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Collection Name	Robinson, Roger: Files	***Withdrawer***	
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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
130988	MEMO	NORMAN BAILEY TO WILLIAM CLARK RE: INTERNATIONAL FINANCIAL CRISIS	3	8/12/1982	B1
130989	MEMO	RE: FINANCIAL CRISIS (P. 2 ONLY)	1	ND	B1
130990	MEMO	NORMAN BAILEY TO WILLIAM CLARK RE: OIL PURCHASE NEGOTIATIONS	1	8/16/1982	B1
130991	LETTER	R. T. MCNAMAR TO JESUS SILVA HERZOG FLORES AND JOSE OTEYZA FERNANDEZ RE: AGREEMENT	3	8/15/1982	B1
130992	AGREEMENT	SWAP AGREEMENT	2	8/15/1982	B1
130993	MEMO	NORMAN BAILEY AND ALFONSO SAPIA-BOSCH TO WILLIAM CLARK RE: ARGENTINE DEBT	2	8/26/1982	B1
130994	MEMO	NORMAN BAILEY TO SECRETARY REGAN RE: STUDY OF IMF ROLE IN INERNATIONAL DEBT CRISIS	3	11/1/1982	B1
130995	MEMO	NORMAN BAILEY TO WILLIAM CLARK RE: ROCKEFELLER / KISSINGER TRIP TO MEXICO	1	11/10/1982	B1

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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
130996	MEMO	WILLIAM CLARK TO GEORGE SHULTZ RE: ROCKEFELLER / KISSINGER TRIP	1	ND	B1
130997	MEMO	NORMAN BAILEY TO WILLIAM CLARK RE: ROCKEFELLER / KISSINGER TRIP	1	11/4/1982	B1
130998	MEMO	WILLIAM CLARK TO THE PRESIDENT RE: ROCKEFELLER / KISSINGER TRIP	1	ND	B1

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MEMORANDUM

NATIONAL SECURITY COUNCIL

April 20, 1982

INFORMATION

MEMORANDUM FOR NORMAN A. BAILEY

SUBJECT: ROGER W. ROBINSON, JR. RWR

SUBJECT: Comments Related to Federal Reserve Staff Paper on IMF dated 4/5/82 for Meeting of International Monetary Group on 4/20/82

As per our discussion of 4/19, please find below some brief comments/questions concerning the Federal Reserve Staff proposal referenced above after a "once over" reading.

1. Overall, I concur with the general thrust of the paper proposing some type of new permanent "second tier" facility of IMF support for the increasing number of insolvent semi-developed and developing non-oil producing countries. However, the scope of the potential "shock" to the international financial system caused by this rash of sovereign debt reschedulings, in my judgment, has been substantially underestimated. As a result, the prescription recommended does not provide sufficient amounts in the new permanent "facility" to cushion the financial community, particularly the private commercial banks, from the domino impact of substantial risk assets frozen in questionable reschedulings.

2. In order to achieve a consensus view on the approach the U.S. should adopt to restructure or enhance the capabilities of the IMF, a major educating effort will have to be undertaken concerning the nature of the emergent challenges confronting the international financial system. The problem largely involves a fundamental shift in the method of recycling petrodollars that has been in force since the oil price hikes of 1973. Commercial banks (via London merchant banking activities) are withdrawing rather precipitously from untied balance of payments lending to the vulnerable category of countries referenced above due to having largely reached internally determined exposure ceilings and the assessment of inordinate risk attached to continued sovereign lending during a period when their traditional funding sources are uncertain and volatile, i.e., U.S. banks cannot bridge Yugoslavia's financial short-fall if the FRG, UK and Swiss banks refuse to fully participate and vice versa. Although most of these vulnerable countries have implemented austere stabilization programs, it will probably take between 4-10 years until the major economic adjustments entailed can close current account deficits and thereby sharply curtail or eliminate borrowing requirements. During this "window" period, the IMF, which is

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not constrained by consideration for private shareholders, has to be reinforced and restructured to offset this sharp reduction in available financial resources.

3. Consistent with the above scenario, the proposed new permanent "facility" would probably have to be implemented in tandem with a large increase in quota subscriptions, perhaps from SDR 60 billion to SDR 125-150 billion. The new permanent "Restructuring Facility" (possible name for new facility) would probably have to be at least SDR 25 billion or higher if a method is found to consolidate other IMF facilities (i.e. SAMA, the Oil Facility) into the "Restructuring Facility." To support and "fine-tune" these high figures will require considerable research, but at this preliminary stage it may suffice to examine the growing crisis in commercial bank exposure to sovereign borrowers. At present, Poland, Costa Rica, Senegal and Romania are engaged in rescheduling discussions with Argentina, Yugoslavia, the Ivory Coast and possibly Mexico waiting in the wings. In addition, about a dozen other countries are either already in reschedulings or will be imminently. It is probably no exaggeration to estimate the assets involved at between $75-100 billion (of course only a portion of this is rescheduled in any given year). The top U.S. commercial banks probably have between $400-$1 billion in "classified" sovereign risk assets and therefore are rapidly approaching the threshold of sustaining substantial balance sheet damage.

4. The extent of U.S. leverage should be key in determining our level of support for the structure and size of any new permanent facility. The impending disruption of the international financial system is already laced with security dimensions and therefor the need for the Administration to differentiate among countries who are to receive funds, amounts, and terms and conditions (i.e. Hungary differentiated in Eastern Europe and a fire-wall constructed around Yugoslavia to offset continued Eurodollar market denial). We should support a "case by case" determination in all of these categories with particular emphasis on terms and conditions to discipline economic programs, the level of data disclosure, and potentially moderate geo-political behavior. Pursuing our policy objectives within the "neutral" context of the IMF would also be more palatable on Capitol Hill than seeking untied emergency aid to countries such as Yugoslavia on an ad hoc basis.

Argentina: Facing the Financial Facts

WSJ 4/23/82

By Everett G. Martin
Staff Reporter of The Wall Street Journal

BUENOS AIRES—The euphoria that swept up Argentines when their armed forces invaded the Falkland Islands is gone. They are beginning to realize the terrible mess they are going to be in even if the British fleet pulls back without firing a shot.

