U.S. sets policy for Tokyo summit

Treasury, State propose IMF surveillance over U.S. economy

A secret memo now in preparation in the U.S. Treasury and State Departments, under the overall direction of Treasury Secretary W. Michael Blumenthal, Treasury Undersecretary Anthony Solomon and Undersecretary of State Richard Cooper, calls on the United States and other industrial nations to surrender themselves to the International Monetary Fund's "surveillance" powers.

Sections of the memo, obtained exclusively by *Executive Intelligence Review* and reprinted below, call for "countries (to) respond to IMF advice and the surveillance process in a more timely and regularized fashion." That is, as an aid to Undersecretary Cooper explained, "report to the IMF weekly and monthly and not only after they're in trouble." The U.S. Treasury and State Departments, said the aid, support IMF surveillance over the United States because "we do things right the way the IMF wants, anyway."

The memo, which outlines the U.S. position for the upcoming heads of state Economic Summit in Tokyo on June 25, only makes more pointed what has been stated quite openly by Treasury and other monetary and economic officials in a spate of recent speeches—notably by Undersecretary Solomon in his remarks to an international trade and investment conference in Washington, D.C. on May 11. Solomon said: "The IMF has been given potentially important powers of surveillance and advice not only over member countries' exchange arrangements, but over their domestic economic policies as those policies relate to the international adjustment process."

As Solomon made certain to emphasize, IMF surveillance entails not mere supervision of currency rate matters narrowly conceived, but full monitoring of and control over national economic and monetary policies. This includes the application of the IMF's "balance of payments" formula hitherto reserved for "problem countries" like Turkey and Peru on a global scale to deficit and surplus countries alike, and strict supervision of future private bank lending to developing sector countries by the IMF in coordination with national central banks. The essence of the U.S. Treasury supported plan is the full realization of the proposal authored and promoted throughout the 1930s and 1940s by British economist John Maynard Keynes, the father of the IMF, for placing the economies of the advanced and developing sector under the rule of one world central bank.

A senior Japanese official shed some light in a recent interview on the sudden urgency with which Solomon and others are moving to push through their proposals. He described the European Monetary System policy for expanding advanced sector industrial exports to the Third World as the alternative to IMF austerity. The Japanese Ministry for International Trade and Industry (MITI), in fact, has recently drafted a proposal for the formation of joint Japanese-European banking consortia which would finance Third World imports of industrial goods and development.

The official also confirmed that the U.S. position at the Tokyo summit will be surveillance and dollar substitution—the IMF proposal to take dollars out of circulation and substitute special drawing right (SDR)-denominated assets under full control of the IMF. He predicted that there would not be an open confrontation over IMF policies at the summit, however, despite continued opposition to those policies by pro-EMS forces.

The secret memo

A former Treasury official who is again advising the Treasury on international monetary issues disclosed last week that the secret memo recommends that IMF Managing Director Jacques de Larosiere assume direct command over the IMF surveillance. He is to go over the heads of the IMF country directors, whose residual attachment to national interest might interfere with the formulation of supranational austerity policies. The source also revealed that the IMF already has plans to dispatch surveillance teams to 80 countries over the next two months for on-site studies for future loan "conditionality." He went on to stress that the crucial issue is not establishing IMF policy over the U.S. economy per se, but throwing the political weight of the United States behind the institution.

Jurek Martin, the U.S. editor of the *Financial Times* of London, is thinking along the same lines. In an article titled "The International Monetary Fund, A

More Human Face," in the *Times*'s "World Banking" survey May 21, Martin cited the Carter Administration's decision to draw on its credit line with the IMF as part of the Nov. 1 dollar support package as "perhaps the greatest testament to date of the institution's new weight." The loan did not carry conditions because the U.S. was only borrowing funds that it had placed in the IMF itself. However, the imposition of IMF conditionality on the U.S. and all advanced sector nations is by all predictions the proposal the U.S. Treasury team plans to place on the table at the upcoming Tokyo summit. Another informed source said that the strategy of the Treasury group is to have the IMF begin putting outside pressure on the U.S. to adopt austerity measures.

Of equal concern to U.S. monetary officials and their British mentors is the reluctance of forces in other industrial nations to go along with the IMF's world monetary order. In the interview printed below, Undersecretary Cooper's aide also complains bitterly about the "independence" of countries like Japan and West Germany and discloses that IMF surveillance is directed equally against surplus countries like them. The IMF is seeking to force those countries to reduce their surpluses by de-emphasizing industrial exports to the developing countries and the rest of the world in favor of reorienting their economies and banking systems toward services and consumer goods and speculative, secondary financial markets.

The Keynesian world central bank strategy, including its anti-Japanese and anti-European features, was laid out in Anthony Solomon's May 11 speech in Washington. Solomon learned his economics at Harvard from Professor John Kenneth Galbraith, the dean of American Keynesians. Galbraith later launched Solomon on his government career in the early 1960s, when Solomon joined the Kennedy Administration's State Department and first met and became friends with another former State Department official, Treasury Secretary Blumenthal.

