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receive prime attention in the deliberations on a third KWG (Kreditwesengesetz = Banking Act) amendment foreshadowed for the next legislative period. Besides, the international cooperation should be extended and intensified.

The object of all these reflections, whether concerned with monetary policy or with bank supervision, is not to curtail the freedom of the international financial markets. These markets are

serving a useful economic purpose as they have proved more than once. Nor is it their object to relieve the banks of their own responsibilities. On the contrary, we trust that the banks will in their own and the general interest be able to arrive at a correct assessment of the risks springing from their transactions abroad and to keep them within controllable dimensions. Only the weak points which may spell trouble for monetary policy and the international credit system need the pruning-knife.

Do the Euromarkets Need Controlling?

by Wilfried Guth, Frankfurt*

It is remarkable that at the annual meeting of the World Bank and the International Monetary Fund in Belgrade last autumn, not one of the prominent spokesmen of governments, central banks and international institutions except Finance Minister Matthöfer of the Federal Republic of Germany touched on the problem of "control" over the Euromarkets. Instead they all stressed that the impending extensive tasks of financing and recycling in the world cannot be accomplished without a substantial contribution by the private markets. What a difference from last spring! After the second oil shock and the attendant changes in the international economic outlook, great care will clearly have to be taken if and when new regulatory measures are initiated. Otherwise the undeniable advantages of the Euromarkets for the balancing of international accounts will be lost.

What then is the purpose of this Euromarket "control" as it is called? At first sight, the term itself seems inappropriate in two ways: for one thing, because it is often associated with dirigistic interference by the authorities with the market mechanism – a policy which is certainly not intended; for another, because it suggests that the Euromarket – or, to be more precise, the *Eurobanking* market which the discussion is about – has "got out of control", as if

it were in fact some kind of "uncontrolled" jungle growth. Neither is true. So far at any rate, the Euromoney and Eurocredit markets have been working smoothly on the basis of self-discipline and responsible policies of the participating banks. Moreover, there exists an extensive network of – albeit diverse – regulations by national supervisory authorities in the home countries of the international banks as well as in the foreign Euromarket centres where they have set up their branches and subsidiaries.

The – rather nondescript – catchword "Euromarket control" does however serve to remind us of the fact that there are a variety of causes for the unease about the Euromarket's rapid growth in recent years and that by the same token a variety of remedies are being suggested.

First of all, there is a wish for more *transparence*, for more information about this transnational market with its special forms of lending and refinancing, of debtor and creditor structures and its specific risks which are accentuated by the absence of a formal official lender of last resort. This wish is widespread and understandable and fully supported by the banks.

Yet, greater transparence alone is incapable of preventing the possible undesirable side-effects of rapid Euromarket expansion which are causing concern and giving rise to calls for "controls". The emphasis here is on three aspects:

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- ☐ the danger of inflationist tendencies in the world being reinforced;
- ☐ the question of the soundness of the banks engaging in Eurobusiness;
- ☐ the problem posed by delays in necessary balance of payments adjustments by individual debtor countries through recourse to the market, i. e. to credits with no stabilization strings attached.

A Potentially Disruptive Factor?

The idea of introducing *minimum reserve* requirements for Eurodeposits as a means of *actively* influencing the market has been raised and is being pursued especially in US American quarters. The advocates of such credit policy measures are mainly concerned about any possible destabilizing macro-economic effects of the banks' Euromarket activities on price levels, exchange rates and balance of payments discipline. The Eurobanking market is held to constitute a potentially disruptive factor for the control of domestic money supply, especially by the monetary authorities of the USA and the Federal Republic, which rely on interest-free minimum reserves as a principal instrument of their national monetary policies and abstain from controls on international capital movements.

Whether the Euromarket is in itself a source of inflation – that is, the question of its independent credit and money creating capacity – is disputed. To my mind the arguments of the protagonists of the inflation thesis are not conclusive. It is however commonly agreed that the ultimate cause of undesirable developments and distortions in the international monetary sphere – including the inordinate expansion of Euromarket liquidity – is to be found in the lack of discipline in the domestic economic, financial and monetary policies of the major industrialized countries. The requisite stabilization efforts must be applied to the national causes and not to the symptoms, i. e. the expansion of the international financial markets.

The plans for uniform mandatory minimum reserve requirements would hardly seem viable. A broad international agreement such as is needed to rule out a diversion of Eurocurrency business to unregulated markets is probably beyond reach. Even if it could be attained, there would still be the substantive and institutional problem of settling by whom and according to which criteria necessary changes of reserve ratios should be decided.

The efforts for internationally coordinated effective *surveillance* of the Eurobanks by the bank supervisory authorities as pursued for quite some time through the Cooke Committee at the Bank for International Settlements seem to me more appropriate and more realistic. They envisage, in essence, a general obligation for international banks to present consolidated accounts and the introduction of coordinated solvency and liquidity regulations, including in particular minimum ratios of equity capital to lendings as prescribed for instance in Principle 1 of the German Banking Act (Kreditwesengesetz).

