International Liquidity Reconsidered*

By Wilfried Guth, Frankfurt a. M.

I. The Issues

A good forty years ago a distinguished group assembled at Bretton Woods in search of a suitable way to establish a sound and lasting international monetary system. One central issue was how to supply the world with international liquidity and how to control that supply. Since then "international liquidity" has never really disappeared completely from the agenda whenever international monetary questions were discussed.

At this year's London economic summit, for example, it was agreed that the Finance Ministers should "carry forward their current work on ways to improve the operation of the international monetary system, including ... the creation, control and distribution of international liquidity ...". And at the recent meeting of the International Monetary Fund the "Group of 24" has reiterated its request for a substantial new allocation of Special Drawing Rights.

Why is the liquidity question currently receiving so much attention again (as also evidenced by the challenging task I have been given by our Committee)? As far as I can see there are three reasons:

- Firstly, the general concern about the international debt crisis, which some regard as nothing more than a liquidity crisis. The last world recession has also been attributed by some observers to the (allegedly) unsatisfactory development of international liquidity.
- Secondly, uneasiness about the irregular and unpredictable development of international liquidity, which depends largely on the strength or weakness of the dollar.
- Thirdly, general discontent with the present monetary "system" with its wide and often unpredictable exchange rate fluctuations, leading to calls,

---

* Vortrag vor dem Institut International D'Etudes Bancaires am 12. Oktober 1984 in Wien.

particularly from the French authorities, for a fundamental overhaul of the international monetary system and a new Bretton Woods. Here the liquidity problem sneaks in through the back door, so to speak, as any fundamental reform would have to take into account both the exchange rate system and a mechanism for the supply of international liquidity.

As to the last reason I want to make it clear from the outset that to my mind there is no need to refight the battles of the late sixties and early seventies over the virtues and drawbacks of different monetary arrangements. In my view there is no realistic alternative to the present international monetary system as floating exchange rates are the only means to deal with large and volatile money flows and capital movements between the world's key currencies. I am not even in favour of proposals of a more marginal nature such as the introduction of target zones. It is quite another matter to aim at reducing erratic exchange rate fluctuations through appropriate intervention of central banks and, more important, better coordination of national monetary and fiscal policies.

Nevertheless the question of adequate supply of and demand for international liquidity has lost none of its importance in the present monetary environment. After taking a brief look at the questions that arise just in defining liquidity – important, in my view, if we are to appreciate actual developments – I would like to address four problem areas:

- How have the volume and structure of international liquidity developed in the past? In particular the role of the different reserve assets, the multicurrency reserve system and the role of the international financial markets for the supply of liquidity need to be examined.
- Has discussion on providing the world with an "adequate supply" of international liquidity achieved results tangible enough to allow us to determine the necessary amount of global liquidity growth? Or is it rather a distribution problem?
- How can international liquidity be controlled at present and what improvements are conceivable?
- Finally: to what extent is a liquidity shortage responsible for the debt crisis of many developing countries? What role, if any, can an allocation of SDRs play in overcoming the debt problems?

This is a host of questions connected, to a greater or lesser degree, with other pressing economic policy challenges. But before I enter the field, I would like to put forward a somewhat provocative thesis: the main problems which economic policy makers face almost everywhere – high

unemployment in the industrial countries and debt problems in many developing countries – do not stem from a global lack of international liquidity. On the contrary, we can say that in the past an oversupply of international liquidity has contributed to aggravating these problems.

II. The Role of International Liquidity and Definition Problems

In the following remarks I concentrate largely on "international liquidity" as held by monetary authorities. This customary view does not in principle include the sometimes large private foreign monetary assets – despite the fact that the international transfer of these assets frequently has a decisive influence on the world monetary scene and that the boundary between official and private liquidity is not always well defined.

What is the role international liquidity plays in a country's foreign trade and payments? What do monetary authorities need international liquidity for? In answering these questions I would like to distinguish between two main functions:

Firstly, the monetary authorities of every country need a supply of internationally accepted payment media to shelter their economy from unforeseen (negative) and abrupt swings in current payment and capital flows. In this regard the role reserves played in the fixed exchange rate system prior to 1973 was clear-cut since reserves were required to cover temporary balance-of-payments deficits and to defend existing parities or avoid unwelcome exchange rate changes. It was therefore assumed that the introduction of floating would substantially reduce demand for reserves.

