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Statement by

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before the

Subcommittee on International Trade, Investment and Monetary Policy

Committee on Banking, Finance, and Urban Affairs

House of Representatives

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I am pleased to appear today before this subcommittee to discuss the proposed expansion of resources for the International Monetary Fund. I will also review the IMF's role in helping to resolve serious international financial problems such as those that have recently arisen for many countries and some of the regulatory proposals relating to U.S. banks' participation in international lending activities in the future.

The Federal Reserve Board strongly supports United States participation in the proposed expansion of IMF resources that is before this subcommittee. That expansion would involve a global increase in the IMF's basic resources in the form of quota subscriptions from about \$65 billion to about \$97 billion, with the United States providing about \$5.7 billion of that increase. In addition, the United States and ten other industrial countries have agreed, subject to legislative action, to expand from about \$7 billion to more than \$18 billion their credit lines to the IMF under the General Arrangements to Borrow; the increase in the United States commitment is about \$2.6 billion.

This legislation is the result of the Eighth General Review of IMF quotas mandated by the IMF's Articles of Agreement. In this sense, this legislation was already in the pipeline. However, in view of the IMF's declining liquidity, the increased needs for temporary balance-of-payments assistance by a large number of member countries, and the associated threats to the stability of the world monetary system, we and other IMF members are seeking to complete this expansion in IMF resources before the end of 1983. Given the U.S. leadership role in the IMF and especially in negotiating this package, it is highly desirable that Congressional action on this request be completed promptly.

### U.S. Interests in the IMF

As the subcommittee reviews the proposed legislation on the IMF, it is appropriate to consider two central functions that the IMF performs. First, the IMF lends resources to member countries in weak external financial circumstances in order to alleviate the abruptness and severity of the balance-of-payments adjustment process that these countries necessarily must undergo. Second, the IMF through its surveillance role and through conditions attached to the use of its resources helps to limit and reduce the use by member countries of exchange restrictions and other policies that have disruptive or inequitable effects on foreign suppliers, creditors, or competing producers, and encourages its members to adopt internal economic policies that help to maintain or restore external balance. In both dimensions, the IMF contributes importantly to the stability of the international financial and trading system and, thus, the market for U.S. exports.

The preservation of a stable environment for international trade has become increasingly important to the U.S. economy over the past two decades. In 1982, exports of goods and services by the United States amounted to \$350 billion, equivalent to almost one eighth of U.S. gross national product. Exports are more than twice as important to the U.S. economy today as they were 20 years ago. The employment generated by these exports accounts for one out of eight jobs in our manufacturing sector. One of every three U.S. farm acres is producing for export.

While exports have become more important to the U.S. economy, the destination of U.S. exports has also been shifting increasingly toward markets in the less developed, non-industrial countries. Over the past 10 years the share of these countries in our exports has risen from less than 30 percent to about 37 percent of total U.S. exports.

These markets are sometimes more uncertain for U.S. suppliers because government restrictions on imports tend to be more pervasive in these countries and because the restrictions are subject to frequent change. Moreover, some of these economies have experienced phases of excessive growth and resultant unsustainable payments deficits followed by severe cutbacks in imports in order to regain external balance. The sharp reversal in import demands by these countries at times have had unfavorable effects for the U.S. economy. In the case of Mexico, for example, the period of buoyant growth in the late 1970s led to a doubling of U.S. exports to Mexico from an average rate of \$8.5 billion in 1978-79 to an average rate of nearly \$17 billion in 1980-81. When Mexico in 1982 faced severe external liquidity problems prior to the establishment of its IMF program, U.S. exports to Mexico fell sharply, to less than \$12 billion, with exports in the final quarter of last year at an annual rate of less than \$7 billion. By contributing to better stability in the economies of these countries in the long run, the IMF increases the stability of the trading environment and makes possible a more rapid growth of U.S. exports to these countries on a sustained basis in the future.