In view of the differences between the business and capital structures of the Eurobanks, between national accounting practices and also with regard to the criteria and standards applied hitherto by the various supervisory bodies, implementation of these plans is undoubtedly difficult. At any rate, great care must be taken to avoid a distortion of the competitive conditions through new prudential provisions which, in my opinion, can only relate to *global* balance-sheet ratios. Official classification of country risks, for example, would be scarcely conceivable – for political if for no other reasons.

Self-Discipline Important

Considerable time will thus probably elapse before plans of the described kind can be put into effect. It is all the more important that the international banks should exercise self-discipline and demonstrate their readiness to cooperate with their respective national supervisory bodies on a voluntary basis. The German banks have given evidence of such readiness, for instance in the gentlemen's agreement of 1978 by which they undertook to supply the Federal Supervisory Office and the Bundesbank voluntarily with additional information on the business activities of their foreign subsidiaries.

Whatever form the proposed improved prudential controls may eventually take, in the light of my earlier remarks care will have to be taken that they do not lead to a strangulation of the international financing system, e. g. through an overly restrictive interpretation of the requirements of sound banking. The Eurocurrency market is no isolated phenomenon, a trouble spot on the periphery so to speak. Through the commercial banks' growing involvement in balance of payments and development financing it has become an integral part of our international financing system – alongside the official sector and its institutions like the IMF and the World Bank.

From this – wider – perspective it is most important to obviate any exaggerations and unhealthy tendencies on the part of banks and debtors which might jeopardize a further harmonious development of the Euro-banking market. As regards the *banks*, the deterioration of terms and conditions in the market are giving cause for concern. Since the end of 1977 the lending spreads over the interbank offered rate and – perhaps more important – the differentials between borrowers of different credit quality have declined while the maturities of new Euroloans have progressively lengthened.

The introduction of coordinated equity capital ratios could perhaps help bring about a healthier trend, for this would compel all banks to fix the spreads on their Eurocredits with the need to service extra equity capital in mind. Presumably, therefore, such measures would also to some extent curb the expansion of Eurocurrency lending to other than first-class debtors who would in future have to rely more on the IMF to finance their payments deficits.

This – possible and desirable – effect of a global prudential limitation of the growth of bank credits will however not be sufficient to avert all possible threats to the market from the *debtor* side and to ensure the further sound development of the overall international financing system.

More Official Funds

The high oil prices and the economic slowdown in the world are imposing great additional balance of payments burdens on the non-oil developing countries. As distinct from the situation in 1973/74 it is to be assumed that many international banks are approaching their self-imposed lending limits for some already heavily indebted countries. Consequently, more *official* funds will have to be provided to cope with unavoidable balance of payments gaps and possibly also to refinance maturing roll-over credits to these countries. Adequate precautionary measures in the official system will also be called for to prevent disruptive chain reactions in the private markets which might be triggered off by a withdrawal of private loans due to a sudden worsening of a debtor country's political or economic situation.

Apart from such contingency provisions, there remains the fundamental question whether and how individual debtor countries can be kept more effectively than hitherto from unduly delaying necessary balance of payments adjustments by borrowing in the market. Unlike the IMF, the banks cannot make their credits

conditional on the borrowers' adjustment policies (although they do not engage in "unconditional" lending either and their debtors will normally endeavour to preserve their creditworthiness through responsible management of their external position). I therefore still believe that there is no alternative to the IMF making full use of its authority and bringing its weight to bear on debtor countries to this purpose as part of its important "surveillance" function with regard to member countries' exchange and fundamental stability policies.

Cooperation with the IMF

Until now cooperation between the IMF and the banks has been more or less confined to those problem cases where the banks linked their liquidity aid for debtors in payments difficulties to the country's compliance with the economic policy impositions of the IMF. A closer, more broadly based cooperation between the official sector and the banks would no doubt be desirable in the interest of the stability of our international financial system because, as I said, the financing tasks undertaken by the banks have made them a mainstay of the system. This is however easier said than done; despite intensive discussions (and except in the mentioned occasional problem cases) it has proved impossible so far to find reasonable solutions.

Institutionalized arrangements of any kind are certainly out of the question, and so it may be asked whether informal but regular exchanges of ideas between the IMF and the international banks might be of assistance as the provision of more information alone would not help much. But how can ideas be exchanged if the IMF feels obliged to refrain from expressing its own views? And what good would such exchanges be if for reasons of competition the banks will not tie their credits to certain debtors to compliance with IMF stipulations?

There is indeed no lack of questions awaiting an answer and it is certainly well worth the effort of giving more thought to possible ways and means to achieve a more extensive cooperation between the IMF and the banks. On the other hand, we may well find in the end that there are no meaningful opportunities for such cooperation in the framework of our free market system. In that case all those concerned would at least have to ensure by their vigilance that closer cooperation begins as soon as problems *threaten*, i. e. before a debtor country's external position has deteriorated to a near default situation.