Yet this did not happen. Experience since 1973 indicates that even in a floating rate regime no country, perhaps with the sole exception of the United States, seems prepared to let its exchange rate be determined exclusively by market forces, i.e. to refrain from intervention. Instead what we have is a system of managed floating where central banks intervene on a more or less regular basis (though not always on a large scale). And – what is often not realized – floating is far less widespread today than one might think at first glance. Most countries still have fixed exchange rates linked to some key currency and therefore need liquidity for maintaining parity in the short run. Furthermore, countries that have pegged their rates unilaterally to a currency basket such as the SDR or some self-made composite currency also need liquidity to maintain the margins they have set themselves around the parities. All this applies to countries with currency convertibility. In countries which have a centrally administrated exchange regime reserves

are – in the short run – needed to pay for import surpluses and settle debt service obligations.

Irrespective of currency convertibility and the exchange rate regime, it can be stated generally that holding liquidity allows a country to buy time for adjustment when faced with an adverse development in its balance of payments. A lack of liquidity would require the country to undergo immediate economic adjustment which would in all probability place excessive restrictive demands on any economy. Thus a stock of international liquidity is an indispensable shock absorber.

Secondly, a country also needs liquid monetary reserves to safeguard confidence in its currency. Without a level of reserves deemed sufficient by the market its exchange rate might easily come under heavy pressure at the slightest unfavourable incident. By the same token, certain reserve holdings are essential as a basis for successful borrowing operations on international markets; so one can say that without an adequate stock of international reserves the additional liquidity potential of international financial markets is not available; in this sense, market borrowing cannot replace reserves.

International liquidity consists of diverse kinds of assets. According to the standard definition of the IMF, applied for example in its annual reports, international liquidity includes first of all international reserves, i.e. official holdings of foreign exchange, gold, and Fund-related assets; on a broader definition it also includes countries' capacity to borrow from foreign sources which I have just referred to.

In principle, foreign exchange reserves fulfil the stated liquidity functions perfectly. But some provisos ought to be mentioned. Firstly, not all assets counted as foreign exchange reserves by monetary authorities are readily available at all times; for example, in some countries non-liquid claims on countries which have to reschedule their debt have been included in published reserves. Secondly, there is the problem of whether foreign exchange holdings outside the central bank can be included in the reserve position; this has particular relevance for the investment funds of some OPEC countries. Thirdly, it must be borne in mind that the value of foreign exchange reserves can change in the event of strong exchange rate movements; this raises the question of correct valuation. Fourthly, many countries report their reserves on a gross basis only, even though it is highly desirable that net reserve figures should also be published, i.e. gross reserves netted against very short-term liabilities of the monetary authorities.

Although gold is today assigned a much smaller role in the international monetary system than in the fifties and sixties, it should not be overlooked

that it, too, fulfils in part the stated liquidity functions mentioned before: any country can use gold at any time either directly as a payment medium or to obtain internationally accepted payment media on the free markets. And substantial gold reserves are a time-honoured means of bolstering foreign confidence in a currency and are occasionally used as collateral for obtaining foreign credits. But the problem of valuation is even greater here as the gold price has fluctuated wildly in recent years, and it is not difficult to imagine what would happen if several countries were to fall back on their gold reserves at the same time. Nevertheless there is probably general agreement that the valuation used in the IMF statistics of SDR 35 per fine ounce does not properly reflect the importance of world gold reserves. But anyone using the day-to-day valuations must never lose sight of just how questionable they are.

The final undisputed ingredient in international liquidity consists of the IMF-related reserves, i.e. the individual countries' unconditional drawing rights with the Fund (their reserve position in the Fund) as well as their Special Drawing Rights (SDRs). These reserves entitle the "holder" to obtain freely usable currencies (mostly dollars) from the IMF or other member countries in case of a balance-of-payments need; SDRs may in addition be used as a direct means of payment to other central banks. Though the value of the Fund-related assets may also change over time, their denomination in SDRs makes the task of valuation less difficult.