"Six months from now, this country is going to be worse off than it is now," a financial operator says to a group of companions. None of them disagree.

The harsh fact is that the military government of President Leopoldo Fortunato Galtieri couldn't have taken on the British at a worse time for Argentina's economy. "The key point is that we can't pay for this war," says a banker.

Argentina is undergoing one of the worst business slumps in its history. For nine straight quarters economic growth has declined, and with most factories working at half capacity, a further drop of 3% had been projected this year. It could be worse if government funds for civilian projects have to be diverted to the military.

Foreign debt, most of it short-term loans that probably will have to be refinanced at higher interest rates, total $35 billion. Payments this year already were expected to gobble up more than two-thirds of anticipated export earnings of $10 billion. But even if the current embargo on Argentina's products by the European Common Market, which takes up to one-fourth of the exports, doesn't last long, export earnings would be cut. And if European banks hold back, financing for the debt not only would be harder to come by but it would also be more costly.

Living With Inflation

Argentines had been learning how to live with one of the world's highest inflation rates (it is forecast to be well over 100% this year). Wages had kept pace with the rising prices and jobs were so plentiful that many workers held down several at once. Now, however, many businesses are going bankrupt and the jobs aren't there. Unemployment, officially 10%, might be double that, economists guess.

Those with jobs have lost a quarter of their buying power in the past year. Those who have lost their jobs don't get state aid and they were already staging demonstrations against government handling of the economy before the dispute with the British diverted national attention.

The man caught in the middle is Economy Minister Roberto F. Alemann, a tough-minded believer in orthodox measures such as trimming government spending and letting free-market forces sort out the situation. When the Falklands erupted, he had been in office less than four months, but he had already squeezed inflation down to 5% for all of March, from 14% during January.

"I froze public-sector salaries, including the armed forces," he says. "I'll raise them in July but it's going to be with money from new taxes." He had just completed an austerity budget that includes a 10% cut in military spending and intends to whittle the budget deficit by two-thirds to about 2% of gross domestic product.

Mr. Alemann still sticks optimistically to his program. "If we don't get to outright war," he says, "once this outburst is over, then it will have been only the biggest military maneuver in history."

Public Projects Delayed

He concedes that "it is expensive, but not too costly. There hasn't been any procurement—only transportation and that isn't too high. I just sit here and wait for them to take the money they need. Until it is over, we are delaying government projects to see how much it is going to be."

Mr. Alemann says the cost of the military operation so far is $20 million. This may increase soon; Brazilian newspapers reported yesterday that Argentina has come there with a long shopping list of war materials, including long-range submarine patrol aircraft, rockets, ammunition and electronic parts for Mirage aircraft.

Mr. Alemann concedes that his firm economic managment has made him unpopular among local businessmen, politicians and labor leaders, who argue that his harsh measures coming when the economy is already down are too much to bear. Even if British Prime Minister Margaret Thatcher survives the confrontation between her country and Argentina, many here are betting that Mr. Alemann won't. "At the end of the crisis, we are going to have a different economic policy," says the Argentine manager of a foreign-owned bank here. "It will be impossible to continue with Alemann."

Mr. Alemann's enemies call for a virtual rollback to the populist policies of the late dictator Juan Peron. Among other measures, they want government-subsidized loans for businesses, protection from import competition, export subsidies and price controls. To fit their demands to the current situation, they call for a "war economy." "They want an economy of war," scoffs Mr. Alemann, "but it is a war against me."

He argues that if he can continue cutting government spending and sell off some 400 state-operated companies to private operators he could reduce the government's demand for credit. "That will reduce interest rates and companies will begin to recover," he says.

But first attempts to sell off the state oil company indicate that there isn't enough capital in private hands to buy state firms. Matters were made even worse after the Falklands invasion. In a perverse form of patriotism, when members of the public weren't out cheering the invasion they were rushing to banks to take out deposits and empty safe deposit boxes of valuables.

"If you aren't quick here, you are dead," explains a banker. A true Argentine, he says, immediately tries to anticipate what the government will do. They fear that Mr. Alemann might announce that yesterday we put a 50% tax on all deposits and the contents of value in safe deposit boxes. That's the way it works here."

All of Mr. Alemann's efforts to halt the run have failed so far. He was forced to violate his free-market principles and block all purchases of dollars with pesos, except for paying foreign debts and import bills. But to conserve foreign exchange, he decreed yesterday that profit remittances and royalty payments abroad must be made in "Argentine external bonds" that are paid for here in pesos and can be sold abroad for dollars.

While Argentina's gross foreign reserves are estimated at $4 billion, the net available cash reserves are thought to be less than $600 million.

"I have suffered much more in the money market than from anything else," Mr. Alemann says. "We are losing trillions of pesos from the banks. They (depositors who withdraw funds) are crazy to do this, but they want liquidity."

As a result, banks ran out of pesos and even the best companies needing short-term loans faced interest rates of 15% a month. At one point, interest on loans from one bank to another needing an injection of cash soared to nearly 300% on an annual basis. Mr. Alemann has taken steps to feed more pesos into the economy, but Argentines are still wary and interest rates are still a crushing 10% a month.

'Wait For First Shots'

For the time being, it is believed people are keeping their pesos at home. "Wait until the first shot is fired," says a businessman. "They will start buying anything they can find to get physical assets." He claims that furniture and auto sales already have begun to pick up because of this.

The owner of a small lime-producing firm says he has taken to bartering lime with his suppliers to avoid lending from the banks. He is paying a contractor in lime for removing 30,000 metric tons of overburden at his lime deposit. "He builds roads so he can use the lime to make cement," he says. He has even traded lime for a new car. And he is asking a cement company buying $75,000 worth of land from him to pay him in cement. "I can sell it to small building-supply firms I deal with for $300,000 and it's a sure hedge against inflation," he explains.

Other firms such as Casa Perramus, a large clothing firm that has done business for 86 years in downtown Buenos Aires, are simply selling off their stock and closing for good. The manager, Juan Papayoanu, looks sadly about at his bare shelves and explains that "people just don't have any money. We can't raise prices, but our city taxes have increased 100%. You can't borrow at these rates for new inventory. We can earn more by putting the money into time deposits."

