

How the Bank of England plans to exploit the Polish debt issue

by David Goldman, Economics Editor

“The Polish crisis is the most complex that has come up since the end of World War II. The political dimensions that come into play are so complex that I doubt if any of the actors have them all straight. At some point or other, all of the principals have taken all of the different possible positions on loan conditionality. The American banks who were pushing it six months ago have given up on it, and now the British banks are pushing for a sort of political conditionality. We sit around with and discuss this with a fair number of people, and the discussions that go back and forth are hysterically funny. Nobody has a clear idea of how you get out of it.”

The above is a summary of a senior Federal Reserve official's trepidation over the Polish debt situation, which the head of the Bank of England has already predicted might turn into the trigger for the next great world banking crisis. In fact, the Fed is less a player in the game than part of the stage-setting. On the one hand, the Bank of England under Governor Gordon Richardson is committed to pressing the Polish debt issue to the breaking point, with profound consequences for the world balance of strategic power and the future of the world economy. But West German Chancellor Schmidt, Soviet President Brezhnev, and Pope John Paul II are apparently working closely to stabilize the Polish internal political situation and its foreign debt position in order to avoid a crisis. Whether they succeed depends largely on the response of U.S. President Reagan.

The West and Poland

To the extent that Reagan gives the West Germans room to work out refinancing and aid arrangements for the Poles, who are no more capable of repaying their debts than they are of leaving the Soviet sphere of influence, negotiations already in progress for a Russian-assisted loan bailout will probably succeed. West Germany's official warning, delivered by Foreign Minister Genscher Dec. 22, that all Western decisions on economic sanctions against Poland must wait until the conclusion of the Vatican informational mission to Poland under Cardinal Poggi, indicated how strong the contacts between Bonn and the Vatican have become. Genscher's remarks also frustrated the hope of State

Department Undersecretary Lawrence Eagleburger, who was in Europe to investigate the possibility of imposing sanctions on Poland.

Behind the scenes, according to the West German daily *Handelsblatt* Dec. 21, the West German banks were already negotiating with the Soviets, following an informal meeting of East bloc heads of state in Moscow the previous weekend on the occasion of Brezhnev's birthday. The meeting concluded with undisclosed resolutions to help Poland economically, the newspaper said. The most important indication that the Russians had taken such a decision, *Handelsblatt* added, was that the Soviets had already moved into the Eurodollar market for funds in approximately the volume of Poland's foreign debt payments shortfall, including a \$100 million loan from a single West German bank.

Whether the Russians actually commit their own credit on behalf of the Poles depends upon a number of criteria, Western banking and government sources emphasized in background discussions during Christmas week; but the overriding among these was the American government's attitude. Should the United States take what is loosely described as the “State Department position,” that is, economic sanctions aimed at the Soviets, with emphasis on wrecking the multi-billion dollar natural gas pipeline project, then the Soviets would have no interest whatever in bailing out Poland. They would, in this case, be better served by permitting the West to take the consequences of a Polish default after they had moved into the country militarily, while leaving the possibility of a Soviet debt bailout of Poland to be a bargaining chip following such an invasion.

Directed toward precisely this unpleasant result have been the efforts of the Bank of England, whose objectives are broader than the Polish issue per se; its Governor, Gordon Richardson, wants not only the end of the major German-Soviet energy project, and an opportunity to impose British designs on the European Community at West German expense, but a fundamental change in East-West relations, and the collapse of President Reagan's tentative efforts toward negotiation with the Soviets. It must be remembered that Richardson, the former Chairman of Schroeders Bank, comes

from an institution that in the 1930s handled the covert financing of Adolf Hitler, and in the 1960s and 1970s maintained on its board of directors such brinksman-ship advocates as present Defense Department Undersecretary Paul Nitze, and Carter Defense Secretary Harold Brown.

An ill wind blows nobody good

Irrespective of Poland's present de facto debt default, the world monetary system is in an impossible bind, as the Bank of England knows better than anyone else. The Bank of England Governor told a West German audience Dec. 17:

Between 1973 and 1980 the outstanding stock of loans from commercial banks to developing countries increased by something approaching \$170 billion—thereby enabling these countries to maintain much higher levels of imports and economic activity than could otherwise have been sustained. . . . Since 1973 there have been twenty-one countries which have had to enter into negotiations to reschedule their debts. As might be expected, given the increased debt outstanding and the higher costs of servicing, the pace had quickened recently, with nine of these countries seeking rescheduling since the beginning of 1980. You will be well aware of the special difficulties of Poland, which raise questions of the broadest political character which the events of the past 36 hours have brought to the very center of our attention. Thus far, the magnitude of rescheduled bank loans has not been such as to give rise to anxiety about the ability of the banking system to handle them. *A more widespread difficulty could, however, arise if a failure to agree on a rescheduling were to lead to a default or moratorium which caused banks to react defensively toward other indebted countries, precipitating difficulties for them* [emphasis]

At issue is not the 3 to 4 percent of U.S. banks' stockholders capital potentially compromised in an outright default of Poland, or even the considerably larger problem posed for West German banks, who hold \$4.5 billion in commercial debt against less than \$2 billion for the United States, most of which is unbacked by government guarantees. Clearly the \$27 billion in Polish foreign debt may be handled; it represents less than 2 percent of total outstanding Eurodollar banking assets. That is, however, not the issue. Every major developing-sector borrower has been bankrupt, de facto, for the past two years, and compelled to borrow chain-letter style to maintain itself, and the potential for defaults is growing such that an argument that the reschedulings may always be handled is not much different than arguing that Achilles would never



Pope John Paul II

overtake the turtle.

