Click here for Full Issue of EIR Volume 16, Number 40, October 6, 1989



# Brady Plan unravels as central banks bash the dollar

by Eric Rosso

As the International Monetary Fund ends its three-day annual meeting (Sept. 26-28) in Washington, it is clear that the U.S. economy is in serious trouble and that one of the pillars of the Bush economic policy—the Brady Plan for debt reduction—stands on quicksand with nearly all the banks and governments. Moreover, the two showcase items of the Brady Plan, the debt reduction agreement with Mexico and the assistance plan to the Philippines, are tarnishing fast.

The IMF meeting and the meeting of the Group of Seven leading industrial nations, which immediately preceded it, under the outward show of harmony, were characterized by unheard-of volatility and acrimony. Reportedly, at one point Treasury Secretary Nicholas Brady and West German Bundesbank President Karl-Otto Poehl clashed in public while leaving a meeting of the Group of Seven.

The week began on a sour note for Treasury Secretary Nicholas Brady when Lewis Preston, the chairman of J.P. Morgan, announced that the bank was going to raise its loan loss reserves on Third World debt by $2 billion to 100%, basically declaring that for every dollar lent to the developing sector, they would have to have a dollar added to their reserves. This was taken as a signal that Morgan was jettisoning its Third World debt, and would not be taking part in the plan of the Treasury Secretary to reduce the debt of these countries.

The Brady Plan, which had been somewhat tentatively launched earlier this year, was premised on the idea that the commercial banks, the holders of the Third World debt, would be willing to accept a significant reduction of the debt on their books at the same time that they would lend new money to the debtor countries in order to assist them in implementing their IMF-ordered austerity programs. Although the plan envisioned a major role for the IMF, it was contingent on the willingness of the banks to accept a loss on the book value of their debt. But . . .

## 'Beginning of the end'

On Friday, Sept. 22, Brady and Federal Reserve chairman Alan Greenspan had a two-hour luncheon with a battery of bank executive officers to rally their support. The luncheon turned into a free-for-all with "some yelling and screaming about the process and the need for balance," according to one participant. "We'll be damned if we're going to be jerked around by these countries anymore," one senior banker commented. "I look at Venezuela and I get super-pissed," was another colorful comment. "It's the beginning of the end of the Brady Plan," said a senior New York banker.

On Sept. 25, Chase Manhattan chairman Willard Butcher voiced doubts that Mexico would win as much new money from its banks as it needs. He ripped the "debt forgiveness" element of the Brady scheme. "The siren call of debt forgiveness will be paid for by an unavailability of new money," said Butcher. "Debt forgiveness and new money are incompatible." He complained that the Brady Plan had created "an increased expectation of debt reduction and decreased willingness to meet commitments" by debtors. Just a week before, Chase Manhattan had, following Morgan's lead, surprised the markets by boosting its loan loss reserves by $1.5 billion to 46% of its LDC (least developed countries) debt. The real question broached was "Who's going to pay?" or as one newspaper headline put it, "Whose Pound of Flesh?" "The banks must be prepared to bleed," said Deutsche Bank's chairman Alfred Herrhausen, a man with his own debt reduction plan. But the banks have clearly said, "Not us!"

President Bush tried to come to his Treasury Secretary's assistance by holding a White House reception for two dozen chairmen of the world's largest non-American banks on the first day of the IMF meeting. There, he was to "strongly endorse just how badly he feels the Brady Plan is needed." But the European and Japanese bankers, although somewhat less exposed in LDC debt than their American counterparts, were not especially enamored of the Brady proposal. One LDC specialist commented that Brady was "offering forgiveness on obligations which he doesn't own." Their objections centered on the attempt by the government to pressure the commercial bankers on the issue of debt reduction, and the refusal of the IMF to agree to a reduction debt of the developing sector to the IMF.

Among the Germans, Commerzbank chairman Walter Seipp noted that "symmetry of sacrifice" was lacking, saying he believed "the IMF and the World Bank should share in debt reduction," and Hypobank chairman Eberhard Otto



© 1989 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Martini said there could only be equality of interest between lenders and debtors if there were "no pressure from the governmental side." Commerzbank is said to be studying the Mexican agreement closely, but Seipp indicated that new money was hardly likely to be given to Mexico.

British Chancellor of the Exchequer Nigel Lawson probably expressed the views of U.K. bankers most succinctly when he said in a press conference on Sept. 27, that he didn't think it would be useful to "twist the arms of the commercial bankers."

