivetti corporation drew the full conclusions of this predicament, warning earlier this month in the Italian press that the U.S. federal deficit along with the Third World debt represented a "land mine" for the dollar.

It is not merely that the Swiss believe that they have the least to lose of any of the players in the game, and that the last player left in the game will take home all the chips, no matter what his previous losses. The Swiss are playing the geopolitics of *Mitteleuropa*, a term that used to refer to the territorial expansion of a Third Reich and is still not used in polite conversation in Switzerland. Commenting on the prospects for a Brazil rescue package, a Swiss National Bank source close to Leutwiler said: "Honestly, it is senseless to try such an operation. Sure, we might try to create a big wave of confidence, but I am a pessimist, and I don't think it will work. After all, in the end market forces *will* prevail. The debt is the result of historically evolved economic and social structures, and this is something that cannot be solved in six months. It will take years. Governments and the IMF have little latitude. Governments cannot take over the risks of the banks without considerable internal problems; only the United States can do it. Sooner or later the Europeans are going to have to consider well: which is really closer to home, Europe or Latin America? We Europeans have seen ourselves for far too long merely as part of the West rather than as Europeans."

The new question, the official added, is Britain. Won't Britain be more pro-American than ever? "That depends, it really depends. It depends upon whether Europe can gain the self-confidence necessary to represent a fascination for the new Thatcher government; if Europe can show that it can really perform. This is what is necessary. For example, on the debt issue, we actually see eye to eye. All that money that flowed into the Third World—you cannot compensate for that with budget deficits."

The United States must be reduced to the status of a merely continental, or at most hemispheric, power, the official concluded: "Economically, Europe can be autarkical, we can adjust to the new structures." What new structures? "The weakened position of the United States. That is the new structure. . . . Of course, the problem arises that economic independence cannot be truly effective as long as Europe has to ask for protection from another power [the United States]."

At a seminar sponsored by Prof. Alexandre Swoboda of the Geneva Institute for Higher Studies a week before the BIS meeting, dominant Swiss banking opinion was summarized by a participant, Prof. Larry Sjaastad: "If the IMF is crazy enough to think that Brazil is going to pay, or that Delfim even wants to pay, then the entire staff ought to be fired for incompetence." Sjaastad was Brazilian central banker C. G. Langoni's mentor at the University of Chicago. Salomon Brothers partner Bruce Brittain, the only senior American banker present, complained that American banks would never have lent the huge sums they committed starting in 1980 had the IMF and BIS not withheld information from them concerning the state of the debtor countries. Brittain's gripe is unjustified; the banks did not know because they did not want to know. Sjaastad told him, "Take it to court."

Fear of miscalculation

Three political lines of development have disrupted the Swiss banks' sense of apocalyptic flippancy. The first is the unexpected (for them) success of debt diplomacy among the Ibero-American nations. The second is the prospect of independent American action outside the doomed framework of the International Monetary Fund. The third is the feared defection of the Thatcher government from its previous posture of collaboration with the League of Comrades of the Oath, as the Swiss call their government, in the manipulation of the $2 trillion offshore market.

The Swiss banks are already decapitalizing their branches in offshore centers such as Nassau, Panama, and the Cayman Islands, anticipating a chain-reaction collapse of the trillion-dollar interbank market which would force many banks to walk away from subsidiaries engaged in such business. The Swiss are thereby minimizing the amount of capital that would have to be abandoned in such damage limitation exercises, according to well-placed Federal Reserve Foreign Department sources. The same sources emphasize that the bankruptcy of several secondary banks engaged in interbank business—an expansion of the 1982 Ambrosiano or the 1974 Herstatt problem—is now viewed as a short-term danger to the banking system on a par with the Brazil crisis itself.

Fearing the effects of an offshore liquidity squeeze (see International Credit), the Federal Reserve, far from tightening monetary conditions as most pundits predicted, is attempting to lean against the pressure on interest rates. Continued Federal Reserve largesse prolonged the fool's paradise on the New York stock market the week of June 13. The Federal Reserve is repeating its maneuver of early April, when it responded to a threatened international payments crunch by leaning against a rising interest rate trend, but with

much less scope for action than last time. It is unlikely that interest rates will fall significantly over the next three to four weeks, and Fed officials believe that a sharp rise in rates must inevitably begin mid-summer.