This is well-known to the Bank of England; Gordon Richardson's old sidekick from Schroeders, Geoffrey Bell, released an "opinion poll" of international bankers Dec. 15 to precisely this effect. Bell's poll showed bankers confident in "the system" in general, but querulous about each other. "The international banking system would be vulnerable to chain-reaction collapse in the event of a crisis affecting a significant bank or group of banks," a majority of bankers reported back to the Bell survey. It was conducted through the Group of 30, an adjunct to the International Monetary Fund chaired by former IMF Managing Director Johannes Witteveen. Problems at a single bank "can jeopardize the whole operation" of rescheduling international debts, Bell was told.

An entire array of British-associated institutions, including most of the British and American financial press, has spun out a fantasy in which a crash of the Polish debt and ultimate Soviet intervention into Poland would bludgeon the West Germans back into the NATO fold, collapse the current efforts around the natural gas pipeline with the Soviet Union, and place the world economy under a form of central-bank receivership. Not since Philip II's vision of a universal monarchy under the Spanish and Austrian Hapsburgs at the time of the 1577 Spanish bankruptcy, has the European oligarchy attempted to parlay so much weakness into so much strength.

Some of the suggestions that accompany Richardson's untoward burst of central-banking candor are plainly absurd. Senior American central-bank and government officials dismiss out of hand a suggestion in a

Wall Street Journal editorial Dec. 23 that the U.S. government might trigger a default of the entire \$27 billion Polish debt by declaring its own holdings of Polish paper in default, in order to "hit the Soviets where it hurts, in their credit standing," and ruin the natural-gas pipeline deal. "Governments simply do not do that," scoffed a senior official of the Eximbank, while a member of the Federal Reserve Board of Governors added, "The *Wall Street Journal* is just a newspaper, and not worth the extra dime they have begun to charge for it." Even further off the deep end is a *Financial Times* editorial proposal to refuse further credit to Poland unless the reform process continues, i.e., unless chaotic conditions are allowed to emerge which would make both old and new debt unpayable!

There is a sense of desperation in the British pronouncements. At the Cancún summit of industrial and developing nations, the Japanese and some of their friends, e.g. the Philippines, informed the rest of the world that if the present monetary system were stifling world development, then they would have to find a better one. Such was reiterated in a Japanese government white paper linking world disarmament negotiations to an expanded flow of high-technology exports to the developing sector.

Weapon of choice

What would happen if the Germans and Soviets were able to freeze the Polish debt crisis? The influence of the Bank of England and the Bank for International Settlements, the guardians of the Eurodollar system, would be at risk. In the Mideast, the way would be somewhat clearer for a comprehensive peace settlement along the lines of the Fahd plan, mutually acceptable to the Reagan administration and the Soviets. The worst effects of the monetary crisis resulting from a decade of British-inspired monetary politics and two years of Paul Volcker's imitation of Bank of England methods might well fall on the perpetrators, rather than on the remainder of civilization.

As such, the propensity to use the weapon of chaos and monetary destabilization, allowing the potential for monetary crisis to rear up in a sudden and terrible fashion, must not be underestimated. Since the crisis of 1773, which established the London City as the world's financial center, it has been the weapon of last resort of the British-centered European banking oligarchy, and the weapon of most frequent choice.

The balance hangs on the decision taken in the Oval Office. Should President Reagan accept the advice of his friend, West German Chancellor Schmidt, and of the Pope, he will keep the way open to American help, if only passive help, toward Poland's economic reestablishment. If he follows British advice on the subject, he will permit the eruption of events that he will not—and perhaps no one would—be able to control.

Henry Wallich on Poland

The following excerpts from a Dec. 23 interview with U.S. Federal Reserve Governor Henry Wallich have been provided to EIR.

Q: Governor Wallich, in October during the IMF meeting, you called in a speech before BIS bank regulators for the use of Poland as a test case for central-bank control over loan negotiations. You said that the BIS had to get banks to cut lending by forcing banks to declare loans in default when they in fact were in default, and you said Poland was the first case. Will there be a successful reorganization of the Polish debt? Or, do you see the situation blowing up?

A: The situation will be handled purely as a financial matter by the banks involved. It can be handled.

Q: What is the role of the central banks? Have you gotten more control over the process?

A: I don't want to comment on the role of the central banks, because the private banks will be able to handle this on their own. The debt can be renegotiated as far as I can see.

