IMF Interim Committee:

U.S. Impotence, European Incompetence

SPECIAL REPORT

International Monetary Fund Managing Director Johannes Witteveen's claim at a press conference April 29 that his proposed multi-billion dollar kitty for financing payments imbalances would be operational by next summer represented a conscious lie. In fact, within minutes after Witteveen made this claim in response to a direct question, a senior American official, Undersecretary of the Treasury Anthony Solomon, fumblingly contradicted Witteveen. Solomon told reporters that the summer deadline is impossible given the need for Congressional appropriation of the American contribution to the so-called Witteveen Facility, and insisted that Witteveen could only have meant agreement in principle.

Witteveen's extraordinary performance, which probably did more to tarnish the IMF's shopworn credibility than any other declaration in the course of the two-day meeting of the IMF's Interim Committee last week, nonetheless had a specific motivation. A senior Witteven aide explained privately that the Fund was trying to manage "a short-term, emergency situation," and that the money would be "useless" if the operation of the facility, which Witteveen hoped would come to SDR 16 billion, were put off very far into the future. High-level IMF, World Bank and U.S. Federal Reserve officials, who were at pains to put the best possible front on the situation, nonetheless said they hoped for actual lending through the facility by the end of this year.

These officials described the operational problem in the world monetary situation as one of "confidence," adding, in the words of a senior member of the U.S. delegation, that "the certainty of having additional funds six to eight months from now would permit us to spend the resources we have now in the intervening period."

If creating a patina of "certainty" and "confidence" was the American objective at the Interim Committee meeting, nothing remotely resembling this emerged. But if the American and IMF staff position failed, despite Mr. Witteveen's attempt to represent things otherwise, it is equally doubtful if anybody gained. The members of several European delegations freely predicted that without the infusion of the IMF's SDR 15 billion into the accounts of Third World and other debtor countries, the Eurodollar market and the most-exposed American banks would not survive the end of the Third quarter of 1977. Several European officials complained privately that their governments, some of which are supporting the U.S. position and some stolidly blocking it, have not yet faced up to the reality of the situation.

The breakdown of negotiating positions around the Witteveen Facility is as follows:

Half of the proposed facility must come from the cash-rich oil-producing countries if the Europeans are to contribute, under the terms of the agreement reached April 19 among the finance ministers of the nine member-nations of the European Community. This condition was dictated by West Germany, the only European country with the financial resources to contribute in the first place. "The Germans are absolutely serious, they are not posturing" about their demand that the Arabs give half the money before they contribute anything. Virtually no progress was reached during the Interim Committee negotiations themselves, according to a senior member of the West German delegation, who said, "We have only just begun the negotiations, and it is impossible to say at this point how long it will be before the (Witteveen) facility becomes operational."

The Saudi Arabians, who hold the key to the success of the facility, were represented at the Interim Committee meeting in virtual observer status, with a low-level delegation that did not have authority to speak for their government. Previously, the Saudis ignored Managing Director Witteveen's request to state their attitude towards his proposed SDR 15 billion facility.

In an interview with Ray Vicker of the *Wall Street Journal* published Friday, the Saudi Finance Minister indicated that the Saudis were willing to make some contribution to the IMF, but not nearly in the range of the $4 billion handout they must give if OPEC is to make up half of the total funds. This official Saudi view is corroborated by Western observers of Saudi affairs, who doubt whether the Saudis will part with this portion of their reserves. In addition, the Saudi Finance Minister disputed some Western claims that Saudi financial reserves are in the range of $55 billion, half again as high as the Saudis themselves report, and warned that the Saudis intended to reduce their payments surplus sharply by spending money on infrastructural and industrial development.

In effect, the Saudis have triggered an automatic West German refusal to contribute to the Witteveen facility. In addition, the West Germans have thrown a number of objections, often contradictory ones, in the way of the bailout plan. German Bundesbank Deputy Director Otmar Emminger told the French daily *Le Monde* before he left for Washington that a large part of the world problem of payments deficits must be attributed to American oil imports, which heavily contributed to the OPEC oil surplus. The logic of Emminger's statement might seem to indicate West German sympathy for the Carter Administration's energy "conservation" program, which is very far from the case. West German Finance Minister Hans Apel, who represented West Germany at the Interim Committee meeting, demanded that the Witteveen Facility not make loans without the type of strict austerity conditions the IMF demands in return for loans through its usual channels. This seems to contradict the basic West German interest — industrial exports — in financing Third World and weaker OECD countries, since IMF austerity conditions invariably reduce the imports of the debtor country.

