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Remarks by

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It's a particular honor and delight for me to receive your award today. Central bankers, even more than others, are bound to admire and respect the success of the Swiss both in maintaining so large a measure of monetary and economic stability internally over the years and in contributing so importantly to world financial affairs. What a demonstration of the tangible benefits of financial discipline and common sense Switzerland is!

I am tempted to hypothesize that Swiss success reflects the fact that Switzerland maintains a strong and independent central bank.

Now, I'm not about to reject that thought entirely. But I am ready to acknowledge that something even deeper may be at work as well -- a matter of national character and experience and enlightened self interest of those living in what is, after all, a small country poorly endowed with natural resources.

The career of my good friend Fritz Leutwiler, who will soon be retiring from his responsibilities at both the Swiss National Bank and the Bank for International Settlements, has been squarely in the Swiss financial traditions, and he has brilliantly added to it. All of us in other countries who have worked closely with him during these turbulent recent years are bound to sorely miss his practical leadership and wise counsel. In no area will that be more true than in dealing with the continuing problems of international debt.

Fritz brought to the days of crisis from the earliest tremors in Eastern Europe an understanding, a willingness to act and to lead, and a personal influence that were indispensable to managing the situation. That job is still far from complete -- by its nature it will be the work of years. But I also think it is fair to say that today, for all the obstacles still ahead, we can see that the earlier sense of hopelessness expressed by some is plainly not justified, that the main avenues to success can be more clearly identified and are more broadly understood, and that strong cooperative efforts by borrowers and lenders alike can be elicited, in their mutual interest, to help manage the situation.

Before substantiating those points, a sense of the origins and nature of the problem seems to me essential. It's often explained in terms of specific events -- the successive oil crises, the impact of historically high interest rates in the early 1980's, coinciding in part with a prolonged recession, and errors by lenders or in economic management by particular borrowers. Obviously, those particular events and circumstances were significant. But there have been broader forces and attitudes at work.

The international debt problem -- important as it is quantitatively and in terms of its impact on so many countries, so many people, and so many financial institutions -- is only one symptom of a larger challenge: a transition from

a highly inflationary environment to restoration of the financial underpinning of sustained, non-inflationary growth.

Bank lending to a whole tier of important developing countries -- those moving rapidly toward industrialization -- got its initial strong impetus in the early 1970's when the first oil crisis greatly added to financing needs at a time when strong growth patterns and rising commodity prices had greatly improved confidence in the basic outlook of the borrowing countries. The ability of the banking system to respond flexibly and vigorously to those needs itself reinforced confidence. But the exponential further rise in bank lending through the 1970's, and the second 1979-80 oil crisis, can only be fully explained, in my judgment, in the context of other, more fundamental, developments and attitudes. There was a common perception of continuing and even accelerating inflation and exceptionally low real interest rates, a sense that governments would nonetheless be able and willing to maintain relatively strong growth in the world as a whole, and an implicit assumption that the kind of financial crises experienced by our fathers and grandfathers were more a relic of history than a future threat.

So long as new loans flowed freely, rapid growth could be maintained in many developing countries, and inflation seemed to wash away much of the increased debt burden. It was also true that both interest payments and debt maturities were, in effect, being made only with the proceeds of new

loans. That is not, in itself, an unusual or necessarily disturbing circumstance -- it is, in fact, a normal part of the growth cycle for a company or country. But it is sustainable only when the debt is maintained, and seen to be maintained, in some manageable relationship to real growth and productivity, with a liquidity or borrowing cushion against inevitable periods of recession and disturbance.

Looking back, it's much easier now than in the 1970's to see the warning signs that the process was not in fact sustainable for some countries, and that it had become dependent on accelerating inflation and exceptionally low real interest rates. Lending banks had permitted their own capital ratios and liquidity to erode, increasing their own potential vulnerability. And, perhaps most ominously, late in the 1970's and at the start of the 1980's accelerating capital flight from a number of borrowing countries signaled deteriorating prospects for productive investment; at the same time, larger amounts of external, public borrowing were required to finance the outflow.