By providing temporary balance-of-payments financing to countries in weak financial positions, the IMF helps to stabilize the pattern of international trade. The role of the IMF is sometimes incorrectly criticized by observers who argue that the IMF is responsible for cutbacks in imports or sharp currency devaluations by countries operating under IMF-approved stabilization programs. While the adjustment actions undertaken in these circumstances are sometimes severe, without assistance from the IMF the adjustment that would occur, after the country's own resources had run out, necessarily would be even more severe. During the period of IMF assistance, the hardships for the borrowing country are in part alleviated by the resources

that are disbursed in connection with the IMF program. Such disbursements normally include both the funds directly supplied by the IMF and the funds that other foreign creditors agree to lend or to roll over because of the confidence-building effect of the IMF's "seal of approval." Thus, the IMF's assistance implies that adjustment is less draconian for the borrower than would be the case if the country were completely cut off from foreign financing and less burdensome on the United States in terms of lower exports.

The financial resources provided by the IMF are temporary and must be completely repaid over a relatively short period. The standard maturity is 3 to 5 years, although for some multi-year arrangements--such as those recently approved for Mexico and Brazil--maturities are extended to 6 to 10 years. The loan repayments generate a revolving fund of resources for the IMF that is replenished during periods of calm in the international economy. Interest rates paid to members on the use of their quota subscriptions are based upon short-term market rates of interest in the United States, France, Germany, Japan and the United Kingdom.

When the IMF provides a stand-by credit to a member, it requires the member to forgo any intensification of exchange restrictions. In general, IMF members are prohibited by the IMF's charter from interfering with the free flow of foreign exchange payments for imports of goods and services, from imposing discriminatory taxes/subsidies on importers/exporters, and from engaging in bilateral payments arrangements that unfairly exclude third-country competitors. As a condition for its stand-by credits, the IMF normally requires the borrower to avoid any new transgressions of these rules and often, in the case of Extended Fund Facility programs, requires the borrower to reverse its recent or even long-standing actions in these areas.

Historically, the United States has been adversely affected by the application of exchange restrictions on international trade. During the 1930s, U.S. exporters were badly damaged by the spread of bilateral trade and barter agreements among other major countries, while U.S. private holders of foreign bonds and the U.S. government suffered heavy losses because of the suspension or restriction of payments by foreign debtors for many years.

Currently, the United States retains a vital concern for the maintenance of free and non non-discriminatory payments for international transactions. In particular, the United States is the world's largest recipient of the types of payments that are most frequently discriminated against, such as dividends, royalties, and license fees. Worldwide export receipts for services by the United States amounted to about \$140 billion in 1982—of which nearly \$40 billion is estimated to have originated in Latin America and a further \$30 billion in other non-industrialized countries.

The unhappy history of the 1930s should also remind us that one of the IMF's central objectives is to avoid competitive exchange depreciations in the world economy. This fact is important to remember at a time when the current high unemployment throughout the world may tempt some countries to seek depreciation of their currencies as a short-run device to stimulate employment—rather than to correct a fundamental imbalance in their external accounts. The United States is vulnerable to the adoption of any such exchange rate practices by other countries because the dollar is so widely used as a reserve or reference currency. This latter role for the dollar tends to create a situation where any exchange rate depreciations by other countries would lead to further appreciation of the dollar. Such an appreciation would be particularly unwelcome at the present time since the United States has already experienced a large exchange rate appreciation and loss of export competitiveness

over the past two years. The dollar's appreciation that has already occurred, along with the weak growth performance of the world economy as a whole, has been restraining and will continue to restrain our own economic recovery.

Resolving Recent Payments Crises in the World Economy

The International Monetary Fund requires a prompt expansion of its resources in order to provide adequate assistance to countries that are currently experiencing severe balance-of-payments adjustment problems, but as I noted earlier the broad scope of the proposals before you was determined by discussions associated with the Eighth General Review of IMF quotas--discussions that had been underway before the international financial strains emerged last summer. Thus, the proposals need to be evaluated in a longer-term perspective as well as from the perspective of the IMF's immediate liquidity needs. The increases would not result in an inordinate expansion in the IMF's role in financing payments imbalances. Nor is the proposed enlargement of IMF resources and its lending activities designed to provide an opportunity for banks to reduce their exposure in major borrowing countries or a possibility for borrowers to follow an easy path toward correction of their payments imbalances.

The IMF's effective influence over policies that its members follow in correcting their payments imbalances is partly a function of its lending capacity. In some extreme cases, countries may face negotiations with their foreign creditors over new private credits or debt rescheduling that require the borrower to conclude an IMF stand-by arrangement as a precondition. In other cases, the IMF may be able to influence a member's policies in the course of its ongoing surveillance activities and discussions with members of their exchange policies and exchange restrictions. However, it is clear from recent events that, during the early stage of a country's balance-of-payments problems, the size of a potential IMF stand-by credit relative to a member's need may affect a country's willingness to establish an IMF-approved stabilization program.

The growth of IMF quotas over the past two decades has lagged well behind the growth of the world economy—which, to some extent, may have reduced the IMF's influence. As an offset the IMF has allowed countries' borrowing limits under conditional arrangements to grow to a larger multiple of their quotas. Consequently, most countries have been able to borrow, over a three-year period, about the same amount from the IMF in relation to imports as they could borrow in the early 1960s.

To permit member countries to borrow larger multiples of their quotas, the IMF in recent years has had to rely increasingly upon special borrowing arrangements with members to supplement normal quota subscriptions. Recently, such borrowings have included those under the IMF's temporary Supplementary Financing Facility (SFF) established in 1979 and subsequent ad hoc borrowing arrangements with Saudi Arabia and various industrial countries. The United States participated in the SFF but not in the subsequent ad hoc borrowing arrangements.

The provision of resources to the IMF through borrowing arrangements has the advantage that the creditor countries have somewhat greater control over the availability of credit to borrowers from the IMF. But these arrangements have the disadvantage that ad hoc multilateral efforts to raise supplementary funds for the IMF take time to establish. For U.S. participation, they of course require Congressional approval. Thus completion of the arrangements can come too late to meet the problem at hand.

The proposed expansion of the General Arrangements to Borrow (GAB) now before Congress would retain the advantage, but avoid the disadvantage, of past temporary borrowing arrangements, such as the SFF. The General Arrangements to Borrow were established in 1962, and the size of those arrangements has not



significantly increased for more than 20 years. The proposed expansion in these permanent lines of credit for the IMF would bring them more in line with the IMF's longer-run needs. Under a proposed change in the provisions of the arrangements, GAB resources could also be used by the IMF in the future to provide loans to non-participants instead of just to other participants as is now the case. However, the GAB resources would be available to the IMF to lend to non-participants in the GAB only in circumstances that threaten the stability of the international monetary system and where the IMF's other resources were not sufficient to meet the threat. Thus, the enlarged and expanded GAB provides a mechanism whereby the industrial countries can respond quickly to the IMF's legitimate financial needs in extraordinary situations.

The current urgency of expanding the IMF's resources stems from a sharp upsurge over recent months in demands for IMF financing. In the past four months, five developing countries that had encountered payments imbalances or liquidity problems--Mexico, Brazil, Argentina, Chile and the Philippines--have sought and are now obtaining substantial financial assistance from the IMF. In view of these and other existing and upcoming demands upon the IMF, disbursements of more than \$15 billion may be required in 1983, seriously depleting the IMF's present liquidity.

Most of the IMF's loans go to non-OPEC developing countries, which collectively had a deficit in their balance of payments for goods, services and private transfers that amounted to more than \$70 billion in 1982 and more than \$85 billion in 1981. In view of the abrupt reduction of new lending to many of these countries from international banks since last September, that deficit will have to be reduced substantially further in 1983. Under the stabilization program Brazil recently introduced, its current account deficit is scheduled to fall from \$14-1/2 billion in 1982 to \$7 billion in 1983. Similarly, in the case

of Mexico the current account deficit is expected to decline from \$13 billion in 1981 to about \$4 billion in 1983, and in Argentina the deficit is expected to decline from \$4-1/2 billion in 1981 to \$1 billion in 1983. These represent burdensome, but necessary, balance-of-payments adjustments to restore financial stability for these countries.

In addition to an expansion of their exports and continued restraint of their imports, some developing countries will need to implement policies to improve their capital accounts. For example, Mexico and Argentina experienced large outflows of domestic private capital in 1981 and 1982. With a return of confidence in government policy and with appropriate incentives, these funds can be attracted home and can help to finance these countries' needed imports and the rebuilding of their foreign exchange reserves. One objective of the recent IMF-approved programs is to maintain exchange rate and interest rate policies that will facilitate such reflows of capital.

While the borrowing countries will have to assume the main burden of resolving their current financial difficulties, foreign banks, the IMF, and foreign governments will also be extending new loans to smooth the immediate adjustment. The recent negotiations with Brazilian, Mexican, and Argentine authorities provide a basis for estimating the amounts of new funds that will be available from the IMF and the banks.

For Brazil, the IMF has approved credits that amount to \$2.2 billion in 1983 and \$1.6 billion in 1984. Bank lending to Brazil, net of repayments, is expected to amount to about \$4 billion each year. For Mexico, financing from the IMF should amount to \$1.3 billion in 1983 and in 1984, while net lending from the banks is expected to be about \$5 billion in 1983 and can be estimated at around \$3 billion in 1984. For Argentina, IMF credits have been approved to allow disbursements of \$1.9 billion in 1983 and a further \$300 million in early

1984. New financial commitments of banks to lend to Argentina in 1983 amount to about \$2 billion, but will be partly offset by the payment of some arrears on debt service obligations that fell due in 1982.

Foreign governmental assistance to major Latin American borrowers will mainly take the form of direct or guaranteed export credits whose magnitude cannot yet be determined. The largest such arrangement undoubtedly will be the guarantees for three-year credits by the U.S. Commodity Credit Corporation to finance shipment of substantially increased amounts of U.S. agricultural exports to Mexico during 1983. Similar assistance will support sales of U.S. wheat to Brazil. Bridging credits that U.S. and other monetary authorities have provided to or supported for the major Latin American borrowers do not show up in longer-term assessments of the adjustment and financing prospects for 1983 and 1984. These loans have been useful to meet minimum immediate liquidity requirements while adjustment and borrowing programs were being arranged, but the loans have been or are scheduled to be repaid within a short time.

#### Future Bank Participation in International Lending

In formulating their external adjustment programs, major foreign borrowers have realistically accepted that their future access to new bank financing will be less than in the past. Outstanding bank loans to Brazil, Mexico, and Argentina are projected to grow by 5 to 10 percent annually in 1983 and 1984. Under these circumstances, the claims of U.S. banks on these countries relative to their capital will decline somewhat.

The prospects for 1983 and 1984 represent a major adjustment from the period 1979-81, when bank exposures in Mexico, Argentina and Brazil were rising at annual rates of 15 to 40 percent. That expansion produced a rapid growth in these claims in relation to bank capital; such a process cannot continue indefinitely.

The level of capital exposure by some banks in some countries has led many observers to conclude that banks have not paid adequate attention to diversification of their assets. In the current circumstances, however, it would be unwise for regulators to force abrupt reductions in bank claims on large borrowers. The risks of loss on foreign sovereign loans would be increased rather than reduced if banks attempted to pull back quickly from lending, say, to Brazil and Mexico. In 1974, following the first sharp increase in oil prices by OPEC, the expansion of international bank lending to developing countries was viewed by many, given the absence of obvious alternative sources of funds, as a constructive development that helped to meet the growing financing needs of these countries. The current international economic situation requires a continuation of international lending at a realistic pace. Nevertheless, recent international financial developments have raised legitimate questions about the future international activities of banks, and these questions require prompt consideration.

To discourage excessive exposure or lack of adequate diversification of some banks, two broad possibilities can be considered. First, some banks may be encouraged to slow the future growth in their outstanding loans to some foreign borrowers. Second, banks may be encouraged to expand their capital base.

The expansion of bank capital in relation to total assets has been a primary objective of U.S. regulatory agencies for a number of years. Recently, we have witnessed some improvement in the capital base for the large banks, and such banks are especially active in international lending. Given the buoyancy of the stock market, conditions are now more favorable for further actions to improve their capital positions.

To ensure moderation in the growth of bank lending to the largest foreign borrowers over the longer term, there recently has been a good deal of discussion of closer supervisory surveillance of banks' international lending activities and possible restraints on exposures to individual countries. Among the options that have been mentioned in those discussions are:

- (i) specific country limits, akin to the limits on loans to an individual borrower that are now in effect;
- (ii) disclosure requirements that would warn stockholders of country concentrations that might affect the safety of their investments in the bank;
- (iii) establishment of specific reserves for troubled country loans; and
- (iv) income-accounting requirements that loan fees be amortized over the life of the loan.

Country lending limits are likely to be either too rigid or so flexible that they are not workable. Limits based on objective criteria would tend to enforce diversification but would not necessarily steer banks away from the greatest potential dangers. Large countries with stable, diversified economies and politically mature governments tend to attract higher levels of bank exposure than do large countries that lack those characteristics. Should one place "too low" a limit on the former countries in order to reach an adequately low limit for the latter? If, alternatively, countries are differentiated among risk classes based on subjective evaluations, the limits would have to be changed periodically--requiring controversial judgments by the supervisors, provoking diplomatic pressures or misinterpretations, and possibly inducing abrupt financial dislocations if classifications are changed.

Financial disclosure requirements have a number of advantages for the investor, both directly and through providing a solid base of information for evaluation by independent security analysts. On balance, requirements to

provide additional information could contribute to a more effective market policing of and hence prudence in lending practices by banks.

Specific reserves have been proposed for the purpose of dealing with severely troubled country credits. They have been proposed to combat the view espoused by some bankers that sovereign credits never turn bad or become unrecoverable because the borrower can never disappear or be liquidated. Some have also argued that regulatory action in such cases might be harmful because it would further damage the debtor's reputation and tempt the debtor not to pay. These arguments appear to me to be unconvincing. It is clearly appropriate for banks to make some provision against loans when there has been a protracted period where the debtor has been unable to service its debt. Indeed, some banks make such provisions now. The question is whether such practice should be more universally adopted.

A requirement that fee income, over and above identifiable expenses, be amortized over the life of a loan might reduce somewhat the enthusiasm that some banks have shown toward foreign lending. A fee is normally received by banks at the time a loan is made--amounting to up to one percent or more of the value of some loans. In some cases, such fees are not taken into income right away. However, if they are in whole or in part, they tend to enhance reported bank income at a time when the "strength" of the bank's assets may in fact have deteriorated, e.g., when a rescheduling is involved. One may of course ask whether an accounting requirement to amortize certain loan fees, which under some proposals would only come into play in the case of a rescheduling, would have a significant bearing on banks' lending decisions, but more uniform treatment is probably desirable.

When considering the various regulatory approaches, we should guard against over-reaction to problems in foreign lending whose dangers were once downplayed by banks and the markets but which may now have been exaggerated.

We must in any event retain an awareness that a growing economy can carry a growing external debt. We must also acknowledge that the current difficulties in international lending are more aptly described as liquidity problems than solvency problems. Finally, where regulatory action is warranted, we should work with authorities abroad to seek solutions that are consistent and compatible with the supervisory and regulatory actions that other industrial countries take with respect to the banks under their jurisdiction; such a cooperative approach will help to avoid competitive inequities and a retreat to the "lowest common denominator" in the supervision and regulation of international lending.

As you know, the federal bank regulators have had this entire subject under careful review. Their review is essentially complete and I expect that the Banking Committee will receive a more detailed report on their conclusions by the end of the week.

#### International Lending and the Availability of Domestic Credit

In addition to questions raised about the adequacy of the regulatory and supervisory approaches to international lending, concern also has been raised that continued lending by banks to developing countries, or lending through the IMF to its members out of the U.S. quota subscription, will reduce the amount of credit available for the domestic economy. There are a number of ways to assess the effects on domestic credit markets of any increase in international lending. One approach is in the context of the overall balance of payments; a second is in terms of the specific amounts involved for specific countries; and a third is in terms of the repercussions on domestic credit markets of a breakdown of private international credit flows.

In the context of the overall balance of payments, any increase in foreign lending by private banks or financed through the IMF may have only limited domestic credit implications in the short run. As long as there is no induced change in the demand for U.S. goods and services, the borrowed funds would have to be held, either by the original borrowers or by others, in U.S. credit markets, and there would be no net effect on credit available to the U.S. economy. On the other hand, if there is an increase in the demand for U.S. goods and services as a consequence of the lending, our exports will be larger, and the effect on U.S. business would be the same as if the credit had gone directly to U.S. exporters to finance their foreign sales.

Even if the incremental bank lending in connection with these programs were quite large, it would not in itself create any difficulties for domestic borrowers as a group, though some may gain (exporters) and some may lose. Moreover, as noted earlier, the additional bank lending contemplated under the various arrangements between banks and major foreign borrowers is a considerable reduction from the rate of lending over the past few years. It should also be viewed in the context of large gross capital inflows and outflows from the United States; in fact, much of the international lending by U.S. banks is in effect financed from foreign sources.

Finally, the moderate further extensions of credit that are involved in these programs may very well be essential for the maintenance of a healthy flow of bank credit in our domestic credit market. A sudden cut off of lending by U.S. and foreign banks to the countries with severe liquidity problems could force them to suspend all servicing of their debts. Such an event would trigger write-offs of a large amount of banks' assets, weakening their capital base and most likely causing them to raise the cost and slow down the expansion of domestic credit that would otherwise prevail.



A more general point may be added. There are very significant feedbacks from the economies of other countries to the pace of economic activity in the United States. Should a sudden contraction of foreign lending occur, the economies of some of our important trading partners would be forced to contract abruptly. This could mean another year of declining U.S. exports, after a year in which the weakness of the external sector was a major factor in the slowdown of the U.S. economy. In that perspective, a relatively small U.S. share in the flow of new financing to some of these countries may well have a widespread positive effect on the U.S. economy.

#### Role of the IMF

My comments above on the role of the IMF in helping to resolve current international debt problems focused on the Fund as a source of funds and its function in promoting appropriate adjustment. The Fund also has assumed a greater role in recent months in developing a closer working relationship with commercial banks. This aspect of the Fund's activities is still evolving, but on balance it is likely to contribute to better informed lending and borrowing decisions.

In the context of the IMF's surveillance function, the Fund is reviewing its procedures in generating and sharing information and analyses on external financial circumstances of individual member countries with the commercial banking community and with national supervisory authorities. Over the past months, the Fund also has assumed a role in coordinating various forms of private and official balance-of-payments assistance in the framework of IMF-approved stabilization programs. Time will tell whether this will become standard procedure for the Fund or only reflect the exceptional circumstances prevailing in international credit markets over the past half year. Finally, in designing performance criteria in Fund programs, the IMF is intensifying its

focus on the growth and structure of members' external debts and the relationship of such criteria to assessments of medium-term debt capacity of the borrowing country. These new and expanded activities by the Fund are likely to have favorable effects on the quality of lending and borrowing decisions, and will help create an environment that it is to be hoped will avoid a recurrence of debt problems of the severity we have experienced recently.

In conclusion, the United States has vital long-run interests in strengthening the International Monetary Fund, and in strengthening the supervision of banks' international lending. The liquidity needs now present in the world financial system, and the consequences of failing to meet those needs, also argue for prompt, favorable consideration by Congress of the legislation to augment the financial resources of the International Monetary Fund.