Underlying West Germany's hostility to the IMF fund is an extremely clear perception that the Witteveen Facility has no particular relation to levels of world output and trade, and is exclusively directed toward refinancing the illiquid Eurodollar banks. A senior IMF official admitted, "The situation hasn't been helped by Arthur Burns's statement (at Columbia University April 12 - ed.) linking the IMF to the problems of private banks." The size of the proposed facility is roughly equal to the $17 billion amortization payments coming due this year from Third World countries, principally during the second and third quarters. Full expenditure of the Witteveen facility would probably not even touch the merchandise trade portion of the current account deficits of LDC's and weaker OECD countries, but would be absorbed entirely into debt-service. Privately, World Bank officials are talking of an $8 billion reduction in Third World imports, a figure several times larger than the economists of Chase Manhattan believe is physically possible (and Chase Manhattan has just as strong a motivation as the World Bank to want to reduce Third World imports). The adoption of the SDR 15 billion Witteveen facility would involve a sharp net reduction of Third World trade, and thence West German exports.

The perception of other Western European governments is less lucid. Among the EEC nations, the antipode to the West Germans' hostility to the Witteveen plan is Britain's "total enthusiasm" for it. British Chancellor of the Exchequer Denis Healey went so far in his press conference Friday morning as to lend his credibility to that of Mr. Witteveen, and predict an operational facility by the summer. The central element in current British thinking is demoralization. Their close cooperation with the U.S. authorities and the IMF staff stems from a belief that the world economic outlook will be wretched for at least the next two years *no matter what course of action world leaders take* — something that no government will admit as a matter of record, but which permeates British official thinking. Resigned, the British are playing for a "margin" of growth and output and trade which will enable them to get through an already bad situation. They are hopeful, but not blindly so, that additional financing through the IMF can give them such a margin.

To the outsider, this attitude seems in line with Britain's long tradition of using their financial cleverness to outsmart themselves on policy issues. Possibly the fact that the Callaghan government's survival appears to depend on percentage-point margins in current pay negotiations with the trade unions defines a context for this view. Reality is nonetheless bearing in on British policy. Nothing has upset the British Treasury's marginal calculations of world-economic effects on Britain so much as consideration of the impact of the Carter energy program on the world's biggest economy.

The Denouement

During the next several weeks IMF officials will go out of their way to represent the Interim Committee meeting's limp endorsement of the Witteveen facility as a fait accompli, while the West Germans and other opponents of the facility will go out of their way to do and say nothing definitive. All indications are that no progress on the bailout plan will emerge, judging from the internal contents of the IC's published decisions:

"Open-Endedness:" A major concern of IMF staff was to establish the facility as "open-ended," i.e., that contributions could be spent as soon as they came in, rather than wait for the entire SDR 15 billion to be assembled. Witteveen indicated in his press conference Friday, however, that no such "open-endedness" had been agreed upon. Since the three main contributors in any case would be West Germany, Saudi Arabia, and the U.S., any such arrangement would be unlikely, since the first two will not contribute until the U.S. Congress appropriates the U.S. portion. (Several Congressional sources in leading positions indicated they foresaw a grueling battle before an appropriation for the IMF could be passed, if it could be passed at all.)

QUOTAS: Under the 6th review of quotas (the contributions of members that make up most of the IMF's resources) the IMF is scheduled to get an additional $11 billion, putting its total resources at $43 billion. This increase is now stalled in the French national assembly and elsewhere. The U.S. Administration, through Assistant Secretary of Treasury C. Fred Bergsten, has proposed doubling quotas to $86 billion, a proposal which the West Germans, Japanese and others oppose outright. IMF officials had hoped for some preliminary agreement on this issue at last week's Interim Committee meeting, on the grounds that the outcome of this issue would show how fast countries would be willing to make up the Witteveen Facility. But the Interim Committee meeting postponed the issue entirely until next year.

SAFETY NET: Japan warned that it could not consider participation in the Witteveen Facility until the disposition of the 1974 "safety net" plan for a $25 billion fund among the OECD countries had been settled. But the safety net issue was also tabled until next year.

EXCHANGE RATES SURVEILLANCE: Although Witteveen claimed that an "agreement on principle and operation" had been reached on giving the IMF gendarme powers to monitor exchange rates of member countries, senior IMF officials admit that they have no muscle to dictate rates to erring members, and will not have for the forseeable future. Disbelieving U.S. reporters asked Undersecretary Solomon whether the U.S. would bring (for example) Japan before the IMF board if it thought the Japanese were unfairly manipulating their exchange rate. Solomon unconvincingly answered, "Yes."