The implicit assumption of rising inflation, low real interest rates, and sustained world growth were abruptly undermined in the early 1980's. When the crisis erupted in Mexico, reflecting a particular combination of political and economic circumstances, the simple fact is much of the continent of South America, as well as some other important borrowers, had become vulnerable to even a temporary change in circumstances and market psychology. One clear danger

was that self-protective instincts of individual lenders to cut risks and exposures by suddenly curtailing new loans would not only grievously impair the stability of their borrowing customers but also pose large risks for all creditors with large loan exposures -- a category including most of the major international banks.

Happily, there was not only prompt recognition on all sides of that danger to the international financial system but a strong willingness to participate in a collective approach to deal with it. I will not review today the details of that cooperative effort. Suffice it to say it had several critical ingredients.

The efforts of the borrowing countries themselves to reduce external needs -- an effort that initially inevitably required emphasis on curtailing swollen imports -- and to become more competitive and productive over time were absolutely critical. But those efforts would have been fruitless without recognition by banks of their own interest in orderly refinancing of old loans and the provision of enough new money to maintain the viability of the adjustment programs undertaken by borrowers. The role of the International Monetary Fund in the process has, of course, been essential. It could, as it was designed to do, provide a critical margin of new money. I sense more important, if less measurable, has been its ability -- as an internationally respected, competent, and neutral financial (and intellectual!) intermediary -- to seize the initiative in coordinating the

effort, country by country, and to maintain surveillance over the entire process.

The founders of the IMF could hardly have foreseen this role, and few of us, even a few years ago, could have appreciated the importance it would assume. Of course, it has had to be supported, with resources and otherwise, by governments and central banks of the leading countries -- one area where Fritz Leutwiler, working through the BIS and otherwise, was so active.

Now, more than two years after Mexico had to declare a temporary standstill on its debt repayments, we can take some satisfaction from the fact that the crisis facing major developing countries and the system has been contained and kept manageable. For some of the most important borrowers -- notably Mexico, Venezuela and Brazil -- more can be claimed. They have made unexpectedly rapid progress in external adjustment, and have succeeded in rebuilding significant financial reserves. Two of them have negotiated long-term debt restructurings on terms that they should realistically be able to meet, and the third has plans to do so.

It's equally obvious that points of vulnerability remain, and to some extent, problems can remain contagious. Argentina, for instance, only now is at a critical point in negotiating with its creditors for a sizable amount of needed new money and debt rollovers, following prolonged consultations by the new and democratic government on an appropriate adjustment program with the IMF. Other smaller

Latin American countries, as well as a few elsewhere, remain in a very difficult position, economically and financially.

Under the circumstances, it's still too soon to close the book on what might be thought of as "stage one" of handling the LDC debt problem -- urgent crisis management. But it's not too soon to begin work on stage two -- the transition to renewed growth and stability. I suggested at the start that the broad prerequisites for success can be identified, and at a general level command a broadening degree of agreement as consistent with realistic and reasonable assumptions.

In essence, econometric and other analysis at the IMF and World Bank, as well as among some private analysts, suggest trend growth by the industrializing developing countries of 5 percent or more annually can be restored in the years ahead consistent with significantly falling debt burdens and much reduced exposure relative to capital of lenders. Our own work in the Federal Reserve supports these conclusions.

The assumptions typically made in these studies do not strike me as heroic: growth averaging about 3 percent a year among the industrialized countries, well within historical experience; real dollar interest rates within the range of those experienced over the past year or so

(an assumption which could well be unduly pessimistic); and no large change, up or down, in oil prices. Projections for individual countries made by both borrowers and lenders in developing longer-term restructuring programs, such as for Mexico, lend credence to the more general analysis.