Later in the week, when President Bush gave his speech to the IMF plenary session, he returned to the need for commercial bank support of the Brady Plan. "Commercial banks have a special role in making this process work and must follow through on efforts made with Mexico and the Philippines, and broaden their efforts with other countries." A similar appeal was made later in the meeting by IMF Managing Director Michel Camdessus, which elicited the caustic comment from Lloyd's Bank chairman Sir Jeremy Morse, that "sometimes we object to being lectured."

## Japan demurs

Even the Japanese, long the most loyal supporters of the United States in monetary questions, were not so forthcoming with their support—but for different reasons. The Japanese, who would like to double IMF quotas and thereby their influence in the IMF, were expecting the U.S. to back their demands. A doubling of the Fund's quota would make Japan the Fund's second-largest donor. This has been opposed by the British, who now occupy the number-two spot and by the IMF bureaucracy. The United States has been the biggest opponent of quota increases for domestic fiscal reasons, which annoys the Japanese. At a joint press conference on Sept. 26, the Japanese Finance Minister Ryutaro Hashimoto and Bank of Japan Governor Satoshi Sumita warned that disappointment over Japan's effort to raise its IMF quota could have an adverse impact on the willingness of Japanese politicians to give increased financial support to the Brady Plan. Other Japanese said simply that they feel the U.S. has stabbed them in the back.

The growing opposition to the Brady Plan is also in undermining the deals touted as the Brady Plan's "successes," the Mexican deal and the arrangement with the Philippines. When senior Mexican officials held a meeting with 250 bankers to present their country's debt-term sheet on Sept. 26, they met with a deafening silence. One British banker bravely asked what the consequences would be if there were insufficient collateral. Sir Kit McMahon, chairman of Midland Bank, one of Mexico's major U.K. creditors, said "It's not in our minds to start lending again to Mexico."

## Bring down the dollar

The three-day IMF meeting also saw the start of major moves by the industrialized sector's central banks to bring down the value of the overinflated U.S. dollar. This was in accordance with decisions taken at the Group of Seven meeting, where Brady and Greenspan apparently were criticized for their attempts to maintain advantageous interest rate differentials, helping to keep the dollar high. The U.S. was also cited as a major cause of "disequilibrium." The communiqué issued after the G-7 weekend meeting emphasized that the dollar had risen to levels "inconsistent with longer run economic fundamentals" and that a rise of the dollar above current levels or an "excessive" decline could "adversely affect prospects for the world economy." The U.S. was also urged to meet the Gramm-Rudman deficit targets.

On Monday, Sept. 25, a concerted effort by the central banks of the industrialized countries in Asia and Europe began to push down the value of the dollar. It fell during five consecutive days of central bank intervention, meeting considerable market resistance. The undecided question is whether the dollar will keep its low value without the continued intervention of the central banks. If the dollar maintains its buoyancy on the international markets in spite of the interventions, it is suspected that the West Germans or the Japanese will be forced to raise their interest rates as an alternative to continued intervention. If this were to occur, there could be a flight of capital from the United States to the higher interest rates and a subsequent, perhaps permanent, collapse of the U.S. dollar—a development which could cause insuperable difficulties for the Federal Reserve.

The fall in the dollar helped precipitate a fall in pound sterling, in spite of efforts of the Bank of England to support their currency. The fall in the pound may also require a raising of the interest rates in Great Britain. Events subsequent to the very rancorous G-7 and IMF meetings could serve rather quickly to plunge the world into a full-blown depression.

Brazilian Finance Minister Maílson de Nóbrega warned early in the week that if international bankers didn't show more "comprehension" of the problems facing Brazil, they could be faced in the coming elections with "the taking of power by radical groups," groups perhaps less interested in coming to terms with the IMF conditionalities (see page 8). The sub-Saharan countries of Africa were put on notice by the Managing Director Michel Camdessus that there would be no let-up for them of the murderous IMF austerity policies, policies which, he insisted, they must learn to live with.

However things may unfold, the world has entered a new phase of economic disorder. The failure of the IMF to attain a quota increase will cripple their efforts to keep the bankrupt monetary system afloat. The collapse of the Brady Plan will mean that Third World countries, if they are to survive, will have to start taking matters into their own hands. And the manner in which the Bush administration has succeeded in alienating almost all its allies, indicates that the U.S. economy will be subject to a battering the likes of which it has not yet seen.