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not imparted a greater degree of cohesion to US foreign economic policies. During the 1970s the US has shown increasing signs of a preoccupation with solely domestic objectives. This may be an inevitable feature of the transition to a new set of international economic relations created by the relative decline of the US.

As the duration of the transition cannot be predicted, it is necessary for Europe to seek a regional approach to its problems. But ephemeral policies ought not to be a characteristic of this approach. Europe can serve the interests of the world economy, as well as its own, by adopting policies and erecting institutional structures which aim at a new and durable monetary order. The evolution of the EMS along the lines suggested above would open the way for the eventual monetary unification of Europe. The economic advantages of such a development are generally accepted¹⁷. What is in dispute is the political feasibility of such an objective and the relative merits of alternative strategies towards monetary union¹⁸. The parallel currency approach, with its emphasis on price stability and predictability to ensure the success of the new money through the market, is certainly the most appealing. However, Europe may not be yet ready to effect such a radical change. But this is not an argument for neither preparing

nor working towards such an objective. If this argument were acceptable, then it would logically support the enhancement of the role of ECU and the creation of an independent EMF as desirable short-run objectives.

While the US searches to find its new role in the world economy, the prospects for a durable reform of the international monetary system are poor. Crucial to such a reform is the creation of a substitution account. The formulation of a common European policy could potentially facilitate negotiations with the US with the EMF playing a complementary role to the IMF part. An enhanced ECU, which eventually becomes available to non-member countries and with a value more predictable than that of the dollar, could erode the world position of the dollar and thus make a substitution account more acceptable to the US. Further, such a development would be welcomed by Third World countries who could hold this more stable asset. Of course, an element of competition with the SDR would be involved if such a course were to be pursued. However, this cannot be judged as undesirable given that the SDR will continue to be the poor relative in the system for as long as dollar balances remain the principal component of the stock of world foreign exchange reserves.

¹⁷ Cf., for example, the studies in: M. Fratianni, T. Peeters (eds.): *One Money for Europe*, 1978.

¹⁸ For a comprehensive discussion cf. R. Vaubel: *Strategies for Currency Unification*, Kieler Studien, No. 156, Tübingen 1978.

INTERNATIONAL MONETARY FUND

Should the IMF Resort to Private Credit Markets for Refinancing?

by Anton Konrad, Munich*

The International Monetary Fund is at present examining the possibility of borrowing on private capital markets in order to meet its growing refinancing needs. Reservations concerning such a step have been voiced in particular by the oil-importing developing countries. Professor Konrad analyses the pros and cons.

The second wave of oil price increases has dashed the hopes of an international balance of payments equilibrium between oil-exporting and oil-importing countries for some time to come. The OPEC countries' surplus in the payments balances on current account in 1980 (including private but not official transfers) amounted to \$ 112.2 billion and the figure not yet available for 1981 was estimated by the IMF to be \$ 96

billion¹. The corresponding figures for 1980 for the industrialised countries and the oil-importing developing countries record deficits to the tune of \$ 44.1 billion and \$ 82.1 billion respectively. The developing countries, however, did not partake of the international improvement emerging in 1981; their deficit in fact continued increasing. The balance of payments problem experienced by developing countries and

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¹ IMF, Annual Report, 1981, p. 18.

created by the rise in oil prices has been further aggravated by the upsurge in interest rates, a result of the fight against inflation in the industrialised countries, and by the fact that such interest rate increases met with a high and rapidly rising level of foreign indebtedness. This meant that the balances on current account were burdened by about \$ 30 billion. In addition, the high level of debts, put at \$ 450 billion for the end of 1980, necessitated further financing of about \$ 40 billion to cover debt rescheduling.

Deterioration of Debt Service Ratio

The international banks have up to now been bearing the brunt of financing current account deficits, their claims against the oil-importing developing countries reaching \$ 235 billion by 1980². The rapid increase in bank credits and their heavy concentration on a number of the more advanced developing countries whose dependence on oil imports is particularly great have, for some years, been kindling fears that the banks might, due to the high country risks involved, become more cautious in recycling petro-dollars. Further grounds for such behaviour could be discrepancies between the maturity periods of assets and liabilities, the rising share of loans which are not project-linked, the banks' insufficient equity capital and efforts by the authorities to gain greater control over the Euro-banks.

Events in 1980 appeared to confirm these fears for the first time, with long-term bank lendings to the oil-importing developing countries receding from \$ 32 billion in 1979 to \$ 24 billion despite rising current account deficits, forcing such countries to resort to currency reserves and official lendings³. Although the expansion of long-term bank lendings was resumed in 1981, there remains a deterioration in the maturity structure of debt. Together with the increased interest rates this led to a deterioration of the debt service ratio, which will undoubtedly have an adverse effect upon the

credit worthiness of individual countries on private capital markets. The fact that severe debt-servicing difficulties have up to now occurred only in exceptional cases is primarily due to the fact that the export earnings of oil-importing developing countries have also witnessed an inflationary expansion. Already, the low income developing countries have hardly any access to the capital markets and usually therefore depend on flows from official lenders.