Q: But I understood from the German newspaper *Han-delsblatt* that the German banks are quite fearful and are moving to make a deal with the Soviet Union to bail out the German debt. The report is that the Soviets will borrow \$4 billion from the West to pay the German creditors of Poland. Doesn't that mean the United States would be left in the cold?

A: I will have to let you worry about that. The Germans would never do such a thing. They are very responsible bankers. Why should they act unilaterally? Cooperation is very important.

Q: Do you believe that the U.S. government might, for its part, do something like the *Wall Street Journal* suggested this morning—pull out U.S. government loans, thus throwing the private loans into default and crisis?

A: I cannot believe this government would do anything of the sort. I will not comment on suggestions by newspapers which cost 25 cents but charge 10 cents more [the *Wall Street Journal* costs 35 cents]. I have heard no such thing.

Q: So you see no financial difficulties with Poland?

A: I will never say never, but I am very optimistic.

Q: Do you see the Polish debt situation developing into a crisis? European banks believe it is deteriorating rapidly.

A: No. Anyway, what difference does it make to us?

American bankers are not that deeply involved. There isn't one U.S. bank with as much as \$100 million in Poland. Individually we have very little exposure, and not that much collectively. They have already long ago classified these loans as doubtful, and it wouldn't change their balance sheets.

Q: But the Germans have quite a lot of money in Poland and according to the German financial papers, they are considering making a deal with the Soviet Union to the exclusion of the United States. This would involve German banks lending the Soviets the money to pay the German banks some of what Poland owes.

A: I've never heard of such a plan. It makes no sense to me. Why should the German banks want to get more Soviet debt now?

Q: Why not? Soviet paper is a lot better than no paper, which is what they'll get from Poland.

A: Is it? Is it better than nothing? I don't think so. Look, the German banks are acting very relaxed. They don't have to make a decision now, or for weeks at all. They don't have to declare the loans in default. The Germans have no reason to rock the boat. They can just let the negotiations go on.

Q: But the Germans believe the situation will blow up, and they need to reach a political arrangement with Moscow.

Q: With Moscow? Why now, if ever? This is the last time that the German government would want to be at cross-purposes with its allies. We're the only thing protecting them from Soviet invasion of Germany. They're utterly dependent upon the United States. They would never choose now, of all times, to treat us this cavalierly. At a moment of major crisis, you don't go out of your way to alienate your allies.

Q: But they would suffer horribly in a banking crisis.

Q: Look, I told you, U.S. bank stock prices haven't reacted at all to the Polish situation. I don't know about the German banks, but that's not important. The banking side of this problem is of no importance. What really matters is the political fall-out. This is the biggest political crisis of the post-war period.

If the Soviets invade Poland, which I believe they will, Europe will run to us. Suppose they move. How will all the little nice guys in Europe react? They will be terrified—the Germans, [even] all the peaceniks. They will run to us. They will be in a very dangerous situation with a very awkward neighbor.

This could be the best thing for the alliance in some time. Look at history—Czechoslovakia [in 1948]. The invasion caused the vote on the Marshall Plan to be rammed through Congress with a mere two dissenting votes. It caused the solidification of NATO, which might

never have been so well-organized. [The Soviet invasion of] Hungary [in 1956] caused an even worse reaction in Europe against the Soviet Union.

Invading Poland now would be much worse for the Soviets than either. There will be major reactions. Europe will turn away from the Soviet Union and toward the United States.

Q: Will it make the emplacement of the Euromissiles, for example, easier?

A: Certainly, much easier, maybe even a fait accompli. Europe will be calling for protection. It will affect perceptions of the Soviets across the board. It will even affect the Middle East. It will be bad for the Palestinians, bad for anyone who smacks of Soviet or leftist influence.

Q: Do you mean it would be bad for the Fahd plan?

A: Certainly the Fahd plan would be weakened. Any identification with the Palestinians would be weakened, any compromise.

Q: Will the United States take strong actions, such as suggested by the *Wall Street Journal* this morning, cutting government loans?

A: No, I doubt it. That's a china-breaking move. Governments, especially this one, would be reluctant to blow up the debt negotiations. I don't see it. I think the *Journal's* editors had a flight of fancy on their own.

Q: What about U.S. moves to try to stop the European-Soviet pipeline deal?

A: That's the first reasonable suggestion you've made. That, now, would hurt the Soviets, is within the authority of the U.S. government, and would be very popular with the American people.

Q: But wouldn't it alienate the Germans?

A: Look, the Europeans can do without a pipeline if they have to. But they can't do without their security. It might well alienate them a bit, but this is not a popularity contest. You have to choose who you're going to hurt.

It isn't the banks who are going to be in trouble. I foresee something on the scale of another grain embargo move—only this time not grain, so it doesn't fall only on the heads of the farmers, which is not practical domestically for Reagan.

Q: Do you mean the President rejecting the current applications by Caterpillar for participation in the pipeline deal?

A: For example, yes, and a great many other people like Caterpillar. Somebody, a lot of people, have to pay. Exports have got to be interfered with, re-classified under national security classifications . . . something must be done.

We'll see what the President says tonight.