As sub-features of the activation of the IMF's "potentially important powers" to set national economic and monetary policy, Solomon called for *(1)* the imposition of "strong management controls" by national banking authorities like the U.S. Federal Reserve over the international lending activities of private banks, including imposing reserve requirements on their Euro-currency deposits, and *(2)* an expanded role for currencies besides the dollar in international lending—while the world moves to the SDR standard—together with a "liberalization" of other nations' financial and capital markets.

The first point—the need for greater controls on the Eurodollar market—is a popular theme currently. It was also sounded by Federal Reserve Board Governor Henry Wallich at the annual convention of the Bankers Association for Foreign Trade in Florida in mid-May. Solomon and Wallich's efforts to increase central bank supervision over private banks to ensure that banks limit exposure to "problem countries," diversify their banking portfolios, maintain adequate loan to capital ratios, and so forth are actually part of the strategy to restrict private, non-IMF credit flows to developing nations, making them entirely dependent on the IMF.

Moreover, as the head of Chase International's London office admitted in print recently, the recent flurry of calls for increased regulation of the Eurodollar market are directed against "newcomers"—the Japanese and West German banks—who are making low interest rate loans and depressing the interest rate margins of U.S. banks.

Solomon's complaint that "other countries" have been reluctant "to open their money and capital markets" is a statement of intent to break up the close relationship which has existed between banking and industry in Japan and West Germany in particular during the postwar period—and which made the growth of their economies possible. Japan recently was induced to open up a market for certificates of deposit which is expected to shift Japan's capital markets to the short-term side—away from long-term industrial loans.

Earlier this spring West German Economics Minister Otto Graf von Lambsdorff, a pan-Europeanist and avid supporter of supranational institutions like the IMF, rocked the German banking community by calling for a 15 percent limit on a bank's ownership of a nonbank company and an effective end to West Germany's unique system of universal banking, in which commercial and investment banking are not separated as they are in the U.S. and Great Britain. The restructuring and streamlining of capital markets and national banking systems now on the agenda in Japan, West Germany, France, and the U.S. is one of the prerequisites for the elevation of the IMF.

—*Lydia Schulman*

Treasury-State secret memo leaked

In an interview with a New York banking source, an aide to Undersecretary of State Richard Cooper leaked the existence of a secret three-part Treasury-State Department memo on the imposition of reserve requirements on the Eurocurrency markets. Taking credit for its contents, the aide commented that the memo, prepared by Lysle Widman (Treasury Undersecretary Anthony Solomon's subordinate Deputy Assistant Secretary for International Monetary Affairs) was "so poorly written that I had to rewrite most of it." Here are some comments from that interview,

Q: *What is the burden of the U.S. paper?*
A: Let's see—well I had to really beef up the part on

the importance of the IMF. You know we strongly support IMF surveillance because we do things right, the way the IMF wants anyway, and it would be Japan and Germany who have these God-awful payments imbalances who would bear the brunt of the IMF's pressure. The IMF would force them to cut the surpluses. The paper says: "Exchange rate stability can only be implemented through stable underlying economic conditions...." subhead: "Evolution of the System." ... "The IMF is continuing to implement its surveillance authority and the review of its success will take place at the end of this year. It is imperative that the IMF develop techniques to exercise surveillance over countries in surplus as well as those in deficit.... We must strengthen the IMF as an institution ... as countries respond to IMF advice and the surveillance process in a more timely and regularized fashion.... This strengthening of surveillance activities will enable the IMF and its member countries to identify problems earlier...."

This means, you see, that countries will report to the IMF weekly and monthly and not only after they're already in trouble: "this will remove the stigma now attached to approaching the IMF ... and create a Distant Early Warning system. ... Aas part of the evolution of the international monetary system the IMF members are working to enhance the role of the SDR. ... The Substitution Account is an integral part of this process and should be seriously considered...."

Q: *What does the Japanese paper say?*
A: Oh, nothing at all: "Convergence of economic fundamentals ..."; "Cooperation in exchange market policies ..."; "Asset Diversification ..." That means they will fight attempts to make the yen a reserve currency, even if it means they will give lip service to supporting the Substitution Account, which they will although they're not much in favor of it.

And of course they end with the mandatory paragraph saying "We must strengthen the role of the IMF."

The U.S. Treasury to the IMF: 'Come 'n' get it'

Excerpted here at some length are remarks by Anthony M. Solomon, Undersecretary of the Treasure for Monetary Affairs before
tional Trade and Investment Conference May 11:

You have asked, "will the current international monetary system serve the future international trade and investment environment."

My answer is—in the short run—"yes," fundamental changes have been introduced in recent years which give us more workable monetary and credit arrangements. But in the longer run, the present system will not necessarily meet future needs....

First is a cluster of concerns about the operations of the international banking and credit system, and particularly the Eurocurrency market. Does it provide adequate credit, or too much? Is it aiding international adjustment or retarding it? Is the market adequately supervised, or is there a risk of imprudent banking practices?...

...The marked expansion of the Eurocurrency market in recent years is often viewed with awe and apprehension. Some favor greater official action to bring the market under tighter control.

...In part, the comparative advantages of the Euromarket are attributable to clear financial incentives. There are no reserve requirements, no interest rate ceilings, and no credit controls....