Policy of Enlarged Access

The IMF tried to meet the increased demand for official balance of payments financing by means of the policy of enlarged access. Whereas the use of the credit tranches was originally restricted to 100 % of the quota, it was extended in May 1981 to an annual level of 150 % of the quota or 450 % over a three-year period. Cumulative borrowing can amount to 600 % of the quota (excluding drawings from the Compensatory Financing Facility and the Buffer Stock Facility).

Essential for the enlarged access policy was an increase in the Fund's resources. This was primarily achieved via the 50 % quota increase following the seventh general revision of quotas, in which overall subscriptions were raised to SDR 60 billion. However, the nominal sum of quotas casts too favourable a light on the liquidity of the Fund, since most deposited currencies cannot be freely used for international transactions. Linear quota increases can only mobilise a limited capital flow from the major surplus countries, namely the oil-exporting countries, due to the latter group's low share of the quotas. Direct borrowing from strong-currency countries would seem more promising. This method was applied in the General Arrangements to Borrow, which, however, are only available to the eleven industrialised countries participating; in the Oil Facilities of 1974 and 1975, which, however, have already expired; and in the Supplementary Financing

² IMF Survey, August 17, 1981, p. 256.

³ IMF, Annual Report, 1981, p. 32.

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

Facility. Within the latter arrangement, capital amounting to SDR 7.784 billion was supplied by 14 countries, including 6 oil-exporting countries, and used to grant loans to countries whose balance of payments deficits are large and of long duration as compared to their credit tranches.

This facility, which was effected on March 23, 1979, is also already exhausted. Efforts towards further borrowing from surplus countries were rewarded by success on May 7, 1981, with an agreement being signed between the IMF and the Saudi Arabian Monetary Agency (SAMA). In this agreement SAMA undertook to make available to the fund a sum of SDR 4 billion p. a. during each of the first two years of the agreement and, the Saudi Arabian balance of payments and reserve position permitting, a further SDR 4 billion in the third year. According to this agreement, drawings can be continued during a commitment period of six years. Repayment is effected in four equal instalments, starting at the end of the fourth year. The interest rate is a weighted average of five-year government securities in each of the component currencies of the SDR. At the same time, Saudi Arabia's quota was increased from SDR 1,040 million to SDR 2,100 million, which represented a further contribution towards the liquidity of the Fund. Saudi Arabia's share of the total quota sum thus rose to 3.5 %.

The agreement with the SAMA is certainly the type of borrowing arrangement most preferred by the IMF; however, the announced negotiations with other surplus countries have not as yet led to similar arrangements. There has merely been a short-term agreement with the central banks or official agencies of 13 industrialised countries, according to which the latter agree to provide the Fund with SDR 1.1 billion over a period of two years to finance the policy of enlarged access.

Resort to Private Capital Markets

In order to meet the demands for credit to the extent foreseen in the new guidelines, the IMF's borrowing requirements are estimated at SDR 6 billion to SDR 7 billion p. a. over the coming three years. The fund is at present examining the possibility of borrowing on private capital markets as a means of acquiring such amounts. The Governors and the Interim Committee have repeatedly come out in favour of keeping this path open, the last time during the 36th Annual Conference in Washington at the end of September 1981. However, they left no doubts about the fact that they would only approach the private capital markets as a stopgap measure, merely intended to bridge the gap until a further quota increase is introduced. With this in mind,

preparations have begun for the eighth general quota revision. Since this is to consist of a combination of linear and selective quota increases, the time needed will probably be quite considerable. The earliest date mentioned was the end of 1983. Recourse to private capital markets may therefore indeed be necessary. To a certain extent this possibility was already anticipated in the agreement with Saudi Arabia, according to which SAMA may obtain at its request bearer notes which would be transferable to other parties, official or private.

