European Communities

EUROPEAN PARLIAMENT

Working Documents

1983 - 1984

16 March 1983

DOCUMENT 1-1542/83

REPORT

drawn up on behalf of the Committee on External Economic Relations

on the Community's external trade and the problem of global financial instability

Rapporteur : Sir Fred WARNER

PE 88.178/fin.

English Edition

During the Plenary Session of 15 December 1982, the European Parliament referred the Motion for a Resolution of Mr. SEELER and others on the Community's external trade and the problem of global financial instability (Doc. 1-1023/82) to the Committee on External Economic Relations as the committee responsible and to the Committee on Economic and Monetary Affairs for an opinion.

On 19 January 1983 the Committee on External Economic Relations appointed Sir Fred WARNER rapporteur.

It considered this Motion for a Resolution at its meetings of 27 September 1983, 22 February 1984 and 28 February 1984.

At the latter meeting the Committee unanimously adopted the Motion for a Resolution and the Explanatory Statement with 6 abstentions.

Present : Sir Fred CATHERWOOD, Chairman; Mrs. WIECZOREK-ZEUL, Vice-Chairman; Sir Fred WARNER, Rapporteur; Mrs. BADUEL GLORIOSO, Mr. BLUMENFELD, Mr. HARMAR-NICHOLLS (deputizing for Mr. HOOPER), Mr. JONKER, Mr. PELIKAN, Mr. PESMAZAGLOU, Mrs. PRUVOT, Mr. RIEGER, Mr. RIVIEREZ, Mrs. SEIBEL-EMMERLING (deputizing for Mr. SEELER), Mr. SPENCER, Sir John STEWART-CLARK and Mr. ZIAGAS.

No Opinion has been received from the Committee on Economic and Monetary Affairs.

The report was submitted on 7 March 1984.

The deadline for the tabling of amendments to this report appears in the draft agenda for the part-session at which it will be debated.

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The Committee on External Economic Relations hereby submits to the European Parliament the following motion for a resolution with explanatory statement:

MOTION FOR A RESOLUTION

on the Community's external trade and the problem of global financial instability

The European Parliament,

- having regard to the motion for a resolution tabled by Mr Seeler, Mr Radoux and Mr Pelikan pursuant to Rule 47 of the Rules of Procedure on the external trade of the Community and the problem of global financial instability (Doc. 1-1023/82);
- having regard to the Communication from the Commission of the EC to the Council on financial integration in the Community (Doc. 1-231/83);
- having reviewed the numerous resolutions and reports adopted on these and allied matters during the life of the present Parliament;
- having regard to the report of the Committee on External Economic Relations (Doc. 1-1542/83);

A. Believing that renewed prosperity and economic growth within the Community, full employment, an improved standard of living for the peoples of Europe and better international understanding and cooperation are all dependent on a renewed increase in world trade;

B. Convinced that international financial instability, as evidenced by wide and uncontrolled fluctuations in exchange rates and by the crisis in liquidity and banking problems, is an obstacle to the development of world trade and a threat to the welfare of individual countries and the international community as a whole;

C. Believing that many of the pressures on the GATT system stem from the breakdown of many of the international arrangements of the post-war economic settlement;

D. Noting the difficulties posed for the financing of international trade by the world's current liquidity and banking problems;

E. Concerned by the prospect of countries engaging in competitive devaluation to gain trade advantages and by the protectionist problems associated with a weak US dollar and a strong Japanese yen;

F. Welcoming the modest agreement achieved at the Versailles and Williamsburg Summits but wishing to see a more effective attempt to mcve out of the present recession;

I.

As regards Exchange Rate Instability

1\. (a) Given the continuing divergence of the economies of leading industrial countries, a return to a system of fixed exchange rates is at present neither financially possible nor politically feasible.

(b) Nevertheless, a floating system does not mean that either frequent or wide fluctuations in currency values have to be accepted.

(c) Such fluctuations distracting of management time and effort, are discouraging to export activities and to investment and have a depressing effect on world trade.

(d) Currency instability encourages demands for protectionism or competitive devaluation in countries with high-value currencies or which are otherwise uncompetitive. The Parliament strongly condemns such threats to world trade.

(e) Non-intervention in foreign exchange markets is no more neutral than intervention; there is a need for a fresh review of the possibilities for limited joint intervention, as a short-term contribution to the stabilization of exchange rates.

(f) Progress towards convergence in the economies of the industrialized countries should not be based on money-supply policy alone but should include exchange rate targets.

(g) The acceptance by the US Government of large budgetary and trade deficits, compensated by very high interest rates, has damaged both trade and investment in the Community and tended to delay world economic recovery.

2. The Parliament therefore:-

(i) Welcomes the decision at the Versailles summit, reinforced at Williamsburg, that Finance Ministers should study these problems.

(ii) Calls for an acceleration of the work of the Finance Ministers' Deputies and for the early presentation by them of proposals for greater stability in exchange rates.

(iii) Requests that the work of the Deputies be fully integrated with that of the OECD, GATT, IMF and BIS.

(iv) Calls upon the Governments of Member States of the Community to continue their attempts to persuade the Government of the United States to adopt a less inflexible approach to the problem of the dollar exchange rate and to move to a lower level of interest rates.

(v) Welcomes the formation of US/Japan Consultative Forum on monetary problems and calls for the Governments of the Member States and the Commission to consider the best way of opening discussions with the Japanese Government on the parallel problems for Europe.

(vi) Strongly endorses considered intervention by the Central Banks of Member States to smooth out temporary fluctuations.

(vii) Believes that the Central Banks should continue to study and practice joint intervention to correct "overshoot", where this is likely to be effective.

(viii) Draws attention to the importance of limited intervention as a means of signalling to currency holders and giving time to reinforce corrective policies.

(ix) Accepting that the prudent management of corporate assets requires a reasonable return, stresses that the main task of manufacturing companies should be the production of tangible wealth and looks to the Finance Ministers of the Community to ensure a state of affairs where the return on productive investment is more attractive than the prudent management of accumulated cash balances.

(x) Reminds the Governments of Member States that their efforts in this field are more likely to be effective if they harness the political, productive, commercial and financial resources of the Community as a whole and hopes that the Commission will continue to play an active and effective rôle as the guardian of the Community's collective view in this field.

II

As regards International Indebtedness

3. (a) While the international credit system has survived the 1983 crisis and the prospects for a return to general stability are improving, rescheduling is far from complete, the exposure of private banks is still very high and the European banking system is vulnerable to any disorder in the US banking community.

(b) Many developing countries have suffered severe damage during the debt crisis. Their trading abilities have been seriously impaired and in some cases they have been subjected to disturbing political strains.

(c) The international machinery represented by the IMF, the World Bank, the OECD, the BIS and the Paris Club has generally withstood the test of the crisis and individual institutions have rendered outstanding services.

(d) While the Commercial Banks have in the past, often with the encouragement of national governments, shown a certain disregard for political risk and some weakness in evaluating credit ratings, they have acted in a responsible fashion when faced with the recent demands for rescheduling and increased loans to borrowers.

(e) National or international guarantees of commercial loans are not desirable; they could have the long term effect of increasing instability.

(f) There is a pressing need for improved early-warning of debt problems.

l. The Parliament therefore:-

(i) Calls upon Governments of Member States to intensify their support for the IMF and the World Bank, both through prompt financial reinforcement when needed and by maintaining the authority of those institutions.

(ii) Requests the IMF and the World Bank to consider improved co-operation and burden-sharing when dealing with problems of indebtedness, while retaining their distinctive roles.

(iii) Requests the Member Governments to discharge their responsibilities in the IMF by careful monitoring of "packages of measures" to ensure that their political effects have been adequately considered.

(iv) Requests Governments to consider possibilities of direct bilateral support to debtor countries where the IMF's reasonable economic criteria are in conflict with political factors.

(v) Welcomes the steps taken by the IMF to improve surveillance and establish a more sensitive early-warning system acceptable to borrowing countries.

(vi) Believes that the international credit system must be used to strengthen the trading capacity of borrowing countries and considers that this criterion should be more generally applied.

(vii) In this connection, welcomes the closer and regular co-operation between GATT, the IMF and the World Bank on problems of indebtedness and asks that this activity should be extended and made fully effective.

(viii) Requests that the co-operation now established between the IMF, World Bank, and Commercial Banks be maintained and intensified so as to ensure a common understanding and remove possibilities of conflict.

(ix) Welcomes the creation of the Institute of International Finance and requests Member Governments to publicly recognize its' importance.

(x) Requests the Governments of Member States to study, as a matter of urgency, ways of improving the flow of direct equity investment to developing countries while safeguarding their interests and economic independence.

(xi) Reasserts its view that a fall in world interest rates will be the paramount factor in reestablishing the credit-worthiness of borrowers and calls upon the Governments of Member States to renew their efforts in this respect with the US Government, as well as for the reasons in 2(iv) above.

(xii) Recommends that further attention should be given to analysing the balance of investment between industrialized and Third World Countries.

(xiii) Recommends that the Community analyses the rapid rise of countertrade and other linked trade and its long-term effect on international liquidity, the international financial system and the world trade pattern.

III

5. <u>As regards European Monetary Co-operation</u>:-

(a) The European Monetary System has failed to realize its original aims which were to bring about economic convergence within the Community and to increase institutional and political unity.

(b) Community influence in world trade and monetary problems and its ability to negotiate on such matters with other major-currency countries would be improved by a strengthening of the EMS.

(c) The performance of the EMS in the field of exchange rates has been satisfactory but, on balance is weakened by the failure of the United Kingdom to co-operate fully in the Exchange Rate Mechanism.

(d) Problems of global financial instability provide an opportunity for closer unity of the Community and should not be the occasion for individual or divisive action.

6. The Parliament therefore:-

(i) Calls upon the European Council, at an early next meeting to devote special attention to the question of how to strengthen the EMS.

(ii) Requests that this discussion should reexamine the problems which have delayed full participation by the United Kingdom in the Exchange Rate Mechanism.

(iii) Further considers that this discussion should also establish directives for accelerating the transition to Phase 2 of the EMS and for enabling all member countries to participate in the system to a fuller extent.

(iv) Requests the Council of Ministers to approve, without further delay, the administrative measures proposed by the Commission in its Communication No. 7152/83.

(v) Asks the Governments of Member States to examine the present standing of the ECU and, in particular, ways of encouraging its wider use for:-

(a) Settlement of intergovernmental transactions
(b) Providing a clearing system for intra-Community commercial debts
(c) Eurobond issues
(d) Invoicing of Commercial Debts
(e) Loans and other financial transactions with non-Community countries

(vi) Invites the Chairman of the European Community Monetary Committee and the Secretary General of FECOM to attend a meeting of the Economic and Monetary Committee of the Parliament to discuss their organizations' contributions to European Monetary Co-operation.