I am well aware that econometric projections are not the same as reality; the real world has more surprises, and more fluctuations, than can ever be captured in a series of equations averaging past relationships. But I believe the work does demonstrate effectively that all the effort on crisis management has not led us into a blind alley, only postponing an inevitable day of reckoning. Hard analysis simply does not support the pessimistic earlier view of some that such extreme and unlikely measures as substantial new official aid programs or across-the-board writedowns of debt would inexorably become necessary to avoid financial breakdown.

But, conversely, there should be no presumption that favorable results are assured and automatic. All those who have cooperated in crisis management will have important continuing roles to play. That sounds as though the patience of all could be sorely tested -- except that the actions needed are basically consistent with the individual interests of the several parties, debt problems or no.

For example, the most important need for the industrialized world is to maintain orderly economic expansion, with the important by-product of a favorable external economic environment for developing countries

seeking to expand exports. For the past 18 months, the United States has played a particularly large role in supporting world growth. Our huge and growing trade deficit and the much slower rate of U.S. growth for some months -- while not in itself exceptional during an expansion period -- should also be reminders enough that the responsibility for encouraging growth should not fall on one country alone. Indeed, looking ahead, the historically high levels of unemployment that have persisted in Europe for some time, and the progress that has been made against inflation, suggest the potential for above-average growth rates in that key industrial center for a while.

To me, it is obvious as well that prospects for balanced growth with more moderate interest rates in this country would be greatly enhanced by a strong and early attack on our now chronically large budget deficit. Given our weight in the world economy, that deficit not only overstrains our capacity to save domestically, it absorbs too much of the limited supply of capital abroad.

All the industrialized countries will have to work hard and in concert to resist protectionist pressures. There is no doubt that rapid increases in imports from the developing world pose difficult adjustment problems for long-established industries here and elsewhere; temptations to curtail imports become well nigh irresistible when markets in other countries are closed.

But there is also no doubt that the ability of the developing world to grow and service its debt is dependent on rising exports -- and that their development will also stimulate a comparable flow of exports from the industrialized world. In the end, the productivity and standard of living of all countries is at stake.

The question should not be addressed to industrialized countries alone. Protectionism, or what amounts to the same thing -- a network of subsidies, controls, and artificial pricing -- can be as much or more of a handicap to growth and development when practiced by the developing countries themselves. Far too often, a few favored industries are supported and pampered at great cost, budgetary or otherwise, sacrificing the competition that spurs efficiency and harming other sectors -- often including agriculture -- operating far below their potential.

That lost "potential" may have appeared less urgent when bank loans from abroad seemed abundantly available on easy terms. But the only prudent assumption today is that those days of lenders aggressively "selling" loans to the most heavily indebted are gone, certainly for years ahead. Realistically, given the scars of recent experience, the relative exposure of a number of large banks to particular countries is likely to remain larger than they would desire for some time. Many smaller banks, attracted to foreign business beyond their normal market areas, may wish to retrench. I do not suggest that when conditions justify --

including satisfactory performance with respect to IMF-sponsored adjustment programs -- long-term restructuring of existing debts at reasonable spreads should not be expected in more countries, or that cooperative efforts to raise essential amounts of new money will not be successful. In appropriate circumstances, the common interest in those efforts remains compelling. But truly spontaneous lending by individual institutions to countries with serious debt servicing difficulties may be confined largely to trade credits for a time, and even as confidence more fully returns, new lending is likely to remain moderate by the standards of the 1970's for years to come.

There can be, in fact, no common interest in simply resuming the lending patterns of earlier years -- lending that would ultimately again threaten the stability of lenders and borrowers alike. Banking and supervisory agencies here and elsewhere will themselves want to guard against that eventuality.

All of that emphasizes the need to make more effective use of savings generated internally as well as externally -- the former in any event will always be the most important source of capital for any country. That is a difficult and politically sensitive area in which every country will have to find its own solutions, suited to its own traditions and philosophies. But having said that, I cannot refrain from making several observations on the current scene.