Wily Argentine businessmen who are quick to seize any opportunity are discovering that declaring voluntary bankruptcy can be good business.

A lawyer tells of a chocolate factory owner boasting at a dinner party about his bankruptcy deal. There is at least a 12-month delay before the slow-moving courts gather all the creditors to work out a settlement, the chocolate maker explained. During that time the system gives him interest-free funds to continue operating.

He offered to pay his creditors all the pesos he owed them plus 6% interest over eight years. The creditors protested because a year's inflation had already cost them 80% of what they were owed. The chocolate maker finally satisfied the court by promising to make up the inflation loss out of any profits he might have in the seventh and eighth years of the deal.

'They All Laughed'

"You should have heard everyone around the dinner table laugh and clap when they heard that," the lawyer recalls. "They all know how easy it is to hide profits with Argentine bookkeeping. Anywhere else, the man would be considered a crook, but here he is a hero."

With business debt already at crisis proportions, the worry here is that there isn't enough local capital left to fund new job-creating investments if Mr. Alemann's policies finally work. Some economists argue that the country needs a good dose of inflationary policies such as subsidized loans to business to pull out. "Inflation is the only way companies can liquidate their debt," says an economic consultant.

"They act as if our economy is somewhere on the moon," retorts Mr. Alemann. "They don't realize that our foreign debt limits how much we can stimulate the economy. We have to convert our debt to long-term obligations and foreign bankers won't do it with a program like that."

A foreign banker notes that "we aren't happy with the way they can just go off and start a war the way they did. They are going to have a tough time getting the kind of loan terms they want," he predicts.

MEMORANDUM NON-LOG

File: International Economic Finance

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NATIONAL SECURITY COUNCIL

April 28, 1982

INFORMATION

MEMORANDUM FOR WILLIAM P. CLARK

FROM: NORMAN A. BAILEY NB

SUBJECT: Bank Credit Analyst

Thank you for sending me the April 1982 issue of the Bank Credit Analyst. The analysis is brilliant and right on track, particularly the following excerpts:

> "The U.S. and world economy is now approaching the moment of maximum danger. A stampede for liquidity at this point would result in a mass liquidation of asset holdings, pushing many prices, already depressed, to ridiculously low levels. The financial system would be very quickly bankrupted, followed closely by a great many property owners and many industrial corporations . . . . In fact, liquidity would be greatly reduced, if not eliminated altogether."

* * *

> "Mass liquidations have been avoided so far, but without eliminating the problem. Debt burdens have continued to mount and the debt structure has become ever more fragile. . . . The longer such an approach continues the greater the fraility and the more potentially vulnerable the financial system and the economy becomes."

> ". . . for the moment there is a worldwide attempt to turn back the inflationary tide primarily through the use of restrictive monetary policy. Only time will tell how successful that attempt will be, but one thing is sure. It imposes extreme pressure on the economy, particularly on debtors, and there is the danger that a very fragile financial system will break with catastrophic consequences for the whole economy. . . it is not clear that the Administration is fully aware of the risks it is taking."

* * *

> "Gradually, piece by piece, the international financial jigsaw puzzle is coming apart, and in the process destroying the assumptions on which it was built up in the first place."

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"Russia is in no position to bail out Poland and may yet go into technical default as well . . . . The Russians have been consistent throughout. If their behavior is now unacceptable we have to ask why on earth they were allowed to go into debt on such a massive scale in the first place."

". . . in the present deflationary environment, this is an extremely dangerous time to try to change direction -- just when the vehicle is starting to run out of control . . . the major change required is a tightening of the conditions under which credit is granted, both internationally and domestically."

"As in the number of technical defaults (reschedulings) increase . . . the financial sector could become extremely vulnerable."

* * *

"The financial system, both internationally and domestically, is highly fragile . . . For the moment it looks as though the system can be held together, although some companies, countries and financial institutions are likely to go under."

cc: Henry Nau
Gus Weiss
Roger Robinson

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BRAZIL-UNITED STATES BUSINESSMEN'S CONFERENCE

Washington, D. C.

May 12 - 13, 1982

Speech by Antonio Gebauer

Senior Vice President, Morgan Guaranty Trust Company of New York

President, Brazilian-American Chamber of Commerce

"Brazil: A Banker's Perspective"

In today's increasingly troubled world, international lending requires thorough analysis of a wide range of interrelated political and economic variables if a banker expects to distinguish between more and less attractive lending opportunities. In my address to you today, I would like to focus on five of these variables and consider how they have affected Brazil and how the country has responded to them over the past several years. First, we must take stock of the country's internal resources, both natural and human - its assets, if you will. Second, we need to understand the external environment in which the country must operate. Next, it is essential to assess the manner in which the country is managing its economy , especially with respect to resource development and adjustment to the external environment. Fourth, we must consider the financing requirements arising from both internal policies and external forces as well as the country's ability to service its existing and projected financial obligations. Finally, we need to appraise the manner in which the country manages its financing program, in particular its external borrowing activities.

I shall be very brief on the subject of Brazil's internal resources, recognizing that the people attending this conference are quite familiar

with Brazil and that there is an abundance of published material on this particular topic. Suffice it to say that Brazil has been blessed with a tremendous variety and wealth of natural resources which very few countries can match. These include a large land mass, a temperate climate, varied and abundant mineral deposits, vast hydro resources and enough arable land both to satisfy the domestic demand for food and to export large quantities of agricultural products. In addition, the country's population is large and, by developing country standards, well-educated. These factors lead the prospective lender to conclude that Brazil does indeed have the potential to continue its development of a vigorous and diversified economy under appropriate management.

Let us turn our attention, again briefly, to the second major variable: the external environment and its impact on Brazil. In recent years, this environment has changed rapidly and, in several respects, adversely for Brazil. Three important developments are especially worth mentioning. First, world oil prices increased over 250% between the end of 1979 and early 1981. This imposed a heavy burden on Brazil, which depended on oil for 41% of its total energy consumption at the beginning of this period. The country's oil import bill jumped from \$4.2 billion in 1978 to well over \$11 billion in 1981, almost a 40% compound annual growth rate.

