For release on delivery
11:[illegible] A.M., E.D.T.
Monday, May 13, 1985

Remarks by

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before the

Sixty-third Annual Meeting

of the

Bankers' Association for Foreign Trade

Boca Raton, Florida

May 13, 1985

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I am delighted to be with you today in these inviting surroundings and to receive your 1985 Distinguished Fellow Award. However, the pleasure and honor are acceptable on one condition only: that we forthrightly recognize that this can be only a pleasant interlude in the midst of continuing challenge. The simple fact is we have a lot of unfinished business before us in dealing with the problems of international debt.

No doubt we have come a long way.

More has been accomplished in a shorter period to resolve the crisis than many observers thought possible. But obvious points of strain and large uncertainties remain. "Normality" -- even assuming we could define it -- still lies in the hazy future. And success in the end, as in so much human endeavor, will be as dependent on the collective ability to sustain the necessary effort at least as much as on the first response to crisis.

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The appropriate goal can't be restoration of the economic conditions and lending practices prevailing before the onset of the crisis. Those conditions were characterized by an inflationary environment, and by excessive lending and borrowing to support growth (growth of the lenders as well as the borrowers!) at the expense of healthy capital and liquidity ratios. There were implicit assumptions that interest rates could remain low or negative in real terms and that confidence would never be impaired. The inconsistencies could be disguised only so long. They surfaced abruptly in the early 1980s when the inflationary process was stemmed, and for a time both growth and stability were jeopardized.

By the time the crisis erupted in Mexico in 1982, much of Latin America, as well as some important borrowers elsewhere, had become overextended and vulnerable to even a temporary change in circumstances and market psychology. At that stage, the international financing and banking system was certainly not prepared to respond resiliently by purely market processes to the clear threat to its own future.

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Out of all the turmoil, we want to rebuild a foundation for solid non-inflationary growth in the future in both industrial and developing countries. And we want to do it in a way consistent with restoration of competitive market processes in international lending, and with the banking system better equipped to cope with any disturbances that, from time to time, may be an inevitable part of the economic and financial environment.

We are not there yet. Success is going to take a lot more cooperative effort.

When the crisis broke, participants on all sides clearly recognized the dangers to their collective well being. They demonstrated a strong willingness to work constructively together.

I need not dwell here in detail on the essential elements of the approach that emerged. That approach has often been labelled, with some justice, "case by case," because both the timing and substance needs to take account of the varying

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specific circumstances of different countries. But the individual "cases" also have certain broad elements in common, and the success of one country or one restructuring program is not independent of others.

Absolutely essential are the efforts of the borrowing countries themselves to achieve what we, euphemistically, call external and internal adjustments. Specifically, they have had to scale back swollen imports and their reliance on external financing to live more nearly within their means. They have to deal with the incentives for capital flight and to become more competitive and productive over time. Some of the most important borrowers -- notably Mexico, Venezuela, Brazil and Yugoslavia -- as well as a number of smaller borrowers (for example, Ecuador and Hungary) have made unexpectedly rapid progress in bringing their current accounts into, or close to, balance. Looking ahead, it's also encouraging that in the past year or so a significant number of borrowing countries

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have experienced a pickup of economic growth, sparked in good part by an expansion of exports, and a partial recovery of imports.

Equally important over time will be a reasonably favorable world economic and trading environment. The industrial countries, mainly reflecting the strong expansion in the United States, have provided growing and relatively open markets for borrowing countries' exports, even as their own exports to those countries for a time declined sharply. Moreover, the economic expansion here in the United States could be achieved without a trend toward higher interest rates, although interest rates are still historically high.

The IMF has played a crucial role in guiding the overall process. Its management has been able to do what no one

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else was fully able to do. As an institution reflecting in its character and composition the international interest, it could advise and help design effective adjustment and consistent financing programs, take the initiative in coordinating the various elements of complex international financial arrangments, and provide a limited but critical margin of new money.

In that broad framework, lenders could organize cooperatively the orderly refinancing of old loans and the provision of enough new money to maintain the viability of the adjustment programs undertaken by borrowers. In cases where these adjustment efforts have produced positive results in terms of policies and performance, commercial banks have also been prepared to negotiate multi-year restructuring arrangements, recognizing mutual benefits in providing a more stable base for planning by borrowers and greater certainty for lenders and markets.

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The practical results -- while far from uniform -- have contributed to a greater consensus that the problems of international debt ultimately should indeed be manageable. That sense of progress is consistent with conclusions from analytic studies, conducted at the IMF and World Bank as well as at private institutions and at the Federal Reserve. Those studies make certain reasonable assumptions about growth in the industrialized world, about interest rates, and other "environmental" factors. They find those assumptions consistent with restoration of trend growth rates of around 5 percent or more for many of the more advanced developing countries, declining debt burdens of borrowers relative to the size of their economies, and very significantly reduced exposure of commercial banks relative to capital or assets.

If the assumptions of those studies prove in practice to be conservative -- and I for one think that's possible -- so much the better. But, of course, econometric projections of that kind can never fully capture the risks, the uncertainties, and the volatile psychology of the real world.