A number of heavily indebted countries have made the strongest kind of effort, under crisis conditions, to make fundamental adjustments in their economies, often at the expense initially of cutting already low standards of living and aggravating structural problems of unemployment. The results in their external accounts have been remarkable. Internally, progress has typically been more difficult. Inflation in a number of countries is still rising, or falling more slowly than anticipated. For a variety of reasons, business and agriculture have been delayed in reorganizing and enhancing efficiency, and many incentives seem to remain perverse.

As the immediate crisis recedes, there will be strong and legitimate demands for renewed growth and employment. That will need to be done without counting on such large injections of new bank lending as in the past or much more rapid expansion of official lending from abroad to make up for an inability to generate usable domestic savings.

I would like to be able to say with confidence that many foreign companies or other potential foreign investors are poised today to support those needs by means of large new equity investments -- either as active managers, as partners in local enterprises, or as portfolio investors. Potentially, I believe such investors do exist, and in large numbers, given the local opportunities for profit in expanding domestic markets and international markets. But, with a

few significant exceptions, potential investors are hesitant and reluctant. Many seem less concerned with creditworthiness than with -- as they see it -- a history of distrust about private and foreign business, a perceived absence of security for private capital, and excessive controls.

One does not have to look to foreign capital to make the point. In country after country, debt problems were greatly aggravated by massive capital exports by their own citizens -- capital that once exported is likely to provide little or no earnings for use of the country as a whole. When a nation is unable to attract and efficiently employ the capital of its own citizens, prospects for attracting the equity participation of others is slim. Yet, that is precisely the kind of funds -- whether in the hands of their own entrepreneurs or from businesses abroad -- that could spark and sustain the growth and the productivity that is so sorely needed. And, not so incidentally, in financial terms, a thicker layer of equity risk capital would be the best possible base for encouraging a restoration of normal bank lending.

These are not theoretical propositions -- there are obvious examples around the world of developing countries with an hospitable climate for investment that have managed to maintain their growth and attract foreign capital in the midst of the debt crisis affecting so many other countries. I realize that habits and attitudes built up over many years, whether by foreign investors or within a country,

are hard to change, and the prevailing cautious attitudes of foreign investors may no longer be fully justified by objective facts in some countries. But one senses that, with attention, greater opportunities can be developed in the mutual interest. Certainly, the return of confidence implied by a surge in private investment, domestic and foreign, would provide the strongest possible evidence that the debt problems are indeed behind us, and that hard-pressed borrowing countries can confidently again look forward to sustained growth and raising standards of living.

Let me summarize my thesis in a few sentences. The debt problem is, and with effort should remain, manageable. While the particular conditions and circumstances differ widely among them, a number of developing countries, working with the IMF, have made striking progress toward achieving external balance without heavy dependence on new bank lending. In that context, cooperative efforts by lending banks -- again typically in the context of IMF programs -- will remain justified and essential for some time to achieve realistic repayment schedules for existing loans and to raise amounts of new funds essential to finance adjustment.

As we look ahead, these efforts should be consistent with renewed strong growth by the borrowers, and with significantly reduced debt servicing burdens of borrowers and reduced exposure by lending banks (relative to their capital or assets). Indeed, ultimate success, from the viewpoints of borrowers, lenders and the world at large, is

dependent upon reaching those results. Reasoned analysis strongly suggests those results can and will be reached, provided growth by industrialized countries is sustained, excessive real interest rates are avoided, and open competitive markets are maintained, both in the industrialized and developing worlds.

Viewed in that light, the basic policy requirements for success in resolving the problems of international indebtedness are the same as those for meeting our economic problems more generally.

So far as the United States is concerned, the message seems to me very clear. All the arguments for maintaining progress toward price stability, for dealing with the budget deficit, for resisting protectionism, for encouraging productivity, are reinforced and made more urgent.

I am sure there are pointed lessons for others as well. If we succeed even moderately well in acting upon those lessons -- and that is certainly well within our several capacities -- I see no reason why this debt crisis, as so many crises before, cannot in the end be turned to constructive opportunity.

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