Second, dollar interest rates became extremely volatile by historical standards and reached record highs in response to relentless inflationary pressures and the tightening of U. S. monetary policy. The resulting high interest rates had a severe impact on Brazil, one of the world's major borrowers. The country's gross interest payments on its external

debt rose from $3.3 billion in 1978 to $10.1 billion in 1981, a 45% compound annual growth rate. This was well above the 12% compound annual growth rate of the country's gross long term external debt over the same period.

Finally, industrial countries entered into economic recession in 1980. This resulted in lower demand for many of Brazil's traditional exports of agricultural, mining and manufactured products, a decline in the prices of many commodities which Brazil exports and an intensification of protectionist pressures abroad. Although the recession in North America may be close to bottoming out and Western Europe is showing tentative signs of recovery, the extent and speed of the eventual economic improvement in these countries is far from clear. A significant pick-up in many of Brazil's export markets will not likely occur until late this year, and even then may not prove to be very robust.

This constellation of unfavorable external developments - increased oil prices, high interest rates and weak export markets - combined with the strong internal growth of the Brazilian economy, produced a sharp rise in the country's external financing requirements and a simultaneous lessening of its debt servicing capability. By late 1979/early 1980, lenders became concerned about Brazil's domestic economic management and external financial position. Through its reluctance to lend and demands for larger spreads to compensate for the perceived increase in risk, the international banking community effectively communicated to Brazil the need to adjust to the changing external conditions.

Brazil met this challenge, although the process of adjustment proved to be a mixture of compromise and innovation. Consider the case

of energy: although petroleum remains the single most important source of energy for the country, it has declined as a percentage of total energy consumption. This reduced dependence on oil was the result of continued efforts by Brazil to implement the energy policies formulated after the first oil shock of 1973. The fundamental strategy remains the generation of sufficient foreign exchange to pay for the country's petroleum imports while at the same time undertaking long term projects to substitute these imports with domestic energy sources. These projects include enhanced domestic production of oil, with average annual production increasing over 17% to 220 thousand barrels per day in 1981, limitation of the growth of domestic oil consumption, aggressive exploitation of Brazil's hydro-electric resources and the development of non-conventional sources of energy, particularly alcohol, coal and, to a lesser extent, nuclear energy. Moreover, the country has for several years implemented a well-balanced and broadly-based import substitution program designed to render Brazil less dependent on imported steel, non-ferrous metals, fertilizers, heavy equipment and pulp and paper.

Unfortunately there is less that Brazil can do to reduce the adverse effect on its balance of payments of volatile and high interest rates as they relate to the country's external debt. Although there has been much discussion regarding the high spreads which Brazilian borrowers must pay, their overall effect on the balance of payments is relatively insignificant compared to that of the high base rates - LIBOR and prime. Brazil has, however, made some useful interest

rate-related policy adjustments. In view of the present high level of external interest rates, the Brazilian government has raised domestic rates to even higher levels in order to encourage offshore borrowings and hence maintain a steady inflow of foreign capital. More specifically, Brazil has adopted a very restrictive monetary policy and limited the expansion of domestic credit, resulting in high real domestic rates. This policy seeks to maintain the attractiveness of foreign currency, mainly dollar, financings to Brazilian borrowers. Being restrictive in nature, it also discourages domestic consumption and has brought rates of growth to more realistic levels given the country's internal and external capabilities. This curtailment of domestic economic activity has permitted the country to reduce its imports. This, in turn, has had a material positive impact on the balance of trade and the current account deficit.

Perhaps the most impressive aspect of Brazil's adjustment to unfavorable external conditions has been its ability to generate healthy export growth in the face of sluggish economic activity in the industrialized nations. Between 1979 and 1981, the value of Brazilian exports increased from $15.2 billion to $23.3 billion, a 24% compound annual growth rate -- remarkable, given the generally depressed economic conditions abroad. As a result, the country was able to reverse its $2.8 billion balance of trade deficit in 1980 to a $1.2 billion surplus the following year. This performance was achieved through an aggressive export promotion program, including fiscal incentives for a wide range of industries and

very attractive export financing terms. At the same time, the growth of imports was held down. Brazil now seems more willing to retrench and accept lower rates of economic growth in the interest of containing import demand. This is evidenced by a 3 1/2% decline in real GDP in 1981 and anticipated future growth rates of 3 to 5% per annum as compared to a 7% compound annual growth rate from 1975 to 1980. The country's strong export orientation, however, should allow it to take maximum advantage of the industrialized economies' eventual recovery and higher demand for Brazilian goods and services.

The international banking community responded to Brazil's successful adjustment effort by increasing its lending to the country. Brazil borrowed over $17 billion in 1981, enabling it to meet all of its financing needs and to increase its level of reserves by $600 million to $7.5 billion at year-end. Moreover, Brazil has closed transactions totalling $6 billion through the first four months of 1982. Together with a $2 billion carryover from 1981, this represents nearly 60% of the country's $15 billion external borrowing objective for the current year. The fact that spreads remain high does not reflect a negative perception of Brazil's creditworthiness by foreign banks so much as the size of the country's annual borrowing requirements, the high level of Brazilian exposure in most major banks' portfolios and increasing uncertainty in the area of international lending.

Although the present international environment is somewhat brighter than the picture I painted earlier, there is little scope for Brazil to relax its adjustment efforts. Oil prices have declined and could fall

further, at least in real terms, over the next year or two. Despite strong efforts by Saudi Arabia, certain other OPEC members may be forced by currently weak market conditions and domestic financial pressures to break the fragile OPEC ranks. World oil demand could remain low over the next six to nine months due to continuing sluggish economic activity in the major oil-consuming countries, the seasonal drop in consumption, the existence of ample oil inventories and further conservation and substitution. This scenario would, of course, alleviate some of the pressure on Brazil's balance of trade and hence its external borrowing program. The country's oil import bill will remain high, however, since Brazil will continue to be a large petroleum importer, at least in the forseeable future.