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Successful experience in the short run provides no assurance against changes in the economic climate or against policy mistakes. Among other things, the analyses implicitly assume lenders will continue to act cooperatively in their collective long-term self interest. But they do help demonstrate one essential point -- we are engaged in an effort that, rather than simply postponing problems or leading to a dead end, is capable of producing positive results for all the participants.

In that sense, a certain degree of optimism -- even confidence -- is justified. But we would be sorely misled to interpret either the results so far or the analytic work as any cause for complacency or relaxation. That would plainly be a recipe for failure.

For all the achievements, the experience of the past few years also points up areas of concern and the potential vulnerabilities. Moreover, the difficulties may be greatest as we move from the first stage of crisis management to "stage two" -- the continuing, hard-slogging effort to

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maintain over years internal discipline, reasonable external balance, and adequate financing, while also finding ways to restore and maintain necessary growth.

In "stage one," the adrenalin flows, the common threat is clear, and the instinct to innovate and cooperate is strong. The "hard slog" implied by stage two, in contrast, poses all the risks of "tired blood," impatience, and temptations to return to "business as usual" by borrowers and lenders alike. Those are not the qualities that will win the day.

With respect to the borrowing countries themselves, we have to squarely face the fact that progress has been uneven despite the encouraging number of countries that have showed determination in their adjustment efforts and that on the whole have carried out their policy commitments.

Largely because of factors beyond their control, even some of those -- Chile is a case in point -- have been unable to make significant progress in their external accounts. And some countries have simply failed so far

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to develop and implement appropriate internal measures to correct their economic imbalances and to establish the basis for sustained growth; fortunately, the largest of them -- Argentina -- now appears to be facing the challenge more squarely. In all these cases, extraordinary efforts will be required not only to carry through adjustment but to provide the financial resources -- official and private -- necessary to support constructive programs.

With respect to the external economic environment, there is obvious cause for concern in the persistence of high interest rates, the volatility of exchange rates, the relatively sluggish recovery of some industrial countries, the imbalances in the economy of our own country, and protectionist threats. It is unreasonable to expect perfectly smooth growth along an econometric curve and policy perfection. But one can legitimately ask whether we in the developed world are doing all we can to minimize the risks, and to encourage sustained growth with stability.

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The implication for coming to grips with our own deficit seems to me obvious. Moving ahead as soon as possible toward a new trade round will be crucial as well, on the simple premise that a good offense is the best defense. And there are clearly challenges aplenty for Europe and Japan.

I have already alluded to the catalytic role played by the IMF and its leadership in responding constructively to a crisis without precedent in its -- or anyone's -- experience. Its structure, competence, and neutrality have been tested time and again -- and it has met the challenge.

The World Bank necessarily has a longer perspective in its lending operations. But it too has responded to the needs by reshaping lending programs when possible within a longer-term development strategy.

As they gain experience, I also believe both the IMF and the World Bank -- together with the other multilateral lending institutions -- will want to adapt and refine their approaches and methods of operation further in ways that are

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sensitive and responsive to the needs of particular countries working through "phase two." That is not an easy thing for organizations that, by their nature, must be evenhanded, and operate within an international consensus that can only be achieved by common understanding among member countries and laborious negotiations.

However, constructive innovation is already underway in several directions. The Fund has worked closely with two countries -- Venezuela and Colombia -- to appraise their economic programs and to develop means of monitoring their implementation of those programs without formal stand-by arrangements or the commitment of unneeded Fund resources. In Colombia, the World Bank does have a large financial involvement. The interests of the two international organizations plainly overlap in their concerns about achieving a competitive economy, free of distortions in trade, pricing, or other policies that impede growth. The degree of cooperation that has developed in that case could well become a kind of model

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for closer relationships elsewhere, particularly as attention turns from essential short-term adjustment to the requirements for sustained growth.

The Bank is and will remain predominantly a project lender. But so-called structural adjustment loans, with faster payouts but also with appropriate conditionality, can well be a constructive and important complement to IMF short-term assistance in some cases. More generally, I suspect the Bank's role should be larger as borrowing countries turn to dealing with their longer-term structural problems, and there will be more opportunities for mutually constructive dialogue with borrowing countries. These are broadly, it seems to me, some of the implications of the recent discussions in the Interim and Development Committees.

One of the "givens" in this situation is that the resources of the Fund and the Bank are limited. There is simply no realistic prospect -- and no political support in the United States -- for those organizations to undertake a

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substantially larger amount of the financing needs of the heavily indebted countries. Indeed, the IMF, as a short and medium-term lender, will before too long need to begin looking toward net repayments by some of the largest borrowers.

In those circumstances, I suppose many of you have developed an ambivalent view of the role of the Fund and the Bank. On the one hand, you appear delighted to have them as a sort of neutral international arbiter of progress in adjustment programs and to have them provide a kind of "stop-go" signal for your own lending, even looking ahead over a period of years when that kind of close surveillance may be increasingly difficult or inappropriate. But you are also sometimes resentful that they in effect are the messengers of a hard fact -- that successful adjustment programs are dependent, in the short run, on a critical mass of financing that, as a practical matter, can only be supplied by the world banking system.