...The growth of the market has given rise to a persistent debate: whether it is an engine of excessive credit creation which aggravates world inflation, or essentially a highly efficient intermediary reallocating funds from lenders to borrowers....

The economic problem is to allocate funds from surplus to deficit countries. But in the process we must be sure that these flows do not overburden the financial institutions or threaten the banking system generally. The prospect of continuing growth makes it all the more important that national authorities have adequate information and exercise adequate control and surveillance over the operations of banks in the market.

In recent years, the U.S. banking authorities—the Comptroller of the Currency, the Federal Reserve, and the FDIC—have taken a number of steps to improve the supervision of foreign lending by U.S. banks—including the operations of their branches in the Euromarket. The new approach is designed to promote appropriate diversification of bank portfolios and to avoid excessive concentration of lending relative to a bank's capital position....

...There has been a significant expansion in the amount of information collected through the Bank for International Settlements, and new efforts are underway. The central banks of all major countries meet regularly through the BIS, at the policy level, to exchange views on Euromarket developments and to discuss supervisory techniques. These efforts are being strengthened.

Second is a concern that the large stock of dollars in foreign hands, private and official, is destabilizing, and that the international role of the dollar should be reduced in the future in order to achieve greater stability in the international monetary system....

The concern is whether the existence of large dollar balances constitutes an important source of instability in the international monetary system. Particularly in the light of the exchange market instability of recent years and the heightened perception that external developments do make a difference to the United States, this concern has given rise to various proposals—for funding or consolidating foreign official dollar holdings, for increasing the role of the SDR in the system, and for placing greater reliance on other currencies, such as the deutschemark and the Japanese yen, in international financial transactions and reserves. ....

Consequently, the effort to strengthen the role of the SDR—and as part of that effort, discussion of a possible substitution account in the IMF—should be seen as part of a long-term evolution of the system, an evolution which holds out an ultimate prospect of greater order and stability, but which is not directed to the immediate market situation.

I should stress that in this examination of structural changes in the international monetary system, the U.S. objective is not to perpetuate a particular international role for the dollar. The dollar's present role is itself the product of an evolutionary process—a process that will continue, and that may bring a reduction in the dollar's relative role in the future. Indeed, some of the main factors in the evolution of the dollar's role would appear to suggest some gradual reduction....

Third, and in my judgment most important, is a concern that our arrangements for international coordination of economic policy may not keep up with the demands of an increasingly interdependent world....

In short, the benefits of greater interdependence have come at the price of greater exposure and vulnerability to events elsewhere in the world. One practical implication of greater interdependence is greater constraint on national policy formulation. Today all governments are constrained to take account of the effects of their policies on others; to factor external developments into domestic policy formulation; and to maintain consistency between their international economic objectives and their domestic economic performance....

...We have over the years developed a variety of organizations to facilitate international cooperation in many fields. The OECD has served as a forum for discussion among the industrial countries of economic policies and balance of payments developments. The IMF has traditionally consulted with member countries on broad economic policies, and has been given important new potential for expression of policy advice. The economic summits have opened a new range of possibilities for coordination at the highest level among the largest countries.

...Evolution of the IMF's surveillance role will provide a test. The IMF has been given potentially important powers of surveillance and advice not only over member countries' exchange arrangements, but over their domestic economic policies as those policies relate to the international adjustment process. These provisions afford a framework that can be developed to provide a practical vehicle for policy coordination—if governments are prepared to give the Fund the necessary power and influence...

Blumenthal, Javits stage 'debate' on SDR funny money

During his testimony before the International Economic Policy Subcommittee of the Senate Foreign Relations Committee on May 22, Secretary Treasurer Michael Blumenthal revealed his intent to hand the U.S. economy over to the IMF in the following short exchange with Senator Jacob Javits.

Blumenthal: ... In the postwar Bretton Woods system, the U.S. was central because the U.S. economy was the pre-eminent economy in the world. This is unlikely to be duplicated again. ... The transformation of the world monetary system at this point is going on a process of ad hockery. Very important to this ad hoc transformation has been the institutionalization of a number of forums ... the yearly summits, the IEA, the meetings of the IMF-World Bank, the meetings of the Bank for International Settlements, UNCTAD, etc. ...

Javits: Is it U.S. policy to seek to substitute for the Bretton Woods system an SDR system dependent on the IMF to make through the SDR the same basis of the international monetary system that the dollar is today?

Blumenthal: You have put it more boldly than I would like to put it. It is the policy for the U.S. to cooperate with other members of the IMF to explore ways for the evolution of the international monetary system to take account of the changing role of other countries and their currencies' relation to that of the dollar. The role of the SDR is to be more important gradually. The substitution in account is a way to promote the use of SDRs. ... We are talking about a relatively long-term transformation over a number of years which we want to promote.

Javits: If we can get Japan, France, BRD, and the U.S. to demonstrate an increased interest through the international financial institutions in the LDCs, that will stimulate more private enterprise to seek investment there. Now that the IMF has proven itself over the years to be able to manage the flow of credit to the LDCs in a responsible way, I think the institution should be given the support necessary to concentrate on development in the LDCs.