Interest rates have also declined from earlier peaks and are projected to fall further, although they are likely to remain at high levels by historical standards. In the United States, the recent sharp reduction in inflation and protracted weakness in many sectors of the economy have contributed to this expectation. In Europe, growing concern over unemployment has made most governments anxious to reduce their interest rates in order to stimulate investment and production. A major caveat to this expectation of lower rates is that any decline could be seriously limited by failure on the part of the industrialized countries to resolve their budgetary problems. The outcome of current deliberations on the U. S. budget taking place in Congress will be particularly important. As with the case of imported oil, a decline in rates would have a beneficial, albeit limited, impact on Brazil's

current account balance and external financing requirements. To illustrate, a 1% decline in LIBOR would save the country about $500 million in annual interest payments.

Although the worldwide economic recession appears to have bottomed out and recovery is expected to begin later this year, it will be moderate at best. Real GNP for all industrial countries is projected to grow no more than 1% in 1982. In this environment, unemployment may continue to rise. This will lead to increased pressure on governments to shift their policies from fighting inflation to combating unemployment and protecting domestic industry from foreign competition. Brazil has an interest in the continuation of the fight against inflation, for only by wringing out inflation can the industrial countries establish the basis for sustained economic growth.

We can see, therefore, that the combination of these recent developments - the reduction in oil prices and interest rates and the prospect of some recovery by the Western economies - will benefit Brazil's balance of payments and moderately reduce its need to borrow abroad. Foreign borrowing requirements, however, will remain large and Brazil must continue in its efforts to lessen its vulnerability to adverse external developments.

Let us now turn to the fifth and final element of this overview of Brazil from a banker's perspective: the country's management of its financing program, especially abroad. Brazil's general approach to external borrowing has traditionally been very sensible. The Banco

Central has sought to exert a high degree of discipline over Brazil's foreign borrowing program. It has coordinated not only government and government-guaranteed borrowers in terms of amount and position in the queue but also, to the extent possible, the international bank syndicates in an effort to ensure a smooth, steady and successful series of transactions in the market. All major public and private sector borrowers and regulatory agencies have maintained very good relations with the international banks: the channels of communication have remained open and access to information has been good. This has facilitated the lenders' decision-making processes. Although this approach to external borrowing has been largely dictated by the sheer volume of Brazil's annual financing requirements, overall the country has demonstrated an ability to manage its obligations in a truly professional manner. Moreover, Brazil has historically applied the proceeds of its foreign borrowings judiciously, either enhancing the basic infrastructure of the country (for example in the areas of transportation and communication), or pursuing projects of national interest (such as financing the development of hydro-electric and non-conventional sources of energy) or sponsoring internationally-oriented projects which will generate substantial foreign currency earnings (such as Carajas). This entire approach to borrowing by Brazil is one that most international bankers warmly endorse.

When one considers the principal sources of Brazil's foreign borrowing, one is immediately struck by the overwhelming dominance of the international banking community as a provider of funds. As of December 31, 1981, over

73% of the country's total long-term foreign debt of $61.4 billion was composed of Law 4131 and Resolution 63 loans, the great majority of which had been provided by foreign banks. It is almost certain that Brazil will continue to rely on this market for most of its future external borrowing requirements.

Although Brazil's foreign financing needs may become progressively smaller, several factors will probably affect the country's ability to satisfy these needs in its traditional market. For example, the growth rate of the banking community's capital will pose a real limitation on the amount by which it will be willing to increase its exposure to Brazil. The very large portfolios of Brazilian paper already held by all major international banks should also constrain the country's ability to access this market.

These factors argue in favor of a strategy that would more widely diversify the sources of Brazil's foreign borrowings. This may entail a greater reliance on foreign currency-denominated private placements, especially from American, Japanese and Middle Eastern investors, the bond markets in Europe and the Far East and cross-border lease transactions. A diversified borrowing strategy would help Brazil maintain its access to the commercial bank market. It would also underscore the maturity and sophistication that the country has achieved as an international borrower. This strategy might even include utilization of the long date forward foreign exchange market to hedge long-term non-dollar liabilities. To the extent that such a hedging technique may help the major Brazilian borrowers feel more comfortable in accessing various foreign currency markets, it is worth exploring further.

Brazil's adaptation to trying and unpredictable international economic conditions has been truly remarkable. Its officials have managed the country's financial affairs with the care and discipline that inspires confidence in the international financial community, and continued application of well-thought-out economic policies should foster continued growth. The future of Brazil - a nation exceptionally rich in resources of every kind - from the banker's perspective appears brighter than ever.

THANK YOU.

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130988	MEMO NORMAN BAILEY TO WILLIAM CLARK RE: INTERNATIONAL FINANCIAL CRISIS	3	8/12/1982	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130989	MEMO RE: FINANCIAL CRISIS (P. 2 ONLY)	1	ND	B1

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LDC + EE

~~WORLD~~ DEBT BURDEN

	Total External Debt (billions of US Dollars)			Debt/Exports (Percent)		Debt Service/Exports (Percent)	
	1973	1981(1)	% Change	1973	1981(1)	1973	1981(1)
Total Eastern Europe and Non-oil LDCs	106.5	505.2	374.4	89.2	106.8	14.4	22.1
Eastern Europe	9.7	67.2	592.8	93.3	210.0	20.5	58.2
Non-oil LDCs (including Mexico)	96.8	438.0	352.5	88.8	100.9	14.0	20.6
Brazil	14.0	75.0	435.7	200.0	277.8	35.0	72.0
Mexico	8.5	67.5	694.1	177.1	225.0	36.0	48.0
Argentina	5.0	36.0	620.0	116.2	260.0	27.0	49.9
Poland	2.8	26.0	828.6	112.0	464.3	19.0	157.0
India	10.5	17.3	64.8	297.5	203.5	18.7	11.7
Korea	3.8	16.7	339.5	85.4	72.3	15.1	12.3
Algeria (2)	2.9	16.0	451.7	119.3	106.8	12.2	23.9
Indonesia (2)	5.2	14.9	186.5	158.8	67.3	6.3	8.0
Turkey	3.0	14.9	396.7	94.1	223.2	6.8	11.6
Egypt (2)	2.2	13.1	495.5	156.5	142.0	40.2	18.9
Israel (2)	4.5	12.6	180.0	152.7	118.2	16.0	11.2
Venezuela (2)	1.5	10.9	626.7	29.9	48.6	6.0	13.2

	Exposure of U.S. Banks(3) (Billions)	Exposure of European Banks(3) (Billions)	U.S. Bank Exposure as Percentage of Total
Latin America	55.5	92.9	37.3
Other Non-oil LDCs	28.9	69.9	29.3
Eastern Europe (excluding Yugoslavia	5.1	37.9	11.9
Yugoslavia	2.6	7.9	24.8
Poland	2.1	12.6	14.3
Brazil	15.2	31.2	32.7
Mexico	18.1	28.5	38.8
Argentina	7.5	15.5	32.6

(1) Country data is for 1980 with the exceptions of 1981 data estimated for Mexico, Brazil, Argentina and Poland.
(2) Excludes debt of private sector entities.
(3) Includes guarantees. Data as of June 1981.