Objections by Developing Countries

Reservations as to the Fund's resorting to capital markets have been brought forward in particular by the oil-importing developing countries. The following are the main objections raised:

- In comparison with normal IMF loans, the interest rates would be very high. The rate of charge to be applied to currency holdings financed from the Fund's ordinary resources figured at 6.25 % in 1981, which, taking the present inflation rate into account, is tantamount to a negative real interest rate. The interest rate for loans financed by borrowing on capital markets, on the other hand, would be market-oriented. This, however, is also the case for funds from official agencies on the lines of the agreement with Saudi Arabia.
- Borrowing on private capital markets would contradict the spirit of international cooperation which forms the basis of the Bretton Woods institutions. The fear underlying this assertion is that the rich nations may consequently feel themselves too relieved of the responsibility of providing adequate finance for both the Fund and other development aid institutions. It could also lead to excessive delaying of the next quota increases. Perhaps one could cater for the demand for solidarity by setting up a subsidy account, similar to the Supplementary Financing Facility; this would, however, have to be financed by transfers.
- Borrowing by the IMF could lead to an increase in interest rates on the credit markets, inducing a certain crowding out of those developing countries which have up to now financed their current account deficits directly on these markets. The IMF would be a first class customer; its credit worthiness would undoubtedly be greater than that of individual developing countries. Numerous banks have already expressed their interest in credit relationships with the IMF. However, as the Fund would, according to the latest plans, only approach the market for marginal amounts, fears of crowding out would appear to be exaggerated. The IMF could, in fact, mobilise funds which, due to the high risk

involved, would not at present be channelled towards developing countries, or only at very high interest rates.

More Even Distribution of Risks

As regards the question of risk, some observers pose the question whether it should be the job of the IMF to relieve banks of the country risk. The answer is that in the case of the low income countries this has already occurred, since such countries no longer receive credits from banks anyway, but only from the IMF and other official agencies. Apart from this, today's credit risks cannot remain limited to the banks. Were there to be a larger credit crisis, the central banks of the industrialised countries and the IMF would, contrary to all official statements, have to intervene as a kind of lender of last resort, the close interdependence of the banks threatening to induce an overall crisis of confidence. If the IMF were to step in, the risks would at least be more evenly distributed than is at present the case, with the industrialised countries assuming virtually total responsibility for the international banks.

When the IMF's possible recourse to the capital markets is looked at in conjunction with other modifications of the Fund's credit policy, such as for example the extension of the repayment period to ten years within Extended Arrangements or the cooperation with the World Bank on measures relating to structural improvement (especially in the energy sector), many observers are worried that the IMF may gradually lose its character of being a monetary institution and turn into an organisation for development aid. Such tendencies, however, are an inevitable result of the present international monetary situation. As the present balance of payments difficulties are mainly of a long-term and structural nature, they cannot be overcome with the aid of the monetary approach alone. Despite this, the principle of the separation of functions of the IMF and the World Bank should be upheld.

Stopgap Measure or Real Alternative?

Although market financing of the IMF is at present viewed only as a means of bridging the gap until completion of the next quota increases, the question could well be asked whether market financing does not, to a certain extent, present an alternative. After all, quota increases are a rather inefficient way of raising additional funds. Since at present the current account surpluses are concentrated in a small group of countries, which only represent a small share of total quotas, linear quota increases can only draw upon such surplus countries for balance of payments financing to a limited degree. In addition, most of the currencies to be

paid in following a quota increase cannot be used for drawings. True, Article V, Paragraph 3e stipulates that each country, whose currency is drawn, is obliged to exchange the sum involved for a freely usable currency. However, this procedure can only be expected of countries which have a favourable balance of payments and reserve situation. (During the period of dollar weakness even the dollar was not usable for drawings for a while.) The possible enlargement of practically usable resources by means of a quota increase is therefore at the moment very small in comparison to the resulting new credit tranches. If it is the will of the majority of IMF members to maintain quota increases as the main means of enabling the IMF to fulfil its tasks, then the question arises why this procedure takes so long. The reasons are obviously not of a purely technical nature, but are to be found in reservations towards this standard method of refinancing the Fund. Such reservations cannot be a result of the obligatory payment of 25 % of the quota increase in SDRs, since this in turn represents a 25 % increase in that particular country's reserve tranche, leaving its total currency reserves untouched. Reservations are more likely to come from the surplus countries, whose currencies would probably be drawn upon, and which would therefore have to make real resources or freely usable currency available. The source of these amounts of currency drawn from the IMF is money creation by the central banks. A primarily monetary financing of the present balance of payments disequilibria, however, would neither be appropriate from the point of view of the surplus countries nor from an international point of view. The international banks on the Euro-markets cannot of course be simply regarded as financial intermediaries, for they are also involved in the creation of money or near-money; however, only the central banks create high-powered money or monetary base. The main function of international banks, on the other hand, is to recycle already existing amounts of currency. This would be an advantage of market financing over financing via quota increases or other forms of central bank lending. Admittedly, central bank lending would be harmless if the authorities stuck strictly to their monetary targets.

A further disadvantage of both selective quota increases and official borrowing is their connection with political issues, e. g. the voting rights of the countries affected would have to be increased in conjunction with selective quota increases. In addition, demands have been made which are purely political, e. g. in connection with the Middle East conflict. Such problems could be prevented by the anonymity of the market.