IV

7. As regards future action:-

(a) Global financial instability whether in exchange rates or in the credit system, has a damaging effect on World Trade, and therefore on the external trade of the Community.

(b) The matters discussed in this report are essential factors in any European economic recovery.

(c) It is therefore important that this resolution and the accompanying report be considered by Parliament with those contained in the report by M. Albert and Professor Ball on European Economic Recovery.

8. The Parliament therefore:-

(i) In adopting this Resolution, calls for its consideration by other Institutions of the Community and by the Governments of Member States in conjunction with the Parliament's recommendations on European economic recovery.

(ii) Requests the Commission to report back to Parliament as soon as possible on its own proposals for dealing with the matters discussed and on its present role in dealing with them in international institutions and discussions.

(iii) Requests the President of the Parliament to forward this Resolution and the accompanying Report to the Presidents of the Commission and the Council of Ministers, to the Governments of the Member States, and to the Presidents of the IMF, the World Bank, the Bank for International Settlements, the Paris Club and the Institute for International Finance.

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- Part B : EXPLANATORY STATEMENT

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B

EXPLANATORY STATEMENT

ACKNOWLEDGEMENTS

I should like to acknowledge my gratitude to the considerable number of people who agreed to see me and generously supplied me with facts and ideas before I undertook the writing of this report. All of them are extremely busy people with great responsibilities and I would like to express my warmest thanks for the co-operation which they have so generously given to the European Parliament:-

Dr Fred BERGSTEN	Director, Institute of International Economics, Washington
Mr Shahid Jared BURKI	Director, International Relations Department of World Bank, Washington
Senator Bill BRADLEY	Democratic Senator for New Jersey
M. M CAMBESSUS	Ministry for Economy and Finance Paris
Mrs Eleanor CONSTABLE	Deputy Assistant Secretary, International Finance and Development Department of US State Department
Mr Peter COOK	Associate Director and Head of Banking Supervision, Bank of England, London
Mr Andrew CROCKETT	IMF
Messrs CROSS & FOUSSEK	US Federal Reserve Bank, New York
M. Jacques DELAROZIERE	Director General IMF
Sir Roy DENMAN	Head of Delegation, Delegation of the European Communities, Washington
Mr Arthur DUNKEL	Director-General, GATT, Geneva
Mr Richard ERB	US Executive Director of IMF
Dr Paul KRUGMAN	Council of Economic Advisors to the President
Mr Christopher JOHNSON	Group Economic Advisor, Lloyds Bank, London
Mr Mark LELAND	Deputy Assistant Secretary for Economic Policy at US Department of Treasury

M. Alexandre LAMFALUSSY	Assistant General Manager, Bank for International Settlements (BIS), Basle
M. Gabriel LEFORT	Deputy Governor Banque de France
Mr J G LITTLER	Second Permanent Secretary, Overseas Finance Sector, HM Treasury, London
Dr Bruce MaClury	Brookings Institute, Washington
M. Jean-Paul MINGASSON	Commission of the European Communities, Brus
Mr William OGDEN	Interim Chairman, IIF
M. Francois-Xavier ORTOLI	Commission of the European Communities. Brussels
Mr Charles SCHWARZ	Director, Adjustment Studies Reserve Department, IMF
Mr Bob SOLOMON	Brookings Institute, Washington
Mr J Brian UNWIN	Deputy Secretary, HM Treasury, London
Mr Paul VOLCKER	Federal Reserve Board
M. Jacques WAHL	Director-General, Banque Nationale de Paris
Mr L A WHITTOME	Counsellor at IMF

The effects on world trade of financial instability

I. INTRODUCTION

A. Previous Parliamentary Activity

1. Since the elections of 1979, the Parliament has examined aspects of the international financial system on a considerable number of occasions.[1] Indeed, the whole field had already been studied in an exhaustive and penetrating report by Dr Arndt as long ago as 1973 by the former nominated Parliament.[2] However, in spite of the passage of the numerous resolutions (cited in Notes 1 and 2 below) little account appears to have been taken of the Parliament's views. The explanation for this may be found in the very general and wide-ranging language of some of the resolutions, as well as the large number of proposals contained in them, which faced the Commission and Council of Ministers with too bewildering a choice from which to apply themselves to practical matters. Another discouraging factor has been that reports and resolutions have often been overtaken by events so that succeeding resolutions have tended to contradict earlier ones. Most significantly, reports have sometimes overlooked the strongly expressed views and policies of major governments.

2. The subject of the present report is: "The external trade of the Community and the problem of global financial instability".[3] Once again, this opens up a gigantic field of related problems. Nevertheless, while examining these in some detail, your rapporteur has endeavoured to draw up a draft resolution which is limited to ideas and measures which are within the competence of the Commission or which seem to be within the sphere of what governments of Member States can put into effect at an early date, if they are willing and determined enough to do so.

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[1] (a) Ruffolo report of 11.4.1980 on the EMS as an aspect of the international monetary system (OJ C 117 of 12.5.1980, pp.56-59)

(b) Wieczorek-Zeul report of 14.8.1981 on trade relations between the EEC and the Gulf States (OJ C 260 of 12.10.1983, pp.28-30)

(c) Purvis report of 15.2.1982 on recycling of petro-dollars (OJ C 128 of 16.5.1983, pp.46-50)

(d) Resolution on oil prices (OJ C 68 of 28.6.1983, p.63)

[2] Arndt report of 28.5.1973 on reform of the world monetary system (OJ C 49 of 28.6.1973

[3] Motion for a resolution, dated 14.12.1982, by Mr Seeler, Mr Radoux and Mr Pelikan (Doc. 1-1028/82)

B. Structure of the report

3. The external trade of the Community is only a part of world trade and is affected by the same factors and considerations.

The relationship between world trade and financial instability will be examined under two heads:

(a) What are the effects of wide and uncontrolled fluctuation in exchange rates on the volume and character of world trade?

(b) To what extent does "overborrowing"by certain countries distort or restrict trade by limiting the purchasing power (i.e. import capabilities) of the borrowing countries?

A number or suggestions are made as to how to deal with these two sets of problems and a review of the possibilities of European monetary cooperation is included.

4. Underlying both the above aspects are certain basic problems such as inflation, lack of convergence and interest rates. It is important, therefore, to have an agreed analysis of how the present stage of instability has been reached as a background against which to consider possible remedies.

II. BACKGROUND ANALYSIS

5. In 1973, Dr Arndt, shocked by the breakdown of the Bretton Woods system and the effects of variable exchange rates, wrote "A currency's exchange rate is a matter of international concern. No world monetary system will work if exchange rates are regarded as a purely national affair". Yet that is precisely how they have been treated in recent years, whatever protestations of international concern individual governments may make.

6. Present troubles in the world economy have their beginnings in the 1960's and 1970's. Inflation began to increase fast during the late '60's and at different speeds in the different industrialised countries, thus increasingly forcing the values of their currencies out of line. The fixed exchange rate system was quite unable to contain these strains and was abandoned for floating exchange rates in 1973. A return to the basic condition for fixed exchange rates could then only be achieved by a strict convergence of the economies of the States principally involved - convergence through similar policies for the control of budget deficits and money supply, together with comparable rates of investment and productivity. Such convergence has in no way yet been seriously attempted.

7. The first and second oil crises also put immense pressure on currencies. From 1974 to 1980, the OECD group of industrialised countries faced average current account deficits of $20 billion per year. It is not surprising that they resorted to high and often competitive interest rates in attempts to repatriate part of these balances.

8. Less Developed Countries (LDCs) without their own energy resources fared much worse. During the same period their collective annual deficits were about $47 billion. Lacking the financial apparatus to staunch this enormous loss of capital, they were forced to turn to borrowing and commercial banks readily took up the role of intermediaries between the surplus countries of OPEC and other LDCs. The level of international debt increased sevenfold from 1972 to 1982, reaching $700 billion by the end of the period. At the same time, the high interest rates for such transactions, following those now in force in most industrialised countries and particularly those in the United States (since most loans were made in dollars) put an even greater burden on borrowers.

9. It was unfortunate that much of this borrowing had to be spent on infrastructural projects with low or nil rates of return, was sometimes misapplied in industrial projects without sound financial or management control and was often even used to plug current account deficits. Earning power has therefore not kept pace with growing costs of debt-service. These increased from 18% of the total exports of LDCs in 1980 to 24% in 1982. For the twenty largest borrowers it rose to 40%. To deal with this situation, such countries must achieve increased exports to industrialised countries and reduced imports from them, a most unwelcome solution to Western states with their stagnant production, adverse trade balances and high unemployment.

10. In the most recent phase of events, a ruling factor has been the growing divergence of the US economy away from those of other inudstrialised countries. Inability to control mounting budgetary deficits has led through high interest rates to an overvalued dollar. The trade deficit is now running at $70 billion for 1983 and is likely to reach $100 billion next year. This has greatly increased the problems of restoring stability.

11. It is tempting to look for institutional or manipulative remedies to problems of fluctuating exchange rates and excessive indebtedness. While it is very desirable to use such means, the basic need is for controlled inflation at even rates, convergence, stable energy prices and steady interest rates at levels unrelated to the panic of the moment.

III. EXCHANGE RATE INSTABILITY

A. Definitions

12. It is worth distinguishing three different kinds of exchange rate instability; people take different views as to whether each of them can be or should be controlled and to what extent:

(a) Misalignment

A currency may be held to be misaligned if its internal and external purchasing powers can be seen to differ significantly for a prolonged period. Sterling, for instance, was generally held to be seriously over-valued in 1980/81 when it touched $2.40 to £1. It is equally held that the Japanese Yen at 230/280 has for some years been seriously under-valued. Misalignment may be the result of government policies in setting unusually high or low interest rates or of extraneous factors such as the existence of North Sea oil in the case of Britain, the attraction of holding longer-term American assets in the case of the US (the Secure Haven effect) or the absence of instruments for retaining free capital in the case of Japan. If one accepts the reality of misalignment, then it follows that it must produce significant distortions in trade. An important minority, however, does not accept that misalignment can exist, arguing that all rates reflect market and structural forces and are therefore "real". Your rapporteur does believe that currencies can be wilfully or otherwise misaligned.

(b) Overshoot

A temporarily misaligned currency moving to a new, more realistic level may run beyond it and remain for some time in a state of involuntary reverse misalignment. An example was given by sterling while moving from undervaluation to overvaluation by no less than 68% between the end of 1976 and the end of 1980. Overshoot can equally be produced by non-financial influences such as severe oil-price changes, political elections or notice from governments of changes in their economic policies. All of these affect the expectations of currency holders as to how a currency will behave and can lead to extensive changes in rates.

(c) Flutter

This is the day to day movement of currencies by a few points. It reflects the nervousness of holders of currencies on the one hand and the skills of foreign exchange managers and dealers on the other. For instance, in the first nine months of 1981, the $/DM rate moved by ½ to 2 percent on 104

trading days out of 196.[1] This kind of arbitrange has been brought about by the speed of modern communications and the development of information technology to an ever higher and higher degree of fine-tuning and has been described as "the perfect capital market".[2] I suppose that, theoretically, such developments could lead to a "no-energy state" in which the universality of instant information precluded any dealer from jumping another one, but at present the phenomenon remains a major nuisance (or opportunity) for fund managers. So long as the downside risks of holding currencies for any length of time remain so great as in the present state of exchange volatility, currency holders and managers will be constantly on the move.[3] (Annex 1)
(For figures on exchange movements see Annexes I, II and III)

B. Effects of Volatility

13. The general assumption of earlier discussion in the Parliament has been that volatility of exchange rates must directly inhibit trade and that a direct correlation exists between the extent of volatility and the volume of trade. Your rapporteur has found no evidence to support this view. While a country with a seriously over-valued currency will find its exports inhibited, it is also likely to increase its imports sharply; over the world market as a whole, there is little direct effect from this event. GATT, who are rightly the most watchful of international organisations in this field, have sponsored a detailed study which concludes that the facts examined suggest "... that there was no direct adverse effect of exchange rate variability on the level of international trade, which remained influenced mainly by the underlying GNP growth".[4] Indeed this last clause holds the key to the report's thinking since it further suggests "... that domestic macroeconomic policies have more influence on the trade balance of a country than a change in its exchange rate".[5]

14. Whatever the lack of correlation in these phenomena, it is not possible to believe that frequent and large fluctuations in such an important element as the

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1 Lamfalussy address to the Atlantic Institute for International Affairs, 22.10.1981

2 Blackhurst and Tumlir. Trade Relations under Flexible Exchange Rates, p.5

3 See Lamfalussy. Address to Financial Times Conference, 16.2.1983, particularly Annex 3 which is reproduced with this report as Annex 1

4 Blackhurst and Tumlir. Trade Relations under Flexible Exchange Rates, p.3

5 Op.cit., p.8

exchange rate could have no damaging effects on the economy. They are certainly a diversion and a nuisance and the following points may be made:

(i) Unpredictable fluctuations (and when have exchange rates been predictable?) discourage manufacturers from engaging in export business because of the uncertainties which surround long-term contracts. Exchange risk insurance is a costly, troublesome and sometimes inadequate defence.

(ii) Far too much management time is devoted to exchange management which should be spent on improving products and productivity.

(iii) There has undoubtedly, in some national economies, been a long term ratchet effect with increases in import prices (and consequently wages) in times of undervaluation being carried forward into times of exchange readjustment.

(iv) The persistence of an unnaturally high value for a particular currency leads to clamorous pressure for protectionist policies, as for instance in the United States in 1982/1983. At its worst, it produces competitive devaluation in a search (always fruitless in the long run) for increased exports. Examples have been the competitive devaluations between Sweden and Finland which will be examined in the Pruvot report.[1]

(v) Most serious is the probable effect on investment. There is the discouraging influence of an unsettled outlook in exchange markets and the consequent difficulty of calculating returns. There is the temptation to look for a return on unemployed funds by moving them around the money markets. This becomes very strong indeed where profits are being seriously squeezed in countries with overvalued currencies. Indeed, since the return on investment in manufacturing industry within the Community has steadily fallen in recent years, the inducement to move cash out of liquid funds into plant and equipment becomes less attractive.

C. Government and Academic Attitudes

15. Your rapporteur, in seeking to recommend to Parliament a view on this matter, has found no consensus at all among governments or their economic advisers. A majority of world trade is carried on in dollars and the attitude of the United States Administration towards the value of their currency and its fluctuations is of overwhelming importance. The US authorities withdrew from intervention in early 1981 and their doctrine is that it could only be resumed

[1] Motion for a resolution tabled by Miss Gloria Hooper of 25.11.1983 (Doc. 1-924/82)

in crisis conditions when markets become "disorderly". No definition of this term has been found but it is generally assumed that a President would have to be shot again in order to justify intervention. The arguments advanced by the US Treasury to support this attitude are dressed in economic language. Your rapporteur was told that attempts by the Europeans in the last year to practise intervention (France and Germany) have failed and proved the total ineffectiveness of such action, that even "sterilised intervention" has an accelerating effect on money supply, that intervention is an artificial concept because currencies automatically find their own "real" level and that the only way to stabilise exchange rates is by convergence between economies. One sees little attempt to achieve such convergence and one has to ask whether the motives for such attitudes are really a priori economic or ex post facto political. They certainly have a harsh ideological ring at times. There is also the disconcerting fact that they are dropped when there is discussion of the Yen/dollar relationship. The only recent significant intervention by the United States in foreign exchange markets was to prevent a weakening of the Yen in August 1983.

16. The difficulty of justifying such views is shown by the contradictions in the analysis offered by different speakers at different times. For instance, the Chairman of President Reagan's Council of Economic Advisers, in a highly sophisticated analysis earlier this year, argued that the high value of the dollar was the sole and natural result of the high real interest rate in the US, this itself being in turn the consequence of US government budgetary deficits.[1] The Assistant Secretary to the Treasury, on the other hand, stated six months later: "Interest rates are a factor from time to time but my basic conclusion is that they have not been the dominant explanatory factor in dollar strength".[2] He particularly singled out the "secure-haven factor" as a more important consideration. In all these arguments, the impossibility of finding a "true value" for the dollar is pleaded as the justification for taking no action. As the Secretary of State for Treasury has put it, the Administration would like to see a somewhat weaker dollar in order to help US exports but "... that doesn't mean we're going to do anything about it".[3] The Federal Reserve Bank, which traditionally could be expected to urge a far more interventionist role, has been stripped of freedom of action. The Chairman, while recognising that "... exchange rates have fluctuated wildly throughout much of

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[1] Martin Feldstein. Address to the Council of Foreign Relations, New York 11.4.1983

[2] Beryl Sprinkel. Testimony to House Banking Sub-committee, Washington, 27.10.1983

[3] Donald Regan. Interview with New York Times, 29.3.1983

the floating era", and that "... the extent and timing of some of the changes have, even in retrospect been difficult to explain",[1] has felt himself unable to recommend (let alone implement) any remedial action other than the familiar convergence effort. As a member of the Federal Reserve expressed the situation to your rapporteur, "The primacy of the Treasury over the Fed was always recognised but it was never enforced until this Administration". (Wits have said that if those in the Treasury behave with the vigour of reformed drunkards, people at the Fed show the emotions of deprived children).

17. It is hard to resist the feeling that the present US Administration prefers to finance investment at home by drawing capital from abroad rather than by cutting its own budget deficit. Indeed, they appear to have no political means for such budget discipline. They are not really concerned with the negative effect of this policy on domestic investment in other countries.

18. Of course, this state of affairs is not wholly unfavourable to the Community. The high value of the dollar has given an enormous boost to Community exports to the United States and has inhibited American imports. The U.K., which invoices its oil sales in U.S. dollars, has received an important extra income. Nevertheless, these U.S. views have not been widely accepted within the Community. It is true that the UK Treasury has repeatedly endorsed them but the Bank of England has shown some concern. The Deputy Governor, always a cautious commentator, recently stated: "I believe that the substantial and enduring exchange rate swings of recent years are likely to have played a significant part in hampering economic performance and impairing the strength of the present recovery!"[2]. The figures published by the Bank of International Settlements on "overshoot" are eloquent; their Assistent General Manager has pointed out, for instance, that four full cycles in $1/DM fluctuation took place during the first nine months after the US abandoned intervention.[3]

While most would question the realism (other than as a political stimulant) of President Mitterand's call at Williamsburg for a new Bretton Woods type of agreement, there is a general desire to see some action. And even if the last round of major interventions by the German and French authorities proved expensive and did not achieve the targeted results, there has been no abandonment by either of those Member States of the principle that action to curb volatility is needed. In an extremely detailed and researched examination of the problem,

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1 Paul A. Volcker. Address to the Forex Association of America, New York, 28.4.1983

2 Christopher McMahon. Address to the International Herald Tribune Conference, London, 14-15.11.1983

3 Alexandre Lamfalussy. Address to the Atlantic Institute, Brussels, 22.10.1981

the British House of Commons suggested: "We (therefore) favour what we term a joint exchange rate/monetary policy regime, in which monetary policy takes account of both internal demand and external competitiveness;"[1] and it examines with minute care the problems of targeting for such a policy. This suggestion remains under discussion and has not been adopted by the British Parliament as yet. UNICE, in its declaration aimed at the Athens Summit, has again stated: "Foremost among UNICE's requirements ... is the creation of monetary stability in order that companies' decisions on capital expenditure can be made with the minimum of uncertainty".[2]

D. Intervention in Exchange Markets

19. Whatever view one takes of the need for action, the likely success of intervention by Central Banks in the exchange markets remains in dispute. The minimalist view has tended to follow Friedman's thesis, laid down 20 years ago: "There should be a simple criterion of success - whether the (intervening) agency makes or loses money".[3] However, a study published this year by the BIS concludes that this criterion cannot meaningfully be applied to measure the effectiveness of intervention. Instead, the authors put forward new criteria which "... strongly indicate that official intervention in the case of three currencies (DM, Yen and sterling) was predominantly of the stabilising kind".[4] They conclude that "... in the present world of pronounced uncertainties, well timed official intervention can be influential and has an important role to play".

20. The report on the same subject commissioned by the Versailles Summit is extremely guarded but contains the following passage: "The working group felt that intervention had been an effective tool in the pursuit of certain exchange rate objectives - notably those orientated towards influencing the behaviours of exchange rates in the short run".[5] As for longer term intervention, the report makes a number of points:

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1 House of Commons, Treasury and Civil Service Committee. Second Special Report on International Monetary Arrangements, 11.5.1983

2 UNICE. Memorandum for the Special Council, 3.11.1983

3 Milton Friedman. The Case for Flexible Exchange Rates

4 Mayer and Tuguchi Official Intervention in the Exchange Markets: Stabilising or Destabilising? Basle, March 1983

5 Report of the Working Group on Exchange Market Intervention (Chairman Philippe Jurgenson) March 1983

(i) Intervention alone (particularly sterilised intervention) was sometimes insufficient to affect exchange rates unless accompanied by domestic policy adjustments. This bears out the view in the House of Commons report cited above.

(ii) Intervention can "buy time" for market participants to recognise the factors causing disorganisation and thus acts to restore confidence.

(iii) Intervention can successfully be used to take part of the strain on a currency, rather than to keep it at a particular rate.

(iv) Closely coordinated action between parties had been more effective at times than by one Central Bank.

It should be noted that all these observations are made only to a limited degree of intervention.

E. Towards a European View

21. It is possible to suggest the broad outlines of a view by the Parliament, drawn from this often contradictory material.

(i) Given the growing divergence of the economies of leading industrial countries in the last 12 years, any attempt to maintain a fixed rate system after 1971 would no doubt have proved even more damaging to economies than what we have experienced.

(ii) Within a floating system, countries must be permitted and encouraged to correct misalignment, but devaluations designed to increase exports are neither desirable nor fated to succeed.

(iii) A floating system does not mean that frequent and wide fluctuations have to be accepted. Such volatility is damaging to freedom of trade, to export planning and to investment.

(iv) Convergence in the economies of industrial countries, particularly those with commonly used trading currencies, may be desirable but is unlikely to be achieved by mere exhortation or a general undefined approach. Convergence consists of a complex of factors (money supply, productivity, exchange rates, etc.) for which targets must be separately studied and agreed before being brought together, closely related in a joint policy.

(v) Non-intervention in foreign exchange markets is no more neutral than intervention; it produces its own effect on the balance of rates at any time.

(vi) Every attempt should be made to persuade the American Administration to a trial period of limited, cooperative intervention designed to smooth out flutter.

(vii) The problems of overshoot are unlikely to be adequately resolved in the foreseeable future because it is not conceivable that the present US Administration, grounded on the bedrock of its budget deficit, will abandon its opposition to systematic intervention. Nevertheless, individual countries or groups of countries may be able to pursue limited actions in this field, particularly to counter the many non-economic factors influencing exchange rates.

(viii) Exchange rate control by Community members must be pragmatic; that is to say, it should be the mirror-image of convergence policy, combining intervention with domestic policies.

(ix) Intervention should normally be a joint activity for which common aims must always be agreed between the agents.

(x) Central Banks should have in mind the importance of intervention as a means of signalling to currency holders, influencing their expectations and giving time to reinforce corrective policies.

(xi) The first outlines of international machinery set up by the Versailles Summit should be reinforced, confirmed in their monitoring powers and provided with the staff to study and devise adequate models for convergence. They should draw together, rather than replace, the existing competence in this field of OECD, GATT, the IMF, the Group of Thirty and the BIS.[1]

22. An attempt has been made in the draft resolution to turn such a view into a few limited, practical suggestions in the political plane. Among these, the reinforcement and proper use of the new machinery referred to in (xi) above is paramount. Your rapporteur believes that much preparatory work needs to be undertaken in this way before there can by any point in summoning a general monetary conference as has been suggested by President Mitterand and in the Parliament.

[1] It is worth noting that the first meeting of the Committee of deputies of Finance Ministers set up after the Williamsburg Summit took place in November 1983 to consider the international monetary system.

F. The Problem of the Yen.

23. This extremely important matter has been dealt with outside the general discussion of exchange rate problems because it appears to be unique to its kind. Your Rapporteur does not accept the view, which has been sometimes expressed in Parliament, that the Japanese authorities engage in "dirty floating" and that they are deliberately keeping down the value of the Yen. On the contrary, they have shown readiness to intervene in support of the Yen and and it is the US Treasury which has normally declined to join in such support operations. It snould be remembered that it was the US and certain European Governments who prevailed upon the Japanese Government some years ago to abandon, most reluctantly, their stringent exchange controls. The sharp difference between present high US interest rates and the low rates which are traditional to the Japanese economy, the huge yen balances which became available for conversion into dollars by Japanese banks, insurance companies and trading houses, and the "Green Card" fiasco which led to the wholesale expatriation of private accounts or their conversion into gold holdings are (taken together) quite sufficient to explain the low value of the currency. Only a return to domestic economic expansion (with limited inflationary results) and a liberalization of Japanese capital markets allowing and encouraging a major inflow of foreign funds, can reverse the present position. [1]

24. This situation causes an acute problem for the Community, which ran a trade deficit with Japan of $10.5 billion for 1983. This deficit continues to rise. The basic reasons are certain comparative advantages of Japanese manufacture, the impenetrability of the Japanese market due to organizational and psychological Non-Tarriff Barriers, and the reluctance of many European manufacturers to tackle so difficult and expensive a task as exporting to Japan. But obviously the difficulties are made very much worse by the present value of the Yen.

25. The US deficit with Japan is almost twice larger than the Community's. Moreover, most Japanese trade is in dollar terms. In this field, therefore, the US administration has abandoned its general views (under severe political pressure at home) and has recognized a "misalignment". This is now of great concern to President Reagan and a joint Consultative Forum has been set up by the US Treasury Department and the Japanese Ministry of Finance, following the President's visit to Tokyo last year. The problem must be tackled in the first place as one of the yen/dollar rate, but it is very strongly to be recommended that Governments of Member States and the Commission should urgently consider setting up parallel consultative machinery.

1. For an excellent discussion of this problem see: C Fred Bergsten, evidence before the Senate Foreign Relations Committee. Washington 2.4.83.

A. Nature of the Problem

26. A very brief analysis was made, in Section II of this report, of how Third World countries came to assume an unmanageable burden of debt. Statistics on the extent of indebtedness are set out in Annex. IV. A particularly important indicator is the proportion of the main borrower-countries' exports represented by debt service; figures for this are given in Annex V.

27. However, it is not just the amount of indebtedness (either in absolute figures or per capita) that distinguishes between the plights of the many borrowers. Each country has its own different relationships between debt and economic performance; accordingly, the situation has had to be dealt with as a series of individual cases and not as a global problem. (It should be remembered that 80% of the debt of LDCs is owed by only 20 of them). The situation reached a crisis in the winter of 1982/1983 and threatened to precipitate a collapse of the whole international credit system with a consequent economic depression comparable to that of the 1930's - or worse. Such a disaster has been averted, but we are left with certain effects which could persist if a more rational and secure means of supervising international borrowing and lending is not devised.

B. Effects of the Crisis

28. The effect of last winter's events on the lending countries and institutions was to produce extreme nervousness. The threat of a collapse in the whole credit system had come too near for comfort. Private banks, busy since 1974 (with the encouragement of their governments) in the profitable task of on-lending petro-dollars through the network of interbank and syndicated loans to the eventual third World borrowers, were suddenly aware that their information about the size and structure of debt and of the use to which loans were put was inadequate. Although the route from depositor to final borrower was, in fact, usually a short one the final destinations of loans were often not realised by bankers until the crisis had hit them. They found that they were then unable themselves at the political level to obtain the necessary economic measures by borrowers to protect the banks' loan assets.

29. Apart from these implications of possible weaknesses in the recycling system, the simplicity, easy functioning and profitability of the proceedings seem to have obscured any general economic implications. While the provision of loans to LDCs is at all times necessary in the conditions produced by two major increases in world energy prices, current trends alone determined the allocation of resources between domestic investment in the industrialised countries and on-lending to LDCs for what were often wholly non-productive uses. While your rapporteur does not personally believe in the efficacy of either nationally or internationally planned allocation of investment, he recognises the value of monitoring and guidance. He must therefore draw attention to the fact that the demand factor in this vast flow of resources was often totally undisciplined and, indeed, even unknown except as patternless fragments. While this will have ensured the high speed of redistribution, it cannot have placed funds where they were necessarily likely to strengthen the world economy and ensure an early recovery after the two oil crises. It is puzzling that no proper study of this aspect seems yet to have been undertaken. Some of the required material, however, may be found in the BIS report for 1982/83.[1]

30. The effects of these events on the borrowing countries have also, of course, been serious. The most damaging has already been noted - the high proportion of exports represented for some borrowers by debt service. To this cost must be added the relatively high price of energy imports during the long periods of readjustment after the two oil-price rises. It is also obvious that the general recession which followed those rises has depressed the prices of the main Third World exports such as minerals and tropical agricultural commodities. Anyone or more of these factors or the combined effect of all three, has been disastrous for many countries.

31. Secondly, as also noted in Section, II, the borrowers have had little choice but to cut back imports drastically and push exports, including manufactured goods. This comes ill to the West and has made more difficult the recovery of the industrialised countries.

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[1] Bank for International Settlements. Fifty-third Annual Report. Basle, 13.6.83

32. Thirdly, the financial and trading disciplines adopted, often imposed from abroad or by international institutions, have placed severe political strains on some LDCs and caused internal unrest. Quite apart from the traditional "package" of disciplines always insisted on by the I.M.F., the fact that as much as $11 billion was needed as a bridging loan for Brazil explains why lenders are not easily found today unless they can be assured that adequate disciplines will be exerted in the next phase. The resignation at the beginning of September of the Governor of the Bank of Brazil was an indication of how disturbing such pressures from lenders can be.

33. Finally, the crisis may have brought about a certain coarsening of the relationships between lenders and borrowers. Borrowers knew that creditors were potentially over-lent and their demands for refinancing were sometimes made in rather brutal language, as if to suggest they might not hesitate to pull down the whole system if not satisfied. It is to be hoped that this mood has dissipated with the extreme stage of the crisis.

34. Generally, one can only feel disappointment that a system which sprang up spontaneously, rapidly and effectively to recycle capital balances should not have been an efficient enough means of improving the earning capacity of developing economies, thereby increasing World trade. Instead, that trade has diminished. We must look for a better performance in the next round.

C. International Financial Machinery

35. Debates and Resolutions of this Parliament have often thrown up proposals for new institutions.[1] An exploration of the field, however, reveals a vast web of existing public and private institutions, each highly specialised and competent in its own field, able and willing to apply the lessons of recent events. The nature and functions of these various bodies are not always clearly known by MEPs and I have therefore described them below. We are almost entirely dependent on them for International Monetary (Lending) Arrangements and if the system does not now work properly, we shall be in very serious trouble.

(a) The International Monetary Fund

36. This is the best known of all the public institutions and the centre of the whole web. Its composition is almost universal (146 country members) and its responsibilities all-pervading. They include international monetary cooperation, removal of restrictions on foreign exchange operations, debt rescheduling and influence on World liquidity through the issue of Special Drawing Rights (SDRs). There are many features of the I.M.F. which are of importance to this report.

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1 See, for instance, Motions for Resolutions attached to Reports

37. First, the resources of the Fund are limited and were not sufficient to deal with the recent crisis. The decisions which were made to supplement those funds by an increase in quotas and under the General Agreement to Borrow have still not been fully implemented. The greatest obstacle has been slowness by the U.S. Congress to honour the decisions. This has happily now been resolved but the outlook for the I.M.F. and for the rest of the international monetary system which is so closely enmeshed with it will never be bright if important elements in the U.S. regard the Fund's managers as mostly unreliable foreigners, out to make life easy for undisciplined LDCs at the expense of the U.S. taxpayer. The Community's Finance Ministers have a heavy responsibility to make sure that this view does not gain ground. The I.M.F. must have reasonable resort to increased contributions from members in times of crisis and, if national Treasuries are not prepared or able to make these available, the Fund should itself be able to borrow in international capital markets, as suggested recently by the Group of Thirty.[1]

38. Second, it is essential that the authority of the I.M.F. be upheld. Without this, there is no agency which can maintain trust between borrower and lender or provide a safe haven in storms. Ultimately authority depends on having enough funds, but there are other aspects. The dominant "Group of 10" should always show their confidence in the organisation and this reinforces the point about U.S. attitudes. It has also been strongly argued that the Fund would have greater authority if its management structure were more broadly representative of both creditor and debtor nations from the Third World. This is a constant source of dispute between UNCTAD and the principal contributing governments. Both the Interim Committee of Directors and the Executive Board have been gradually expanded to meet this demand, but the influence of the old industrialised countries is still paramount. It is obviously no good pushing such reforms to the point where the main contributors lose confidence that their quotas and loans will be properly handled. The situation needs regular review without drastic action.

39. Third, the I.M.F. has to show great sensitivity in dealing with borrowers and with the rescheduling of their debts. Sensitivity does not mean laxness or hesitancy in demanding financial disciplines when making available or renewing facilities. This concept of "conditionality" is central to the operation of the Fund and is discussed in the next section of this report.

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1 See Consultative Group on International Economic and Monetary Affairs: Annual Report 1983

40. Fourth, the I.M.F. needs to be able to foresee developments and should not be taken by surprise. A lot of work on this "Surveillance" aspect has been undertaken by the staff. For instance, a comprehensive study of the debts of the Third World had already been written two and a half years ago.[1] Nevertheless, Executive Directors agreed with your Rapporteur that forecasting could be improved and this matter is also discussed in the next section.

41. Finally, there is the question of the speed at which the I.M.F. can move. Frankly, it is slow, largely because of the need to negotiate the "packages of measures" required by conditionality. Also, it has increasingly tended to move towards medium and longer term lending. It is unsuitable as an agent for providing bridging loans in the early stages of rescheduling. This serious problem is also discussed below.

(b) The World Bank

42. The International Bank for Reconstruction and Development (IBRD), with its associated International Development Association (IDA) and the separate International Finance Corporation (IFC), are referred to as the World Bank. The World Bank's aim is to raise living standards in LDCs, and (through the IDA) the poorest ones in particular, by channelling resources from developed countries. The division of labour with the I.M.F. is blurred; it has been said that, "the Fund is a bank and the Bank is a fund". Generally speaking, World Bank finance is usually (though certainly not always) project finance, while the I.M.F. provides for balance of payments adjustments. Also, the Bank tends to operate on a longer term than the Fund. The two should therefore be complementary and should be seen to act in parallel in crisis situations. This does not seem to have happened in the recent liquidity crisis. Your rapporteur got a strong impression, when visiting the Bank, that Executive Directors felt that they had been neglected during these historic events and that they regretted, with some reason, the manner in which their modest request for an increase in "structural adjustment" resources had been brushed aside, the potential lenders clearly feeling that the I.M.F. had already fully used up their available good-will. This proposed increase could have been used for investment in manufacturing and commercial projects contributing favourably to the balance of payments in quite a short term.

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[1] I.M.F. Staff Team. (Nowzad and Williams) External Indebtedness of Developing Countries, Washington, May 1981

43. It is very strongly to be recommended that there should be closer cooperation between the I.M.F. and World Bank and that national Treasuries should look at the requirements of their funding jointly so that money goes where it can best be used. This consideration also applies to the Regional Development Banks (Asian, African, Latin American). It is also important that the World Bank has recently taken certain decisions which will make it easier for it to cofinance projects in LDCs with Commercial Banks.

(c) <u>The Bank for International Settlements (BIS)</u>

44. The BIS proved to be the first line of defence during the liquidity crisis of 1982/1983. The reason for this is just that it was extremely liquid. It holds large deposits for the Central Banks of the Members, which include all the major industrialised countries. When national Treasuries were called upon to provide ready money for bridging loans, preparatory to longer term rescheduling of inter-governmental and other debts, they decided that those deposits should be used, to supplement their own direct contributions. They entrusted the task of fixing the bridging loans to the staff of the BIS. The programme was brilliantly executed and the world owes a considerable debt of thanks to this organisation.

45. Nevertheless, the BIS is simply the clearing bank for Central Banks. It is not intended nor designed to be a lending or rescheduling agency and it has made it quite clear that the operation which it performed in the Spring of this year was for once only and should not be repeated. This raises again the problem mentioned in paragraph 35 above of how to provide bridging loans in a future crisis.

(d) <u>The Paris Club</u>

46. "Club de Paris" is the name used to describe a special Committee of OECD members which meets in Paris under the Chairmanship of M. Cambessus to consider the rescheduling of that part of indebtedness which consists of Government export credits. The "Club" originally met only rarely to review the activities of the official export credit agencies (EXIM Bank, ECGD, COFACE, HERMES etc) but the liquidity crisis placed a heavy call on its services and by the middle of 1983 it had rescheduled 12 billion of export credits, taking one debtor country after another at separate meetings. Although it only acts in respect of loans made from one government to another, its actions can serve as signals or leads for private debt settlements with the same borrowers. Its activities have been outstandingly well conducted and it must be considered a great success.

(e) Commercial Banks

47. A great part of the indebtedness revealed in the liquidity crisis was owed to Commercial Banks. By the beginning of 1982, bank loans to non-oil LDCs amounted to $ 300 billion, representing more than 30% of the banks' net external assets. In their case, no structured machinery existed to deal with the problems. As each borrower country asked for rescheduling of its debts, an ad hoc group of the interested lenders would have to be convened, usually in London or New York, to negotiate. Such negotiation usually proved rather successful, though sometimes lengthy and painful. The term "London Club" has been used to describe these activities but seems to be a misnomer.

48. It is not surprising that many Commercial Banks have been very unwilling to renew loans or (even more) to advance the additional credits required for rescheduling. That they have done so is due in part to governments (and notably those of Community member states) who have urged the importance of not putting any borrower in the position of having to default, while at the same time refusing to underwrite commercial loans. But the major role in persuading banks to meet their responsibilities in this way fell to the I.M.F. From the start of the crisis towards the end of 1982, the Fund worked closely with the Commercial Banks in evaluating situations and helping them forward. A very strong lead was then given. To quote the Managing Director of the I.M.F.: "The essential need for continued lending on the part of the Commercial Banks applies not only to the large banks but also to the smaller and regional banks as well, which together now account for an important part of total international financing flows. In this connection, we must see to it that the planned increases in bank exposure do actually take place."[1] This leadership of the commercial field has been viewed (and even criticised) as an important increase in the authority and power of the I.M.F. Yet it ought surely to be considered an advantage that banks should be able to look to the principal public international source of funds for information, guidance and support.

49. The problems which emerged during the crisis period raised broad questions of the responsibilities of banks to their depositors and borrowers, to each other and to the economic system as a whole. If they got into really deep water, should they be bailed out? Was a higher dgree of monitoring of their activities by Governments or international authorities desirable? Why had national credit ratings proved such a very poor guide to the lenders and why

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1 J. de LaRosiere. Speech to the Annual Meeting of Reserve City Bankers. Boca Raton. 9 May 1983

were they unaware of the precise extent and structure of borrowing by individual LDCs and of the political, as well as financial risks involved? An attempt is made blow to answer these questions.

(f) The Institute of International Finance (IIF)

50. This body is designed to provide machinery for dealing with the last of these problems - scarcity of banking information in the private sector. It was set up after study of the requirement at a Ditchley Conference in 1982. There were 35 founder members, representing a selection of principal banks from ten different countries. The intention was that membership be extended to embrace many banks from all countries. Already it has 180 members of which most are banks, though some insurance companies are included. The Institute should be functioning by early next year (1984).

51. The functions of this body will be to provide the private sector with information, country by country. It will hold voluntary discussions with borrowers about their debt plans. It will exchange information with the I.M.F., World Bank and BIS. It will provide its members with evaluations. It is well aware of the reluctance of lenders to discuss some aspects of their problems and of the doubts of large banks about the value (and confidentiality) of an organisation which will embrace so many smaller fry. But the founders believed that they could create an effective private-sector mechanism to improve international risk lending and orderly capital markets, thus helping to limit the likelihood of future crises by nudging the parties in time. As Mr William Ogden, the original interim chairman, put it to your Rapporteur: "No red lights and no green lights - only amber!"

(g) Conclusion

52. A review of all the above arrangements, combined with the constant calendar, of Economic Summits, interministerial meetings, international committees of Treasury officials and others, and the activities of every sort of private and public, national and international organ and entity, suggests that we certainly have enough machinery. To create more would be useless duplication. What is needed is better organisation of the relationships between the parts, better capability and performance where this has been seen to be weak and clear guidelines as to what is expected. It is particularly desirable to encourage increased co-financing between international institutions, IMF, World Bank or Regional Development Banks, and syndicated Commercial Banks, with monitoring by the former.

53. There is, however, one rather obvious failing. Whereas the world of lenders is organised from top to bottom, the world of borrowers is piecemeal

and disorganised. Neither UNCTAD nor the Group of 77 have thrown up an institution or committee, capable of dealing with organised lending in the way in which OPEC deals with the rest of the World over oil. This may have made things easier for the lenders and (as already noted) the differing problems of the borrowers have required individual treatment. But, in the long run, it is an unhealthy situation if borrowers do not consult with each other in a free and sophisticated manner. The recriminations which arose between Brazil and Mexico at the height of the liquidity crisis illustrate this point. It would be a great advance if UNCTAD were to mute its cries and turn its attention to this requirement in a mature and constructive way.[1] The final recommendations of the recent New Delhi Conference of unaligned countries perhaps contains the seeds of a solution.[2]

D. Problems of Debt Management

54. Some of the problems thrown up in the last year are on the way to being resolved while others remain wide open. The more obvious ones are discussed in this section.

55. Conditionality. It is plain enough that there can be no international credit system which is not based on confidence that loans will be sensibly and profitably used and that servicing is assured. Such confidence has not always been the case in the past and, as this report has tried to show, that was one of the underlying causes in the rapid deterioration of the financial viability of LDCs. After a crisis such as we have undergone, the confidence of the lending community must be restored if finance is to flow again. Otherwise, adequate capital will not be forthcoming to fund the I.M.F. and World Bank or as loans from Commercial Banks. This means that each debtor country must be seen to be making a credible effort to put its house in order, in such a way as to be able to service its external debt. This is an inescapable requirement and it has fallen to the I.M.F. to negotiate the "packages of measures" which will provide the necessary confidence. These packages are therefore conditional for rescheduled debts and new loans.

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1 Committee for External Relations. Opinion on the Report of the Committee for Development and Cooperation on UNCTAD conference (PE 83.909)

2 Seventh Conference of Heads of State or Government of Non-aligned Countries: New Delhi, March 1983; Action Programme, Section C(c)

56. Many Members of the Parliament have argued that I.M.F. conditions are often too onerous. The dangers of domestic political strains which may be caused have been underlined in this report and require the greatest understanding and skills from the Director General and his staff. Your Rapporteur believes that these have normally been shown in the past and that Governments represented in the "Group of 10" should not intervene or attempt to influence such negotiations. But they do have a duty to take note of the agreements completed and to decide if they are in the true interests of the I.M.F. and of the recipients of the loans. Those Governments are responsible for the appointment of the I.M.F. Directors and senior staff and that should be a sufficient safeguard.

57. A country in balance of payments difficulties has no choice but to readjust. If the conditions of readjustment appear to some governments of lender countries to be harsh or dangerous, they have the option of easing the strain through special export credits and bilateral or multilateral development aid programmes. This is also an essential role for the World Bank.

58. Surveillance. The lesson which has been universally drawn from recent events has been that a better early-warning system is required and that the provision of information about patterns of indebtedness must be greatly improved. Not only must the I.M.F. have a firmer grasp of the facts but the knowledge must be shared with the community of Commercial Banks. Although these two parties have different functions and objectives, their activities could be better coordinated with mutual advantage.[1] Such shared knowledge is needed not only to give early warning of trouble but also to ensure a rational allocation of resources. It should also help to dampen swings of sentiment for or against individual borrowers and prevent "self-fulfilling" prophecies (i.e. prophecies that a country will run into difficulty which damage its credit-worthiness and so increase the likelihood of its being in default).[2] One can even see the possibility of "pre-emptive rescheduling". At the same time care will have to be taken that improved smoothness of rescheduling and the favourable financial terms offered to borrowers in difficulties do not lead to attempts by credit-worthy countries to claim the same privileges for themselves and strain the whole structure of lending rates worldwide.

59. The I.M.F. has now given much attention to strengthening this surveillance role, particularly to monitor debt policies. It will provide technical assistance in setting up machinery in member countries which will help them to control

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1 For an illuminating discussion of this aspect see: Graham Bird; The Banks and the I.M.F. - Division of Labour; Lloyds Bank Review No 150, October 1983

2 Anthony F. Solomon (President of Federal Reserve Bank) Address to the International Centre for Monetary and Banking Studies (page 9) Geneva, 8.4.83

external borrowing; it will compile and publish statistics on external debt; it will improve cooperation and exchange of information with the World Bank, BIS and national authorities. Most important of all is the circulation of this knowledge throughout financial markets and for this the Fund will collaborate with the IIF as being the chosen instrument of surveillance in the private banking sector. The IIF has a highly important part to play.

60. Clearly, there are problems of confidentiality for both the I.M.F. and IIF. Information will not be forthcoming for either institution unless the wishes of those who provide it are respected. Both have agreed to be guided by those wishes as regards the use and release of information.

61. Bridging loans. These short term arrangements were the essential first step in dealing with the liquidity crisis. They were provided by national Treasuries and the BIS while the longer term vehicles of the I.M.F. and the Commercial Banks were being trundled into action. They are unlikely to be available in the future. As has been noted, the I.M.F. cannot provide them. The BIS has declined to repeat the exercise. As far as the US Treasury is concerned, the Deputy Assistant Secretary, Mr Mark Leland, told your Rapporteur: "There will be no further bridging loans of any kind". Without the US, the rest of us will not get very far. It is therefore essential that the surveillance system, discussed in the previous paragraphs, be so effective as to make surprise impossible and to allow all rescheduling to start at the medium-term stage. One must hope that this can be achieved. If not, no doubt, some adequate reaction will be devised but it would be very wrong to use that assumption as an excuse for neglect.

62. Guarantees to Banks. During the initial shock of the liquidity crisis, it was feared that some banks might find themselves in over-extended positions which could not be restored by normal commercial means. It was believed that one or two such bankruptcies would produce a "card-house effect" which would spread rapidly, through a calling-in of inter-bank loans, and destroy the whole system. It was suggested by some that governments should guarantee selected high-risk loans or even all additional commercial loans necessary for rescheduling arrangements. The most fundamental proposal was for the creation of a new intergovernmental finance institution which would take over from the banks all loans to LDCs. Fortunately, the immediate crisis was averted without the need for underwriting of any loans by either the I.M.F. or by governments.

63. The prevailing view on this question was that commercial banks must operate at their own risk. Removal of that risk would also remove any real financial discipline. During the phase of rapid credit expansion, commercial loans had been

very profitable and that expansion would be dangerously accelerated if the risk element were removed. It can be said that the security of the commercial banks has been adequately underpinned by the action of the I.M.F. in entering into joint rescheduling arrangements with high conditionality and a stronger system of surveillance. Your Rapporteur does not believe that formal guarantees of any kind should be provided.

64. Trade and Lending. It has been noted in paragraph 34 that the massive lending that has taken place has not been reflected in a comparable improvement in the trade performance of LDCs. This aspect has been of particular concern to GATT. The Director-General, Mr Arthur Dunkel, drew repeated attention to the fact that recovery from the debt crisis could not take place in the face of any increase of Western resistance to Third World exports. He has also drawn attention to contradictions in the present system of allocating resources. For instance, the huge recent investment of external capital in Brazil's steel-making industry could be totally wasted as a result of Western resistance to steel imports. "Western Banks are paying for Western protectionism".[1] Another obvious example is Japanese investment in Korea.

65. In the long run, the solution to these problems must lie in market forces and the historical allocation of certain classes of production to developing and newly industrialising countries. But meanwhile, there are important decisions on resource-allocation being taken each week without full regard to future trade consequences. However, for some time now GATT has been regularly represented by an observer at meetings of the Interim Committee and the Secretary-General and his staff enjoy a close working relationship with the I.M.F.

66. Direct Investment. Problems of debt service would be reduced if a higher proportion of development capital for the LDCs was in the form of equity investment instead of loans. This aspect tends to be overlooked. The mistrust of multinationals in some LDCs and the reciprocal mistrust of many international companies for the reliability of the administrations in receiving countries have gravely damaged this channel of growth. Nevertheless, virtually the whole of productive capacity in the Third World today has been achieved with the participation of US, European and Japanese direct investment.

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[1] Arthur Dunkel. Address to Royal Institute of International Affairs London, 22 March 1983.

67. Parliament has already examined this problem.[1] It cannot be said that the various "codes of conduct" have resolved it, though they have no doubt helped considerably. A comprehensive approach to the whole problem was recently set out by the President of the United States himself.[2] This is a good basis for further consideration by OECD and the World Bank, as well as the various Regional Development Banks. Methods of improving the flow of direct investment should be studied as a matter of urgency.

68. Interest Rates. Finally, the most important aspect of all is the level of interest rates. Increases in industrial production and a recovery in world trade will not be enough to prevent new failures of liquidity in one country after another if the burden of servicing earlier debts remains too high. M. de Larosière has pointed out that present interest rates in the seven largest economies are 5% above inflation rate and has expressed the view that 2% would be enough.[3] Whatever the proper gap, it is clear that these rates are being determined unilaterally in Washington and your Rapporteur has already expressed the view that US budgetary deficits are going to be an insuperable obstacle to any sizeable fall in interest rates for some time to come. The Community has a duty, because of both exchange rate and world debt considerations, to continue pressing for the earliest improvement.

E. Future Outlook

69. In the last year, the world has surmounted a debt crisis of the very gravest nature without a collapse of financial markets. Much remains to be done. Some of the contributions pledged to the I.M.F. are still outstanding. Important rescheduling exercises are still uncompleted. Some countries which have been helped over their immediate problems will be back with their troubles again within two years. The confidence of the banking community has been badly shaken. Most important of all, the total exposure of the Commercial Banks is extraordinarily high. Some US banks have been in trouble and Community banks are very vulnerable to any disorder in the US banking system. There have been complaints by borrowers about what they consider to be the very high charges made by Commercial Banks for their participation in rescheduling. There is also a dangerous lack of prudence on the part of some banks which are reluctant to face up to shareholders and write down unsatisfactory loans on their balance sheets.

70. Nevertheless, there are a few signs of Spring. The most recent analysis of Third World indebtedness shows a distinct settling down.[4] It appears that LDCs will have cut down their aggregate balance of payments deficit by the end of this

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1 Caborn Report on Enterprises and Governments in International Economic Activity. Resolution OJ C 287 of 9 November 1981, pages 25-28

2 President Reagan. Statement on US Investment Policy: Washington, 9.9.83

3 J. de Larosiere. Statement to French foreign trade symposium. 7.12.83

4 Professor William Cline. International Debt and the Stability of the World Economy: Washington, Autumn 1983

year to $67 billion in contrast with $110 billion for 1981. As already noted, the ratio between debt service payments and exports has come down from 24% to 19%, though for some it remains much higher (see paragraph 9). What debtor countries can do for themselves will be greatly helped by general developments in the industrial countries. The latest forecast for growth in this sector is 3.5% for 1984 and this could lead to a 4.5% expansion of world trade. The I.M.F. considers that every increase of 1% in growth in industrialised countries means $35 billion more exports for LDCs. Although these figures are all open to challenge, the trend is encouraging. Nevertheless, the need for a fall in interest rates remains paramount.[1]

V. EUROPEAN MONETARY COOPERATION

A. Scope for Cooperation

71. In the circumstances described in Sections II to IV of this report each major industrialised economy or group of economies should strive to make its best contribution to international stability, recovery and growth. We have seen that certain aspects of US financial policy (neglect of exchange rate problems, higher interest rates) and of Japanese policy (neglect of capital movements) have damaging effects. Is the Community doing any better and is it exerting its full strength?

72. The capabilities of the EEC are obvious enough. Viewed as a single unit, it has the largest manufacturing capacity in the World. Its innovative powers are unequalled. Its external and internal trade accounts for more than 30% of the World's exchange of goods and services. Its Members hold one third of all foreign exchange resources and half of total gold resources. It has three currencies which, to a greater or lesser degree, are used as reserves or for trading. But it is at once obvious that the Community can only exert its full effective weight on the international financial scene if its policies and efforts are co-ordinated and its currencies can operate as one. Such requirements are recognised in the Treaty of Rome.

73. Article 105 of the Treaty set up the European Community's Monetary Committee (ECMC) to report regularly or to deliver opinions to the Council and Commission on the monetary and financial situations of the Member States and their general payments systems. This Committee meets about once a month in Brussels and satisfactorily fulfils its functions. However, its proceedings are

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1 c.f. Report to the European Parliament by Mr M. ALBERT and Professor R.J. BALL, "Towards European Economic Recovery" : section 55

strictly confidential and Parliament is therefore unaware of the scope and aims of its discussions at any time. Without wishing to disturb this system (which is no doubt rather comfortable for national Treasuries and the Commission) the Economic and Monetary Committee of the Parliament might like to invite the Chairman of the ECMC to appear before it to explain the approach of his Committee towards the tasks allocated to it.

B. The European Monetary System (EMS)

74. The main thrust of European financial cooperation is through the EMS. It is on the satisfactory functioning of this system that the force and quality of the Community's contribution to international financial stability depends. Furthermore, the EMS is itself intended to be a potent unifying force within the Community. There had been no major study of the system by Parliament since early 1980[1] until the recent appearance of the Herman report[2]. However, the situation is known to Members and there is no need to recapitulate earlier history. The present situation is as follows :-

(i) Whereas the EMS was originally set up as a new approach to European economic integration, the persistent (and sometimes increasing) divergencies between the economies of the Member States have prevented such progress and have reduced the role of the EMS largely to that of regulating mutual exchange rates.

(ii) In this limited field, the Exchange Rate Mechanism (ERM) has proved rather successful and has considerably improved short-term stability. There has also been some success in preventing unnecessary currency movements against the medium-term trend (cf. the DM/FF relationship in 1981).

(iii) There has been an almost total absence of any joint policy towards the dollar. The result has been that the Deutschemark, as the strongest currency in the EMS, has become the medium of the relationship. The absence of sterling is considered by many to be a notable disadvantage. The achievement of a proper joint Community basis for an ERM/\$ relationship and for dealing with the US (and Japanese) monetary authorities is the outstanding need of the moment.

(iv) The lack of progress towards economic integration is reflected in the failure to move towards stage 2 of the EMS. A major new initiative in this direction will be necessary if the Member States agree that they wish to make progress.

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1 Ruffolo Report of 11.4.1980. Resolution in Ruffolo Report OJ C 117 of 12.5.1980 pp. 56-59

2 Doc. 1-1251/83 adopted by Plenary on 16.2.1984.

75. Recommendations from the Parliament concerning international financial stability cannot be of much significance unless accompanied by suggestions for improved monetary cooperation within the Community. Apart from the general, long-term requirements for greater convergence and strengthening of the internal market as a preparation for monetary union, there are two crucial problems needing immediate attention - first, UK participation in the EMS and second, the international role of the ECU.

C. UK Membership of the EMS

76. While British membership of the EMS since its founding has proved helpful and constructive, the view has been widely expressed in other parts of the Community that refusal by successive British Governments to take part in the ERM has seriously weakened the system. This view has been based on the already-mentioned absence of a common Community policy towards the dollar and the belief that Europe would be in a much stronger position to deal with monetary authorities in the US and Japan, as well as to exert greater influence in international financial institutions, if they operated a common exchange rate policy - even more so, if they were to move on to a common currency in the second stage of the EMS. Although the British Government have stated on several occasions that they are in principle in favour of fully joining in the Exchange Rate Mechanism, they have advanced a number of reasons (not universally shared in the U.K.) for not doing so. The main ones have been the difficulty of reconciling exchange rate targets with money-supply targets, the status of sterling as a "petro-currency" and the different reactions of sterling and the DM to shifts in the international value of the dollar. Indeed, the British Treasury has never judged the dollar/sterling/deutschmark rate to be right for full British entry. These arguments appear to some critics to wax and wane according to the occasion, giving the impression that political considerations are exerting the real pull. The main political factor in mind is that of sovereignty, but one is tempted to ask what is so sovereign in a currency (sterling) that has depreciated by 60% in three years and has been forced to relinquish most of its international role to the DM? In any case, there are other political arguments besides sovereignty, and they do not point in the same direction.

77. In the course of the last year, the British House of Lords carried out the most exhaustive and authoritative examination of this problem published to date[1]. This concludes with the words: "The Committee believes that though exact timing

[1] House of Lords. Select Committee on the European Communities. 5th Report: European Monetary System. London. 26.7.1983

must depend on general government policy, the balance of advantage lies in early, though not necessarily immediate, entry". The British Government did not accept the recommendation[1] in respect of the need for early action. This Parliament has often expressed the hope that the UK Government would decide to join. In fact, the present state of the Community is not such as to encourage major decisions by the UK towards improved cooperation. Parliament, however, will no doubt wish to take a longer view and urge that the matter of full British participation be kept under constant review in the hope that it can be achieved at an early stage.

D. The ECU

78. Use of the ECU as the master currency of Europe has developed slowly but has made strides since it was last considered in the Ruffolo Report. The present situation is as follows:

(i) The ECU is universally accepted by all Community institutions as a unit of account.

(ii) As a means of settlement between member countries, its use has been limited. For instance, only 12-15% of repayments of VSTF credits has been made in ECU. Transfers in and out of ECU have been volatile, presumably to take advantage of exchange rate variations.

(iii) In the private sector, deposits have grown rather faster. At the end of this year, there should be about 1.5 and 2 billion ECU respectively in privately denominated deposits and loans.

(iv) The ECU has risen to third place as a denomination for Eurobond loans, which continue to increase although they still represent only about 4% of total such issues. (See Annex 6).[2]

(v) A few companies have started invoicing in ECU. Notably, these include some Japanese multinationals. This practice ought to appeal to many more firms as an insurance against exchange rate and interest rate fluctuations.

79. Although the ECU has not yet achieved the widespread use originally hoped for, it is more popular than its international rival, the IMF's SDR, which appears to have caused some surprise in Washington. In the longer term, it should be the basis for the issue of Community bank notes and for a world reserve and vehicle currency that could influence decisions about the dollar exchange and interest rates. Meanwhile, there are a number of points which should be considered as ways of increasing the use of the ECU:

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1 House of Lords. Hansard, 14.11.1983, cols. 1138-1142

2 Source: San Paolo News Letter No. 6, September 1983

(i) Most important is the conclusion as soon as possible of arrangements for an ECU clearing system for commercial banks. This, like clearance for central banks of their ECU financial operation, will be handled by the BIS. It should help the flow of ECU as a means of settlement. This should be followed by active canvassing through banks of the advantages of ECU invoicing by private companies.

(ii) While it would be unwise to ask that creditor governments should accept 100% repayments in ECUs, there should be more deliberate pressure to accept ECUs for official settlements above the present 50% rate.

(iii) There should be a serious effort to spread the use of the ECU to inter-governmental and interinstitutional transactions with countries outside the Community.

(iv) The role of the European Monetary Cooperation Fund (FECOM), which is meant to supervise the exchange operations and settlements of the EMS, is in fact rather immaterial. It has delegated its operating powers to the BIS and does not appear to publish its own accounts. Your rapporteur cannot say what takes place at its monthly meetings and the Economic and Monetary Committee of Parliament might care to invite the Secretary General to report on the work of the organisation and to reveal whether it is in a position actively to strengthen the role of the ECU.

80. In addition to the above, the Commission has itself proposed to the Council certain basic administrative measures to give greater currency to the ECU in the private sector.[1] These are the subject of a motion for a resolution[2] on which there has not yet been any report. Parliament will no doubt wish to see urgent action taken on this.

VI FUTURE ACTION

A. Motion for a Resolution

81. This report has reached certain broad conclusions on the subjects of financial instability and Community trade.

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[1] European Commission. Communication to the Council No. 7152/83 (ECOFIN 55), 24.5.1983

[2] Doc. 1-876/83 (PE 86.986)

(i) Volatility in foreign exchanges inhibits both trade and investment.

(ii) Instability arising from illiquidity in Third World countries restricts their ability to trade and puts pressure on industrialised countries to import more and export less.

(iii) Financial instability gives rise to strident ~~demands~~ demands for protectionism.

(iv) In the above three respects, the Member States of the Community should not expect to suffer more than other industrialised countries.

(v) Nevertheless, the refusal of the United States to address itself to exchange rate problems and their insistence on maintaining very high rates of interest throughout the recession and the liquidity crisis have been a major factor in slowing recovery and have thrown an extra burden onto the Commutniy.

(vi) The Community would be in a stronger position to influence world financial and monetary events if it could realise the original aims of the EMS.

82. The details of this report have been concerned with the mechanisms of the above problems. Equally, the draft resolution seeks to advance ways of dealing with them. For the reasons given in the very first paragraph of this report, your rapporteur has sought to avoid sweeping general recommendations in favour of precise ideas and practical measures.

B. The Economic Recovery of the EEC

83. It will be seen that the ideas and conclusions in this report in no way conflict with those contained in the report of Mr Ball and Professor Albert; indeed, they would appear to support and complement them in all respects. Both reports are based on the need for an increasingly united Europe, as opposed to "non-Europe", and on the belief that we should treat our problems as opportunities to increase cooperation rather than to indulge our differences.

84. Mr Ball and Professor Albert dealt only rather generally with financial and monetary problems, though Chapter 5, Section 55, discusses the subject at some length. It is recommended, therefore, that the two reports be considered together and that this document be sent to the temporary special committee, set up by the decision of the European Parliament,[1] for urgent consideration as part of the "Relance Economique Europeen".

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[1] Motion for a resolution Doc. 1-569/83, 6.7.1983. Decision in OJ C 277 of 17.10.1983, p.134

Absolute percentage changes in daily exchange rates against US dollar

1. Deutsche Mark

YEAR	number of observations	of which: larger than 1 per cent.
1973	237	41
1974	244	24
1975	249	9
1976	254	1
1977	252	7
1978	253	39
1979	251	11
1980	252	27
1981	251	62
1982	253	37

2. Japanese yen

YEAR	number of observations	of which: larger than 1 per cent.
1973	237	12
1974	244	15
1975	248	0
1976	251	0
1977	249	3
1978	250	42
1979	250	17
1980	249	36
1981	250	31
1982	249	56

3. Pound sterling

YEAR	number of obsevations	of which: larger than 1 per cent.
1973	253	6
1974	253	10
1975	254	5
1976	255	22
1977	252	6
1978	252	22
1979	253	21
1980	254	16
1981	252	57
1982	253	28

Volatility of dollar rates

YEAR	Average daily pecentage change vis-a-vis:			Same as left : adjusted for the trend factor during the period		
	DM	Yen	Pound	DM	Yen	Pound
1973	.56	.23	.24	.49	.20	.23
1974	.50	.28	.30	.46	.25	.30
1975	.37	.14	.23	.34	.13	.17
1976	.22	.13	.36	.18	.12	.29
1977	.28	.26	.14	.23	.18	.10
1978	.55	.55	.43	.50	.47	.40
1979	.33	.46	.42	.30	.38	.38
1980	.47	.52	.37	.42	.45	.35
1981	.73	.55	.65	.67	.52	.57
1982	.55	.64	.46	.53	.61	.40

Examples of major swings in real effective exchange rates*
since 1975

1. US dollar

			%
Dec. 1975	to	Oct. 1978	-17.0
Oct. 1978	to	Dec. 1982	+38.3

2. Deutsche mark.

Dec. 1975	to	Dec. 1979	+15.9
Dec. 1979	to	Dec. 1982	-15.0

3. Japanese yen

Jan. 1975	to	Aug. 1978	+39.8
Aug. 1978	to	Feb. 1980	-35.1
Feb. 1980	to	Feb. 1981	+25.4
Feb. 1981	to	Oct. 1982	-19.8

4. Pound sterling

Apr. 1975	to	Oct. 1976	-15.5
Oct. 1976	to	Jan. 1981	+68.2
Jan. 1981	to	Dec. 1982	-14.0

(*) Effective exchange rate adjusted for differences in the movements of industrial wholesale price indices.

Non-Oil Developing Countries: External Debt, 1973–83 [1]

(In billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Total outstanding debt of non-oil developing countries	**130.1**	**160.8**	**190.8**	**228.0**	**278.5**	**336.3**	**396.9**	**474.0**	**555.0**	**612.4**	**664.3**
Short-term debt	18.4	22.7	27.3	33.2	42.5	49.7	58.8	85.5	102.2	112.7	92.4
Long-term debt	111.8	138.1	163.5	194.9	235.9	286.6	338.1	388.5	452.8	499.6	571.6
By type of creditor											
Official creditors	51.0	60.1	70.3	82.4	98.7	117.5	133.0	152.9	172.4	193.2	218.7
Governments	37.3	43.4	50.3	57.9	67.6	79.1	87.2	98.7	108.6	120.4	135.3
International institutions	13.7	16.6	20.3	24.8	31.0	38.4	45.8	54.2	63.8	72.8	83.3
Private creditors	60.8	77.9	95.1	114.8	137.3	169.1	205.1	235.6	280.4	306.4	353.0
Unguaranteed debt	29.3	36.0	40.8	45.9	51.4	56.4	67.3	77.5	96.7	103.9	113.7
Guaranteed debt	31.5	42.0	52.4	66.6	85.9	112.7	137.8	158.1	183.7	202.2	239.3
Financial institutions	17.3	25.6	36.7	49.0	59.1	79.5	102.9	121.6	144.5	159.5	193.8
Other private creditors	14.2	16.3	17.6	19.8	26.8	33.2	34.9	36.5	39.2	42.7	45.5
By analytical group											
Net oil exporters	20.4	26.0	34.1	42.4	53.3	61.2	70.5	79.4	96.5	108.1	129.0
Net oil importers	91.4	112.1	129.4	152.5	182.7	225.4	267.6	309.1	356.2	391.5	442.6
Major exporters of manufactures	40.8	51.7	60.9	73.1	85.2	108.1	127.7	145.2	170.6	184.3	212.4
Low-income countries	25.4	29.7	33.2	38.3	46.5	53.1	59.5	67.0	73.0	80.1	90.8
Other net oil importers [2]	25.2	30.6	35.3	41.1	51.0	64.2	80.4	96.9	112.7	127.1	139.4
By area											
Africa	14.2	17.7	21.9	26.9	35.0	42.1	49.6	55.1	60.5	67.1	75.0
Asia	30.0	34.6	39.8	46.4	57.9	67.4	76.1	88.4	100.8	115.1	131.7
Europe	14.5	17.2	20.0	23.4	28.7	38.2	49.0	57.5	63.4	69.2	73.8
Middle East	8.7	10.3	13.3	16.1	20.3	24.7	28.4	32.9	35.4	39.3	43.7
Western Hemisphere	44.4	58.2	68.6	82.0	94.0	114.3	135.1	154.7	192.6	208.9	247.4

Sources: World Bank, Debtor Reporting System; and Fund staff estimates and projections.

[1] For classification of countries in groups shown here, see the introduction to this appendix. Excludes data for the People's Republic of China prior to 1977.

[2] Middle-income countries that, in general, export mainly primary commodities.

From International Monetary Fund World Economic Outlook, p.200, Washington DC, 1983

Non-Oil Developing Countries: Long-Term and Short-Term External Debt Relative to Exports and to GDP, 1973–83 [1]
(In per cent)

		1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Ratio of external debt to exports of goods and services [2]											
All non-oil developing countries	115.4	104.6	122.4	125.5	126.4	130.2	119.2	112.9	124.9	143.3	144.4
By analytical group											
Net oil exporters	154.7	124.9	162.4	169.5	179.3	176.9	144.3	128.4	154.6	179.5	192.2
Net oil importers	109.4	100.9	115.4	117.5	116.8	121.8	114.1	109.5	118.3	135.1	134.3
Major exporters of manufactures	91.7	88.6	103.0	103.3	99.5	101.1	96.9	94.0	100.6	116.2	114.2
Low-income countries	227.9	214.5	226.1	225.1	217.8	226.3	209.8	201.4	231.1	254.1	262.9
Other net oil importers [3]	96.9	84.7	98.3	104.3	111.6	124.8	115.5	110.9	121.9	138.0	136.6
By region											
Africa	71.5	65.4	80.9	94.2	103.1	111.4	100.8	97.4	119.9	147.4	148.6
Asia	92.9	81.0	91.6	84.4	83.3	77.7	70.2	68.2	72.5	80.9	85.4
Europe	102.4	97.1	108.0	114.9	127.4	136.4	125.6	121.6	118.2	129.6	129.7
Middle East	145.4	105.2	131.5	137.5	140.4	142.4	133.8	113.1	112.6	134.3	133.1
Western Hemisphere	176.2	163.4	195.8	204.1	194.1	211.5	192.9	178.4	207.4	245.6	242.8
Ratio of external debt to GDP [2]											
All non-oil developing countries	22.4	21.8	23.8	25.7	27.4	28.5	27.5	27.6	31.0	34.7	34.7
By analytical group											
Net oil exporters	26.2	25.5	27.7	32.3	38.5	39.3	37.4	34.0	36.1	44.7	43.5
Net oil importers	21.7	21.2	23.0	24.4	25.4	26.6	25.8	26.3	29.7	32.1	32.7
Major exporters of manufactures	20.2	19.6	22.2	22.7	23.9	25.1	24.6	25.1	29.3	33.2	33.8
Low-income countries	20.1	20.1	20.9	24.4	24.9	24.0	24.4	23.6	24.7	26.2	26.5
Other net oil importers [3]	26.2	25.2	26.2	27.7	28.6	31.5	28.8	30.6	34.1	35.8	35.6
By region											
Africa	19.4	19.6	21.6	25.8	28.4	29.4	28.9	28.8	30.6	35.2	35.1
Asia	19.7	18.9	20.4	22.4	23.4	22.3	22.2	23.2	25.2	26.7	27.1
Europe	24.5	23.1	22.8	24.6	25.7	28.6	25.1	29.0	33.1	34.7	34.5
Middle East	36.2	34.0	39.0	42.3	45.4	48.3	56.0	52.6	51.3	50.3	47.4
Western Hemisphere	23.0	22.8	25.5	26.4	28.4	30.3	28.8	27.0	31.9	38.2	38.6
Memorandum items											
Ratios (including People's Rep. of China) [2]											
To exports:											
All non-oil developing countries	...	...	...	...	123.6	127.0	116.1	109.4	119.8	136.5	137.7
Low-income countries	...	...	...	...	169.0	170.0	152.0	137.7	140.0	148.7	155.5
To GDP:											
All non-oil developing countries	...	...	...	...	23.9	24.6	23.9	24.1	27.3	30.5	30.5
Low-income countries	...	...	...	...	14.3	13.5	13.4	13.2	14.3	15.1	15.3

Sources: World Bank, Debtor Reporting System; and Fund staff estimates and projections.
[1] Excludes data for the People's Republic of China, except where noted. For classification of countries in groups shown here, see the introduction to this appendix.
[2] Ratio of year-end debt to exports or GDP for year indicated.
[3] Middle-income countries that, in general, export mainly primary commodities.

From International Monetary Fund World Economic Outlook, p.201, Washington DC 1983

In the period January-June 1983 the ECU confirmed its rank as the third currency of denomination for new eurobond issues, after the U.S. dollar and the D.M., reaching a share of more than 3% of the Euromarket. The amount of ECU bonds issued in the first six months of 1983 is slightly superior to that registered in the same period in 1982.

NEW EUROBOND ISSUES
(new issues in period, millions of dollars)

	1983 (Jan.-June)	%	1982 (Jan.-June)	%	Δ % 1983/1982
U.S. $	21,913	81.4	26.137	86.8	—16.2
D.M.	2,687	10.0	1,163	3.9	+131.0
ECU	865	3.2	751	2.5	+15.2
CAN $	497	1.9	970	3.2	—48.8
HFL	325	1.2	367	1.2	—11.4
Other	630	2.3	726	2.4	—13.2
	26.917	100.0	30,114	100.0	—10.6

Source. Morgan Guaranty Trust, World Financial Markets, August 1983

From San Paolo Newsletter No. 6, September 1983, p.3.

Motion for a Resolution (Doc. 1-1023/82) ANNEX VII

tabled by Mr Seeler, Mr Radoux and Mr Pelikan
pursuant to Rule 47 of the Rules of Procedure
on the external trade of the Community and the problem of global financial instability

The European Parliament,

A regretting the increasing trend towards protectionism in the world economy,

B disappointed by the results of the recent GATT Ministerial Conference in Geneva,

C believing that many of the pressures on the GATT system stem from the wider breakdown of the international institutions of the post-war economic settlement,

D noting the importance of widely fluctuating currency values on the terms of trade, with consequences for investment decisions and economic policy making,

E noting the difficulties posed for the financing of international trade by the world's current liquidity and banking problems,

F considering that the current levels of debt affecting certain of the newly industrialized countries (e.g. Mexico, Brazil) inhibit them from assuming their full responsibilities,

G concerned at the prospect of countries engaging in competitive devaluations to gain trade advantages,

H noting the protectionist problems associated both with a strong US dollar and an undervalued Japanese yen,

1. Calls upon the European Commission to investigate the impact of global financial instability on the external trade of the Community;

2. Requests the Commission to report back to Parliament as soon as possible on this matter with a view to a major policy initiative by the Community.