8/16/82

Rut Friand Sydia 22

PRESS GUIDANCE
(White House, Departments of Energy, State,
Treasury, Federal Reserve)

The United States will have no press announcement or conference concerning the modification of the existing contract between PEMEX and the Department of Energy for purchase of crude for the Strategic Petroleum Reserve.

If asked, the following points should be made for the press:

1. The agreements reached this weekend were a modification of the long-standing United States-Mexican crude purchase arrangement.

2. The arrangement was modified simply to provide an expansion of the purchase capabilities by the Department of Energy, and which provided an opportunity for an advance payment the Mexicans wished at this time.

3. The mix of Isthmus and Maya crude was revised.

4. As part of the agreement, the Mexicans secured a commitment from the United States for $1 billion in CCC credits during the fiscal year beginning October 1, 1982.

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130990	MEMO NORMAN BAILEY TO WILLIAM CLARK RE: OIL PURCHASE NEGOTIATIONS	1	8/16/1982	B1

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restric-tions*
130991	LETTER R. T. MCNAMAR TO JESUS SILVA HERZOG FLORES AND JOSE OTEYZA FERNANDEZ RE: AGREEMENT	3	8/15/1982	B1

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130992	AGREEMENT SWAP AGREEMENT	2	8/15/1982	B1

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(White House, Departments of Energy, State, Treasury, Federal Reserve)

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4. As part of the agreement, the Mexicans secured a commitment from the United States for $1 billion in CCC credits during the fiscal year beginning October 1, 1982.

MEMORANDUM 6014 Int'l Financial System

30

NATIONAL SECURITY COUNCIL

August 24, 1982

INFORMATION

MEMORANDUM FOR WILLIAM P. CLARK

FROM: NORMAN A. BAILEY NB

SUBJECT: The Course of the U.S. Economy

Please note that when Chairman Volcker looked into the abyss and flinched, i.e., lowered the discount rates, the markets responded immediately. As I have frequently stated before, the element of the Administration's economic program that has been missing all along has been the monetary. My fear is that Volcker has waited too long; that the solvency position of the American economy has become so impaired that his last-minute injection of liquidity will not prevent a financial crisis.

The whole affair, however, emphasized the peremptory necessity for reform of the federal reserve system. That the country's, not to mention the Western world's economic (and therefore social and political) future should be subject to the personal whim of Volcker and his colleagues is simply unacceptable.

cc: Tom Reed
Carnes Lord
~~Gus Weiss~~
Roger Robinson

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3	15

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130993	MEMO NORMAN BAILEY AND ALFONSO SAPIA-BOSCH TO WILLIAM CLARK RE: ARGENTINE DEBT	2	8/26/1982	B1

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Monetarism Died Last Week, And the Markets Are Celebrating

Monetarism, as we have come to see it practiced by the Federal Reserve Board since October 1979, died on Tuesday, Oct. 5. The event was celebrated on Wall Street in the days that followed with euphoric leaps in the value of the nation's stock, and the party has spilled over into this week with another dizzy climb.

In the weeks ahead, as we get confirmation from the Fed that the monetarist experiment has been buried for good, we can expect more rejoicing in the financial markets. This would merely continue the bull market that began in early July with the first signs that the three-year experiment was coming to an end. The good news promises a dramatic expansion of the U.S. economy, indeed the global economy.

The news leaked to the markets on Oct. 6 that the Fed's policy-making Open Market Committee had the previous day decided on a "temporary policy adjustment." It would let the weekly money supply expand more rapidly than previously planned while it sorted out "changes in financial institutions' deposit flows." Last Saturday, Fed Chairman Paul Volcker publicly revealed the "temporary" obsolescence of the M1 measure of money.

The suggestion that this may be "temporary" is a fig leaf that Volcker tossed to the monetarists who have dominated monetary policy in the Reagan administration, and who continue to expose the president to the charge that the boom on Wall Street and all that it promises is only a temporary political maneuver that will end after the November elections. In fact, the M1 target is going into the Smithsonian.

This does not mean that inflation will soon rear its ugly head. If it did mean that, we would not expect to see declining interest rates and life again in the long-term bond markets. The death of monetarism simply means the end of an experiment with a central-bank quantity target.

The Fed's objective is to provide a dollar that holds its value over time, so that people who make contracts in dollars don't suffer windfall losses or gains because of unexpected changes in its value.

The Fed wants to prevent inflation, a condition that means the dollar is losing value, rewarding debtors and punishing creditors. It also wants to prevent deflation, a condition that means the dollar is gaining value in terms of real goods, thus punishing debtors and rewarding creditors.

The most important way the Fed has of controlling the value of the dollar is to buy or sell government bonds with dollars. Bonds are interest-bearing debt of the Fed; dollars are the Fed's non-interest-bearing debt. By changing the mix of bonds and cash on a daily basis, the Fed aims to provide a money as free as possible of inflationary or deflationary surprises.

When does the Fed buy or sell bonds? That's the central question monetary policy must always address. And there are only three basic options the Fed has as a guide to open-market purchases or sales of bonds with cash.

It can target the quantity of some measure of money, a quantity rule being that which we have come to call monetarism. It can target the price of credit, buying or selling bonds to keep a specified interest rate within a specified range. This was the dominant guide to Fed policy from August 1971 to Oct. 6, 1979.