Paul Volcker shares the same concern for the offshore markets as the Bank of England. No financial center would suffer more damage than London, the mother of the offshore markets. This danger has piqued British concern regarding the Swiss, but the gulf between the two principal branches of the European financial oligarchy is even more profound. Margaret Thatcher's circle purged the remnants of Lord Carrington's wing of the Tory Party from the British cabinet June 11 (see article, page 34) for fear of the success of the *Mitteleuropa* project cited above.

Ironically, the British are now considering the eventual necessity of orderly negotiations with an Ibero-American debtors' cartel, according to a spokesman for Foreign Secretary Sir Geoffrey Howe, for both financial and strategic reasons.

The Swiss National Bank is painfully aware that a crude or obvious Swiss role in the collapse of the Brazilian debt would be a priceless gift to their worst enemies inside the U.S. administration. Although Treasury Secretary Regan and Secretary of State Shultz still have management of the Third World debt issue, an important group of President Reagan's advisers in the defense and security sphere have warned him that the United States has walked into a deadly trap by accepting the discredited IMF approach to Ibero-America. They argue that Regan and Shultz have misled the administration by insisting that a combination of world economic recovery and IMF austerity would contain the debt problem. Detonation of "the debt bomb" could destroy America's world political role unless the administration finds a means toward a political agreement with its southern neighbors. These advisers identify the "Carrington wing" of European politics as scavengers who seek to benefit from such a disaster to the advantage of the Soviet Union and the disadvantage of the United States.

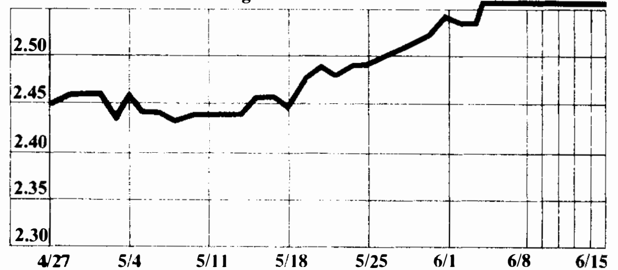
Although contingency plans for a U.S. response to a Brazilian debt moratorium remain classified, it is known that one option is the enhancement of Export-Import Bank credits to Ibero-America and a global agreement to reduce debtor nations' interest payments to a negotiated portion of export receipts. What the Swiss fear most is that the United States and the Ibero-American governments will reluctantly strike a deal similar to *EIR* founder Lyndon H. LaRouche, Jr.'s year-old "Operation Juárez" plan for debt rescheduling on behalf of industrial development.

For public purposes, Leutwiler chose to recommend flexibility on the part of the IMF and continued lending by commercial banks to the debtors. Neither will occur, not in time to prevent the collapse of Brazil's foreign payments in any case, and Leutwiler knows it; out of the other side of his mouth, he has told the Swiss banks to shut their loan books. He is no less dangerous for the softening of his public profile.

Currency Rates

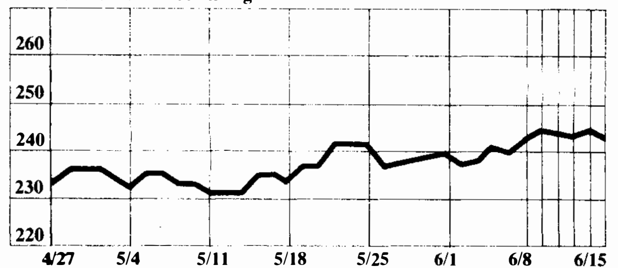
The dollar in deutschemarks

New York late afternoon fixing



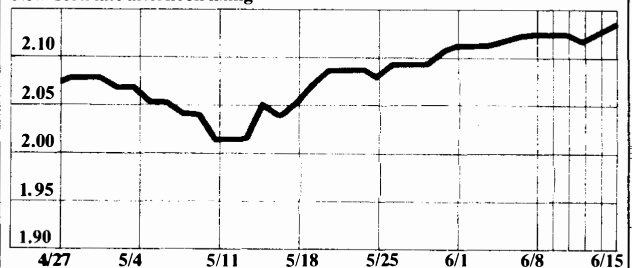
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing