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Opening Remarks by

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before the

Subcommittee on International Finance and Monetary Policy

of the

Committee on Banking, Housing, and Urban Affairs

United States Senate

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I am pleased to have this opportunity to exchange views with the Committee on the international financial situation and the role of the International Monetary Fund. I have elaborated - at some length on these issues in a statement, replete with data and appendices, that I presented two weeks ago to the House Committee on Banking, Finance and Urban Affairs and that I have submitted to this Committee as well. Today, I would simply like to update that statement and highlight the major points.

We face extraordinary pressures in the international financial system. While conditions in the market have been calmer in recent months, in large part because of responsible actions by all the parties involved, the underlying problems persist.

This is not an abstract, esoteric problem of marginal interest to our economy. Failure to address these problems will jeopardize our jobs, our exports, and our financial system. Unless it is dealt with effectively, it could undermine both our own recovery and the economies of our trading partners and friends abroad.

I am confident that the situation can be managed -- but it won't manage itself. My confidence is based in part on the fact that I think the nature of the problem and the needs are well understood. Governments have worked together in analyzing and dealing with the problem; we have seen the borrowers and lenders working together effectively; and the IMF -- as the

designated international overseer of the system -- has been at the center of the process, fulfilling its key role in coordination, providing money in some cases, and promoting necessary economic adjustment.

As we deal with the heavy indebtedness and balance of payments problems of some large developing countries, five interrelated elements stand out.

The first step is that the borrowing countries themselves must adjust. This means strong and forceful measures -- basically austerity programs -- have to be taken by these countries to cope with their internal and their external imbalances, typically with the support and approval of the International Monetary Fund. For example, the reductions in public sector borrowing requirements committed under IMF programs for Argentina, Brazil and Mexico are demanding: they require roughly a halving of deficits over the course of the year.

Forceful adjustment programs will be accompanied, for a time, in slow or no growth internally, reduced imports, and lower living standards in countries where average incomes are already far below ours. The question is sometimes put as to the wisdom of these programs in a world eager for growth. The answer is straightforward. Those programs are fundamentally justified by two basic considerations: 1) In the absence of coherent

adjustment programs that can command support in the international financial community and among other Governments, still more severe and lasting difficulties would ensue as borrowing countries found their access to external resources abruptly cut off; and 2) Well-conceived adjustment programs can lay the base for resuming growth at a sustainable rate for years ahead.

A second element in dealing with the current problems is that, considering the large imbalances the major borrowing countries have faced, an orderly adjustment effort will require additional external credit support during a transitional period. In important cases, restructuring of existing loans and agreement among bank lenders to provide additional credit have become essential. Because adjustment is contemplated and is proceeding, those fresh credits can typically be provided without increasing exposure of the banks in terms of ratios of loans to capital or assets, and in fact with some declines in those ratios.

Third, monetary authorities of some of the industrialized countries have provided temporary liquidity assistance while IMF stabilization programs and associated finance are being negotiated and while the banking packages are being put together. This is something that should not become a norm, but it is justified to maintain continuity in payments and confidence when there is a clear threat to the international financial system.

Fourth, as the earlier points imply, the IMF plays an absolutely essential role, and it needs adequate resources to do its job. It works closely with the borrowing countries

themselves, particularly in reaching agreement on stabilization programs to restore economic balance and in maintaining confidence in their creditworthiness. As part of that process, the IMF provides a key element of medium-term finance in support of agreed adjustment programs. Complementing its own resources, it has also helped coordinate the needed private (and sometimes public) financing. It does not itself replace other sources of financing, but supplements them.

Finally, the success of the adjustment programs and the relaxation of pressures on borrowers and lenders ultimately is dependent upon the performance of the world economy. In an environment of sustained growth in the industrial countries, the borrowing countries themselves can more easily resume growth, their debt burdens will become more manageable, and their adjustment less burdensome. "Normal" financing patterns can be resumed -- not in the sense of the excessive growth of some recent years, but in the sense that lenders and borrowers can freely and individually negotiate mutually acceptable terms free of critical liquidity pressures.

That objective of growth coincides, of course, with our domestic concerns. Conversely, if we fail to come to grips with the international financial situation the prospects for growth in the industrialized world, including the United States, would be impaired. Our concern for maintaining a well-functioning international financial system is rooted in our self-interest, not altruism.

I will not review now the material in my earlier statement about the development of bank lending in earlier years and the lessons for banks and supervisors alike growing out of that experience. Suffice it to say that much of this lending reflected a constructive response by the financial system to the need to ease the adjustments associated with the world oil crisis. International lending will continue to have an important role to play in a developing world economy.

But, of course, there can be excesses, and some of the lending proceeded on assumptions that, in retrospect, seem invalid. None of us enjoys perfect foresight, and it remains central to our financial and economic system that the individual lenders reach their own credit judgments. But it is the responsibility of government to establish and maintain ground rules and procedures that, without stifling the market, provide assurance that the stability of the system as a whole can be protected against the dangers of excessive concentration of risk, and that the element of risk is appropriately weighed. While our present supervisory approaches are aimed at that objective, the rapid development of international lending and today's problems do point to the need for careful review of present policies and other ideas. Possible modified or new approaches -- touched upon in my earlier statement -- are under intensive review by the supervisory agencies, and I expect to be able to report conclusions to you in a matter of weeks.

At the same time, the danger of over-reaction -- of encouraging inadvertently an abrupt retreat from lending -- is equally real. The hard fact is few borrowers, at home or abroad, can suddenly repay substantial debts accumulated over years. An attempt to force the process would be doomed to failure, because borrowers need time to make the adjustments to earn the funds or to restore their market access. What may seem logical and appropriate to an individual bank in demanding payment, if generalized, would place such strain on the system as a whole that it, and the individual banks within it, could only be damaged.

As I noted earlier, the parties immediately at interest in resolving the international debt problem -- lenders and borrowers, governments and the private lending institutions, and international organizations -- have been acting cooperatively to deal with the major points of pressures to the financial system. The IMF stands in the center of this effort, and it has responded with force and leadership.

Last week, at the meetings of the Interim Committee, member governments of the IMF reached agreement -- subject to legislative approval -- to expand the effective resources of the IMF, and to do so promptly. Recent events have ended any doubt about the need for a substantial increase in resources of the Fund -- a matter that had been under discussion before the strains had become so evident last summer. The amount agreed

last week -- at the lower part of the range that had been under discussion -- does not seem to me at all excessive, but it will enable the Fund to discharge its large responsibilities with effectiveness and confidence that the resources it may need will in fact be available.

Last week's decision increased IMF quotas by about 47.4 percent, or by about \$32 billion. The Group of Ten earlier approved an enlargement and broadening of the General Arrangements to Borrow (GAB) from \$7.1 billion to about \$19 billion, supplementing in time of need the resources available to the Fund.

Both the quotas and the expanded GAB essentially provide a standby commitment, with equitable sharing among countries, to contribute to a pool of funds that can be drawn upon for loans to IMF member countries in time of need. As more funds are borrowed by a country, stricter conditions are required.

The increase in IMF quotas and the enlarged GAB require budgetary authority and appropriation for the full amount of these commitments, involving about \$8.4 billion for the United States. These commitments, however, do not lead to a net budget outlay, in recognition of the monetary and reciprocal character of the IMF. Moreover, cash advances will be necessary only when and if demands on the IMF exceed amounts that can be provided from current IMF resources -- and that will only happen in the foreseeable future if, in fact, the Fund requires these added funds to deal with a major threat to the system. In a

sense, the U.S. and other countries assume the position of insurance underwriter, called upon with a showing of demonstrated need. What we are insuring, among other things, is that our own recovery will not be aborted by international financial disturbances.

The events of recent months have highlighted both the risks and the means for dealing with them. The pressures on the international financial system have not disappeared, and we cannot assume some hidden hand will manage the solution.

As the economic, financial and political bellwether of the Western World, we cannot escape the responsibility of leadership and participation in the effort -- not if we want the effort to succeed in our own interest. Early approval of the IMF legislation that will be submitted to Congress shortly will be an indispensable step to that end, reflecting our determination and capacity to do our part in reaching a constructive and effective resolution of the problem.

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