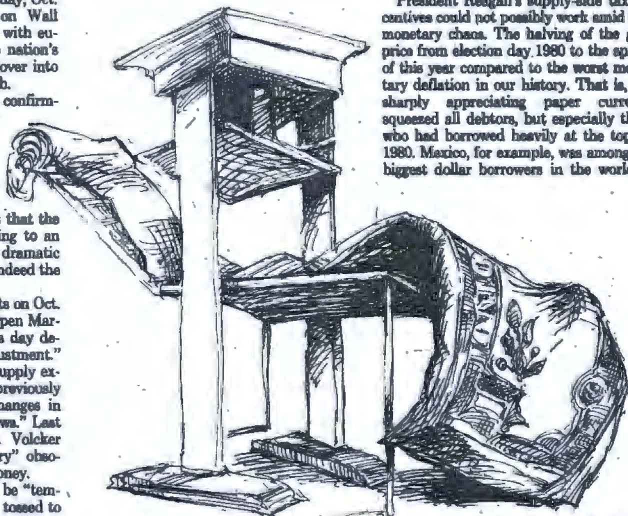
Or it could target the price of money itself, which is its purchasing power in terms of real goods. From 1792 until August 1971, the banking system in the United States used gold as a proxy for the value of all real goods, buying or selling bonds to maintain the value of the paper currency in terms of gold. Theoretically, other proxies could be targeted in keeping with this "price rule."

The problem is that you can only hit one target with the monetary instrument; the other two have to be free to fluctuate.

The monetarists, backed by the Reagan administration, say we should buy bonds when an "M" quantity of money is falling below some specified range and sell bonds when it is rising above that range. Keynesians, backed by Democrats, say the Fed should buy bonds when the specified interest rate rises and sell when it falls. The supply siders associated with Rep. Jack Kemp and Lewis Lehrman, the GOP gubernatorial candidate in New York, say the Fed should buy bonds when the price of gold is falling and sell them when it is rising, a "gold standard."

The supply siders observe that since the Fed began targeting the money supply three years ago the price of gold—the most monetary of commodities and thus the most sensitive—has swung wildly between $298 and $850, and interest rates have swung wildly as well. By contrast, from 1792 to 1971, the price of gold did not vary by more than $20 (including the Civil War greenback period) and long-term interest rates almost never exceeded 5 percent.

President Reagan's supply-side tax incentives could not possibly work amid this monetary chaos. The halving of the gold price from election day 1980 to the spring of this year compared to the worst monetary deflation in our history. That is, the sharply appreciating paper currency squeezed all debtors, but especially those who had borrowed heavily at the top, in 1980. Mexico, for example, was among the biggest dollar borrowers in the world in



By Geoffrey Moss

1980 in order to develop its oil fields when oil was $40 a barrel, but it has to pay its debts with deflated $28 oil.

Had Volcker this summer held gold below $300 in pursuit of M targets, the bankruptcy rate would have accelerated here and around the world. Gold at $250 suggests an unemployment rate of 15 percent; at $200 the rate would probably approach 20 percent. In shelving M as a target, Volcker has brought vast relief to the financial market and to the economic system itself.

Chances are that the Fed will now once again target interest rates as it had prior to October 1979, as the Democrats have urged, but with an eye on the price of gold as a reliable signal. If interest rates alone are pegged while the value of the dollar is free to vary, credit has to be rationed, at great risk to efficiency and liberty.

Targeting the gold price in its current range would leave interest rates to allocate credit; the quantity of money would fluctuate in step with the market's demand for money at a constant price level. In January 1981, Lewis Lehrman told the White House transition that such reform would yield a 6 percent prime rate in 18 months and the greatest bull market in stocks and bonds the country has ever seen. We are moving in that direction.

But if, after the November elections, we find that the temporary holiday from monetarism was indeed just a holiday, the Fed's intervention will unwind the gains of recent weeks and abort recovery. The exuberance of the market is suggesting that Wall Street believes it's permanent. The end of monetarism is here. Someone should tell the president.

The writer is president of Polyconomics, Inc., in Morristown, N.J.

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Int'l Financial System

W. Post 10/13/82

Robinson
Int'l Financial System
34

THE WHITE HOUSE 7128

WASHINGTON

October 25, 1982

Tim

MEMORANDUM FOR THE HONORABLE R. T. MCNAMAR
The Deputy Secretary of the Treasury

SUBJECT: Attendance at Debt Meetings

I understand that an informal group meets in your office on Tuesday and Thursday mornings to monitor the international debt situation. If you would, and if helpful, I would appreciate it if Roger Robinson of my staff could attend these meetings. Roger is very knowledgeable on the subject, having been Vice President in charge of reschedulings for the Chase Manhattan Bank prior to joining the NSC staff. He would, of course, observe strict confidentiality with reference to those discussions.

FOR THE PRESIDENT:

Bill

William P. Clark

Tim, only if comfortable —

MW
35

MEMORANDUM 7128 redo

NATIONAL SECURITY COUNCIL

October 18, 1982

ACTION

MEMORANDUM FOR WILLIAM P. CLARK

SIGNED

FROM: NORMAN A. BAILEY NB

SUBJECT: Roger Robinson's Attendance at Debt Situation Meetings at Treasury

An informal group meets in Tim McNamar's office on Tuesday and Thursday mornings to discuss the international debt crisis. The attached memo (Tab I) from you to Deputy Secretary McNamar asks him to have Roger Robinson invited to attend those meetings. I believe this is important to keep us informed of what is going on within the government, and especially the Federal Reserve on this issue. Tim invited me to attend, but I want to get Roger into this issue.

RECOMMENDATION:

That you sign the attached memo (Tab I) to Deputy Secretary McNamar.

Approve _______ Disapprove _______

cc: Roger Robinson

Attachment
Tab I Memo to McNamar

7128 36

MEMORANDUM

NATIONAL SECURITY COUNCIL

October 14, 1982

ACTION

MEMORANDUM FOR WILLIAM P. CLARK

FROM: NORMAN A. BAILEY NB

SUBJECT: Roger Robinson's Attendance at Debt Situation Meetings at Treasury

An informal group meets to discuss the international debt crisis in Tim McNamar's office on Tuesday and Thursday mornings. The attached memo (Tab I) from you to Secretary Regan asks him to have Roger Robinson invited to attend those meetings. I believe this is important to keep us informed of what is going on within the government, and especially the Federal Reserve on this issue. Tim invited me to attend, but I want to get Roger into this issue.