But the problems still to be faced are absolutely glaring. Peru will probably default by $250 million by the middle of May. Mexico will probably default on about $3 billion of amortization payments during the fourth quarter. One senior European official predicts that capital flight from France will force a French default later this year. Big debtors, including Egypt, Zaire, and Indonesia are already in default. Without an official refinancing capability of the magnitude of the proposed Witteveen Facility, the monetary system will break down sometime this year, probably no later than the end of the third quarter, possibly much earlier.

A European central banker attending the meeting warned that a confluence of defaults in the order of magnitude of $10 billion could create a panic, and "empty the Eurodollar market of $50 billion in deposits within two days." European governments, he complained bitterly, were "falsely optimistic," refusing to come to grips with the severity of the monetary situation.

Most of the burden of decision is on the West Germans. They do not have much time to decide whether they will patch together the U.S. private banking structure with their own hide, or find other ways of doing business.

— David Goldman

Japan Pushes Yen-Based Trade As Shield Against Eurodollar Crises

FOREIGN EXCHANGE

According to Japanese banking circles, the guiding feature in international financial policy at present among Japanese banks, the Bank of Japan, and the Finance Ministry is to shield Japan against the effects of what they see as a very possible Eurodollar crisis this year. One aspect of that shielding is Japan's steadfast resistance to the International Monetary Fund-Witteveen plan and similar proposals aimed at Japan's taking on some of the developing sector's insecure dollar debt.

Japanese banks are also now beginning to reduce significantly their dollar liabilities, which are presently estimated unofficially to be $30 billion. The means chosen by Japan's authorities to effect this reduction is shifting Japan's trade financing from dollars to yen. At present, 95 percent of Japan's imports and 75-80 percent of exports are financed in dollars, the rest in yen.

Seeking Protection

This policy and its motivation were revealed in a front page leak to the *Asahi Evening News* on April 23, in itself a striking development since the Japanese usually like to conceal their motives. According to the leak, the Finance Ministry welcomes the shift to yen-based trade and will aid it, "considering the reliance upon the dollar as a vestige of the past. . . . It is also concerned about the huge dollar-based external indebtedness of Japanese foreign exchange banks which could deal a tremendous blow to the national economy in the event of a credit crisis somewhere in the world."

Most of Japan's $30 billion external dollar debt is short-term debt, in which the principal is continually carried over and interest payments are maintained. Japanese bankers are worried that if a developing country defaults and advanced-sector bank failures produce tightness on the Eurodollar market, then the Japanese would find their existing loans called in, and have great difficulty in obtaining new loans. One Japanese banker reported that there is fear in Tokyo that such a situation might bring down one of the large Japanese international banks. Another recalled with a sudder the post-Herstatt bankruptcy situation in the summer of 1974 when he had to submit to 16 percent interest rates.

The strategy for reducing dollar liabilities is to shift trade from dollar financing to yen financing. When the Bank of Japan (BOJ) cut the interest rate two weeks ago, the cost of borrowing yen dropped below the cost of borrowing dollars for short-term trade purposes. Thus trading companies shifted to borrowing yen and then going into the foreign exchange markets to purchase dollars to pay for imports. This process would tend to continually lower the value of the yen except for the fact that the Bank of Japan now enjoys record high foreign reserves — up to $16.5 billion from about $12.5 billion in November 1975. The BOJ can release these reserves to the Japanese banks which in turn supply the foreign exchange markets. However, this can continue without unduly draining the reserves only so long as Japan continues to maintain a high balance of payments surplus, a very short-term prospect.

Therefore, as a more fundamental policy the financial authorities are now urging actual payments for imports and exports in yen rather than in dollars. According to banking sources, the countries from whom Japan buys have so far been reluctant to accept payments in yen. However, these same sources felt that OPEC and the Southeast Asian countries were likely to change their view in the near future. The sources noted that these countries have sharply increased their holdings of Japanese government yen bonds as foreign exchange reserves. Total holdings of yen bonds by foreigners amounted to $3.6 billion in September 1976 of which $2 billion was held by OPEC and the Asian countries. By December the level had risen to $4.4 billion and by the end of January to $5.0 billion (all unofficial estimates). The level steadied in February and March but there was another big purchase by Arab countries following the discount rate cut. As these countries increasingly use the yen as a reserve to hedge against a depreciating dollar, it is likely that they will then want to accept yen in payment. During the dollar crisis of the summer of 1973, the governments of Saudi Arabia and Abu Dhabi *initiated* discussions with Japan's International Trade Minister Yasuhiro Nakasone regarding yen payments for oil.