

BILL BRADLEY
NEW JERSEY

United States Senate
WASHINGTON, D.C. 20510

August 19, 1982

COMMITTEES:
FINANCE
ENERGY AND
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SPECIAL COMMITTEE ON
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Honorable William J. Casey
Director of Central Intelligence
Washington, D.C. 20505

Dear Mr. Casey:

For more than a year, with Poland on the brink of financial default, the Western world has become sharply aware of the potential risks posed by our lending to members of the Soviet bloc. But the debate surrounding East-West economic relations has eclipsed an equally important message of the Polish debt crisis -- the world financial system may be vulnerable to the possible repercussions of a sizeable sovereign default.

The prospect of losing even a part of the estimated \$27 billion in Western assets held as loans to Poland, should spur the governments of the major financial powers to plan collectively for contingencies. A contingency program should spell out possible scenarios following a Polish default and trace, step-by-step, how the system can be expected to cope with each possible danger. Unfortunately, I fear that such an exercise would expose several points of vulnerability in the world financial system.

Here are some of the factors that spur my concern:

- 1) the huge international debt incurred by Eastern European and Third World countries which are in precarious economic health;
- 2) the shaky financial conditions of many major international corporations;
- 3) the chain reactions and systemic problems which will develop if one or more of these shaky players should start to fall, including breaks in bank lending lines; a race to call in loans; withdrawal of deposits from banks perceived as risky; and a rush of new deposits to "safe" currencies;

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- 4) a failure to define lines of authority among central banks for crises in overseas affiliates and consortia banks, and to change domestic laws which would inhibit effective action in a liquidity or currency crisis;
- 5) a lack of a mechanism to handle severe, system-wide foreign currency shortages.

My impression is that during a crisis spurred by these factors several gaps in the system could develop. At best, there is uncertainty about how existing institutions would perform to close them. A contingency program to increase certainty could play an important role.

If my concerns are not warranted, I hope you will detail for me how we and our major allies would effectively protect Western banking systems, and hence economies, in a crisis. If no such plans exist, or if you lack confidence in them, then I urge you to undertake a study of this problem.

Assuming that adequate protections do not currently exist, I would like to offer a few steps that might be considered. First, we could create a multilateral fund from which central banks could borrow, under agreed conditions, the foreign exchange they need to cover endangered banks. The fund would need authority to borrow from the central bank of the country whose foreign exchange was in high demand in order to relend to the central bank in need. Of course, the fund would have to set rigorous conditions to deter anything but emergency use. It appears to me that the International Monetary Fund would be the appropriate agency to administer this fund, but there are other possible candidates such as the Bank for International Settlements in Geneva. In connection with this proposal, I would like to know whether the lending of dollars in any amount by the Federal Reserve to the IMF or BIS for this purpose would require Congressional authorization.

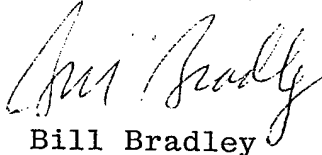
We might also consider creating a financial contingency program which could include (1) a formal agreement clarifying and reaffirming the 1974 central bankers Basle declaration on the allocation of lender of last resort responsibilities; (2) preparations to stabilize a vulnerable currency; and (3) preparations to coordinate the operations of the lender of last resort facilities of major industrialized nations.

These suggestions are at best partial solutions to difficult questions. I recognize that responses to the questions raised are not easily prepared. However, I know you appreciate that the matter is of great importance.

While I do not intend to create undue public alarm. The desire to assure public confidence in a vulnerable financial system, will prove a shabby excuse if an uncontrollable crisis should develop. We must guarantee stability against any reasonable doubt. Equally important, allied threats to cut off credits to Poland would weigh more heavily with Poland's generals (and Soviet Politburo members) if they knew that our economies were braced against the potential repercussions of a default. Similarly, a contingency program is a prerequisite to a credible credit sanction policy. Without it, our hands are tied by our own economic vulnerability.

I offer these comments and questions in a spirit of cooperation and in the belief that our country will be better off if we have a reliable framework for minimizing the vulnerability of the U.S. economy and U.S. security interests to the repercussions of large sovereign defaults. Because of the urgency of this problem, I would appreciate a timely response, at a minimum informing me of the progress being made in preparing answers and, I hope, formulating a contingency program.

Best wishes,

A handwritten signature in cursive script, appearing to read "Bill Bradley".

Bill Bradley

BB:afk