RECOMMENDATION:

That you sign the attached memo (Tab I) to Deputy Secretary ~~Regan~~ McNamar.

Approve X Disapprove ______

cc: Roger Robinson

Attachment
Tab I Memo to Regan

give me a better reading - has it been suggested before?

37

THE WHITE HOUSE

7128

WASHINGTON

MEMORANDUM FOR THE HONORABLE ~~DONALD T. REGAN~~ Tim McNamar
The Deputy Secretary of the Treasury

SUBJECT: Attendance at Debt Meetings

I understand that an informal group meets in ~~Tim McNamar's~~ your office on Tuesday and Thursday mornings to monitor the international debt situation. If you would find it helpful, I would appreciate it if Roger Robinson of my staff ~~could be invited to~~ attend these meetings. Roger is very knowledgeable on the subject, having been Vice President in charge of reschedulings for the Chase Manhattan Bank prior to joining the NSC staff. He would, of course, observe strict confidentiality with reference to those discussions.

FOR THE PRESIDENT:

William P. Clark

38

387

National Security Council
The White House

RECEIVED

Package # 7128

82 OCT 18 P2: 12

	SEQUENCE TO	HAS SEEN	ACTION
John Poindexter	1	P	A
Bud McFarlane	2	m	
Jacque Hill	3	J	
Judge Clark	4		A
John Poindexter			
Staff Secretary	5		D
Sit Room			

I-Information A-Action R-Retain D-Dispatch N-No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other

COMMENTS

New York Times, October 36, 1982

39 - Copy to Bailey [handwritten: Int Fin System]

Bankers Said to Plan Meeting on World Debt

By ROBERT A. BENNETT

About 30 high-level international bankers are scheduled to meet privately in New York today in an effort to avoid a liquidity crisis among the lesser-developed countries, banking sources said yesterday.

A number of these countries, especially in Latin America, are being squeezed financially because many banks around the world, particularly smaller ones, are refusing to renew maturing loans. There are fears, described by some bankers as unrealistic, that these countries will be unable to pay their debts. The fears can become self-fulfilling if many banks pull back, stripping the countries of money needed to pay creditors.

The bankers meeting today at the Vista Hotel are expected to explore ways to persuade banks throughout the world not to draw back on their credits, and actually increase them.

"The immediate liquidity problem arises from the increasing unwillingness of the international financial community to lend," William S. Ogden, vice chairman of the Chase Manhattan Bank, told a luncheon meeting yesterday of the Manhattan Institute of Policy Research. Mr. Ogden is co-chairman of the group that will meet today. The other co-chairman is Peter Leslie, of Barclays Bank. Another key participant will be George J. Clark, executive vice president of Citibank. The sources said that there also will be representatives of the International Monetary Fund, the World Bank and the Federal Reserve Bank of New York.

Few if any of the banks, which are among the world's largest, that will be represented at the meeting are believed to have reduced their foreign lending, the sources said. But they hope to come up with ways to persuade other banks not to retrench.

Asked whether the big banks might decide to impose financial pressure on banks that do not cooperate, one banker replied, "that's not how things are done today. It's more likely we'll try to create a warm feeling for not pulling back — make them feel like they're part of a bigger thing."

To the small group invited to it, the meeting has become known as Ditchly II. The first such meeting was last May in Ditchly Park, outside London.

That meeting was called by Mr. Ogden because a number of international bankers had begun to realize that many lesser-developed countries with large foreign debts would encounter difficulties meeting payments.

Since then, such countries as Mexico and Argentina — two of the largest borrowers — have not been able to meet their debt commitments, and there are fears that other large borrowers will have similar problems.

The first Ditchly meeting focused on the difficulty banks have in determining just how much any country has borrowed. Because the banks do not trade such information among themselves, they depend on information provided by the borrowers. Often the countries themselves have had no satisfactory information about the amounts they have borrowed or when their debts would mature.

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130994	MEMO NORMAN BAILEY TO SECRETARY REGAN RE: STUDY OF IMF ROLE IN INERNATIONAL DEBT CRISIS	3	11/1/1982	B1

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130995	MEMO NORMAN BAILEY TO WILLIAM CLARK RE: ROCKEFELLER / KISSINGER TRIP TO MEXICO	1	11/10/1982	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

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WITHDRAWAL SHEET

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Collection Name	*Withdrawer*
Robinson, Roger: Files	SRN 2/13/2012
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3	15

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130996	MEMO WILLIAM CLARK TO GEORGE SHULTZ RE: ROCKEFELLER / KISSINGER TRIP	1	ND	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

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THE WHITE HOUSE
WASHINGTON

11/9

Norman Bailey,

See Judge's note. How did we get info? Also prepare an alerting memo to Shultz. Return this package to me as a reminder for Judge.

R

41r

National Security Council
The White House

Package # 7641 46

83 NOV 5 A11 : 28

	SEQUENCE TO	HAS SEEN	ACTION
John Poindexter	1	J 8	A
Bud McFarlane	2	M	
Jacque Hill	3	g	
Judge Clark	4	✓	A
John Poindexter			
Staff Secretary			
Sit Room			

I-Information A-Action R-Retain D-Dispatch N-No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other

COMMENTS

Judge,
Sorry I didn't get to this before your Sat. meeting with HAK.
J

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Robinson, Roger: Files	SRN 2/13/2012
File Folder	*FOIA*
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Box Number	
3	15

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130997	MEMO NORMAN BAILEY TO WILLIAM CLARK RE: ROCKEFELLER / KISSINGER TRIP	1	11/4/1982	B1

The above documents were not referred for declassification review at time of processing

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Robinson, Roger: Files	SRN 2/13/2012
File Folder	*FOIA*
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Box Number	
3	15

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
130998	MEMO WILLIAM CLARK TO THE PRESIDENT RE: ROCKEFELLER / KISSINGER TRIP	1	ND	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

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