As indicated, however, international liquidity in a wider sense comprises more than international reserves. Firstly, the possibility of obtaining credit from foreign or international official sources should also be taken into account; the swap arrangements between central banks, the IMF's credit facilities, or the credit mechanisms in the EC (and especially in the EMS) are sources that spring to mind here. Countries can count on receiving funds from these sources when they are urgently needed; but apart from very short-term support these facilities are conditional, i.e. with economic policy strings attached.

Secondly, the liquidity concept takes on a decisive further dimension – and one which the IMF and the BIS for good reasons include in their annual analyses of international liquidity – when we consider that countries can tap the resources of the private international financial markets. Indeed, the most important development in the field of international liquidity since the liquidity shortage discussion in the sixties has been the dramatic expansion of the Euromarkets which has enabled countries to finance their external deficits through incurring liabilities. Foreign borrowing was, of course, not a totally new phenomenon. However, the recycling of the petrodollars after

the first oil crisis added a new dimension inasmuch as more and more countries could tap the Euromarkets on an ever growing scale. As a consequence, "reserve settlement" was widely replaced by "liability financing" in the seventies. Today large credit facilities can be arranged in a matter of days and the drawdown periods may be very long. More recently, the international banks have also come up with ingenious standby arrangements involving only very small fees for the borrower if the loan is not drawn down. The borrowing capacity of an individual country can thus be considered a useful addition to foreign exchange reserves and, to a certain extent, serve as a substitute for actually holding such reserves.

However, recent experience has made it only too plain what happens when excessive use is made of the capacity to borrow: indebtedness increases, in turn jeopardizing the future liquidity position (owing, among other things, to the rise of interest service). And, worst of all, borrowing capacity itself can shrink to zero practically overnight even in overabundant financial markets – which in most cases means disaster. Thus, borrowing capacity is without any doubt not only the least measurable, but also the most volatile and delicate part of a country's international liquidity. This must be properly understood if dangerous developments are to be avoided in the future.

III. The Development of International Liquidity

Any attempt to trace the development of international liquidity in this wider sense is thus hampered – apart from the valuation problems just discussed – by the fact that it is only the actual reserve positions of monetary authorities that are quantifiable and not the individual country's borrowing capacity. Nevertheless a glance at the IMF statistics on monetary reserves does reveal some important trends and changing patterns.

By present standards, the Bretton Woods system, at its creation, started out with a fairly ample global supply of international liquidity. At nearly US $ 50 bn., statistically recorded official reserves in 1951 were equivalent to a world import value of 33 weeks. At the time, of course, reserve holdings were heavily concentrated in the USA with its large gold stock. Over the following two decades – in an environment of strongly expanding world trade and, in the sixties, growing importance of capital transactions and at times considerable US balance-of-payments deficits – overall reserves grew at a moderate though accelerating pace (by around 60 per cent to nearly US $ 80 bn., i.e. by an annual average of 2.7 per cent). By the end of 1969 global import coverage had contracted to 16 weeks or less than half the

figure for the early fifties (while the figure for non-gold reserves had fallen from 10 to 8 weeks). However, in the process the distribution of liquidity improved inasmuch as the United States' share in total reserves declined (from 50 per cent to around 20 per cent) largely in favour of reserve gains, especially in the form of dollar holdings, by other industrial countries.

The picture changed abruptly at the beginning of the seventies. These were the years when the US dollar and with it the whole Bretton Woods System came under severe pressure and world inflation began to accelerate. In the further course of the decade the international payments and reserve system had to absorb the impact of the two oil price hikes and strongly fluctuating exchange rates. In the early seventies and then again in 1977 and 1978 some European countries and Japan tried to counteract the strength of their currencies against the US dollar with large dollar purchases, since they feared damage to their exports. In addition there was the purely arithmetic effect of the strong decline in the exchange rate of the US dollar on the value of non-dollar reserve assets.[1] All in all international monetary reserves (without gold and in gross terms, i.e. excluding external liabilities of the reserve holding authorities) increased by an average of almost 25 per cent per year from the beginning of 1970 to the end of 1980 when they amounted to some US $ 410 bn.