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No package involving lending of net new money in support of an IMF-supported adjustment program has yet to fail in its immediate objective of raising the money -- and that new money has made possible the maintenance of debt service. That success, as you well know, has been dependent on maintaining the discipline of burden-sharing with participation across the full group of lending banks. It has also been appropriate -- and prudent -- only when there is a reasonable prospect of declining needs and progress toward reducing debt burdens and exposure over time.

So far, those criteria have clearly been met.

Looking at the aggregate, international banks' claims on non-OPEC developing countries (after adjustment for the effects of exchange rate changes) appear to have increased less than 5 percent in 1983 and less than 3 percent in 1984. The increases for U.S. banks have been even smaller -- about 3 percent in 1983 and only about 1/2 percent in 1984.

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As a result, the exposure of all banks relative to capital has declined appreciably -- back to about 1980 ratios for the 24 largest U.S. banks, and less than in 1977, when the figures were first collected, for smaller U.S. banks. Reasonable projections suggest that encouraging trend should continue, even assuming moderate amounts of net new lending.

But there is another -- and possibly disturbing -- implication that can be drawn from the data. Reduced relative exposure is healthy from the standpoint of the stability of the banking system, and no one is interested in seeing a return to the excesses of the 1970s and early 1980s. But, as things now stand, some part of the publicized new money packages appears to have been offset by leakages elsewhere. Maintenance of necessary amounts of trade financing, and in time some restoration of voluntary lending, are logical and reasonable parts of "phase two," when justified <u>both</u> by effective policies by the borrowing countries and by declining relative exposures.

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In all of this, I don't think we should lose sight of the fact that it is the leaders in the borrowing countries themselves, faced with larger and potentially more unruly constituencies than any bank, that have assumed the heaviest burden of adjustment. Of course, we know -- and they are acting on the fundamental premise -- that those adjustments are necessary if their nations are to grow and even flourish as part of the world economic community. Countries like Mexico, Brazil, Venezuela, and others have convincingly demonstrated a capacity to adjust -- short-term. Others appear to be addressing their problems with a fresh sense of urgency. Those necessary efforts should not fail for lack of understanding by creditors and others.

The short-term success of many in better balancing their external accounts can only be a prelude to the more basic objective of achieving some fundamental structural changes in the economy -- a process that is inevitably more time consuming, more complex, and less dramatic.

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It is inherently a politically sensitive area because it sometimes challenges long-established modes for the conduct of government and business. Each country will have to find its own solutions, suited to its own traditions and perceived needs. Nevertheless, a few broad generalizations may be appropriate.

Economic success is dependent on respecting certain elements of what we call macro-economic policy -- disciplined fiscal and monetary policies, appropriate exchange rates, and flexible pricing policies. That is a familiar and essential lesson for any country -- including, as we well know, the United States. The difference for some of the large borrowers is that the adjustments needed and underway are, in relative terms, huge. That implies both a difficult economic transition and political challenge.

More subtle, but equally important over time, will be measures to enhance the efficiency and flexibility of their economies. That carries the strong implication of more

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competition, more market-oriented economic systems, and more "openness" at home and in external trade. For all its benefits, it is a difficult process for countries long operating under a different presumption, with relatively large public sectors and a high degree of governmental direction in the allocation of resources. Some borrowing countries already have relatively strong and dynamic private sectors; others are moving in a constructive direction; some have not really made the necessary commitment, intellectually or politically. All will need encouragement and assistance -- in their interest and ours.

Governments in the industrialized world can contribute most to that effort by keeping the external economic environment hospitable. We can also help bring the developing countries more fully into a multilateral world trading system through a new round of GATT negotiations or otherwise. The recent bilateral agreement with Mexico dealing with subsidies is one small but promising step

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in that direction. We must support and adequately fund the multilateral lending organizations -- including, in the case of the United States, keeping abreast of past commitments.

But private institutions have a role to play as well. How could it be otherwise when they have so much at stake financially, and when the whole premise of the effort is that open market economies can work -- and work better and more effectively than any alternative?

In concrete terms, that means to me no retreat from the constructive cooperation of the past. Some strong adjustment programs will continue to require broad participation in well-conceived transitional lending programs. As justified by circumstances, long-term restructurings at reasonable spreads can help stabilize prospects for both lender and borrower. Trade lines need to be maintained. Patience will be needed -- and justified if and when strong adjustment programs are being developed.

In the end, we will be able to see success as it comes. We will see it most fundamentally when the borrowing countries

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succeed in restoring the confidence of their own citizens, and those citizens willingly employ more of their own capital productively at home. Foreign business and direct investment will be attracted, helping in the process to meet remaining external financing needs. And at that point, some banks, with their relative exposure much reduced, will be interested in resuming voluntary lending instead of reluctantly standing by for a call from an advisory group.

Then maybe, someday, we can meet again to exchange views on the temptations of over-lending!

I know we're a long way from there. But it's not an impossible dream.

You, in fact, have an enormous stake in making it possible. You have demonstrated that reality in the unprecedented efforts of the past few years. The effort is still incomplete. But surely there have been enough constructive results to mandate that we carry through.

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