While all groups of countries added greatly to their reserves there was, not surprisingly, a pronounced shift in the distribution of global reserve assets. At around 20 per cent the oil countries' combined share in total non-gold reserves was about three times as high at the end of the seventies as at the beginning; at the same time the ratio of the industrial countries decreased correspondingly from some 70 per cent to about 55 per cent whereas the share of the non-oil developing countries remained more or less unchanged at close to 25 per cent.

The growth in non-gold reserves in the seventies far exceeded the rapid increase in world imports; if at the end of 1969 they covered imports for some 8 weeks, in 1980 this figure was 11 weeks. In addition, it must be borne in mind that the free market value of gold reserves was enhanced by the simultaneous rise in the gold price from US $ 35 to US $ 590 per ounce. Furthermore the borrowing potential of many countries increased substantially in the seventies with the Euromarkets expanding at an annual rate of 20 to

---

[1] In 1979 a large part of the recorded increase in non-gold reserves resulted from the issuance of ECUs against deposits of a portion of EMS members' gold holdings (whereas the issuance against part of their dollar holdings did not add to the size of reserves).

25 per cent. Overall, these facts and figures throw light on the thesis put forward at the outset: the problem of the last decade consisted basically not in a shortage, but in an excessive supply of international liquidity.

Viewed at a more fundamental level, the strong involvement of commercial banks in the recycling of oil surpluses in the seventies has resulted in important systemic changes. The international banking system has become an integral element of the world monetary system besides the established official institutions and monetary support arrangements. One may even say that (unconditional) international bank credits for the financing of external deficits have, to a certain extent, replaced the conditional IMF loans as the first line of defence for countries with payment difficulties.

The development of international liquidity changed again after 1980 against the background of world recession and falling commodity prices. Non-gold reserves contracted by a total of US $ 45 bn. in dollar terms in 1981/82 and despite a subsequent increase (by around US $ 20 bn. to US $ 385 bn. until mid-1984) there has, on balance, been a remarkable deceleration in reserve growth in the eighties.[2] It is interesting to note that this slowdown took place while there was a drastic deterioration in the U.S. balance of payments. The high current account deficit has been financed overwhelmingly through inflows of private capital – which means that private dollar balances have been rising worldwide rather than official monetary reserves.

The deceleration since 1980 in the growth of official reserve holdings was primarily attributable to three developments: firstly, there was a drop in recorded reserve holdings of the OPEC countries partly as a result of their investment decisions, partly because of the emerging sluggishness of the oil market. Secondly, as the US currency strengthened, the monetary authorities of several European industrial countries sold sizeable amounts of dollars in order to support their currencies against the dollar and, in the case of EC members, to keep their exchange rates within the EMS fluctuation band. It is nevertheless an incontestable fact that most industrial countries have no reserve problems at all: while some of them may have rather small reserve holdings, virtually all of them have relatively easy access to credit markets. Indeed, in the last few years some industrial nations have

---

[2] To a certain extent these figures reflect a "valuation effect" of the strong appreciation of the US dollar on non-dollar exchange holdings. But there has also been a marked change in the development of non-gold reserves in SDR terms which is less affected by exchange rate fluctuations: From the end of 1980 until mid-1984 they increased at an average annual rate of 4 1/2% (to a good SDR 370 bn.) compared with an average annual growth rate of more than 20% in the seventies.

raised substantial credits abroad (directly or via their banking systems) with the obvious aim of replenishing their reserves, examples here being France and Italy.

Thirdly, and most important for the world financial scene as a whole, there was, of course, the substantial deterioration in the external position of many developing countries. A growing number of highly indebted countries was compelled – because of capital flight among other things – to call on their reserves. For example, the non-gold reserves of the ten largest borrowers[3] which account for about 75 per cent of the total debt of all countries with payment difficulties fell from US $ 54 bn. at the end of 1980 to merely US $ 25 bn. at the end of 1982. Since then, however, reserve holdings of this group have recovered under the impact of domestic adjustment measures as well as the flow of "fresh money" from the IMF and the commercial banks and, more recently, a reversal in the trend of exports; by mid-1984 Brazil and Mexico, for example, had rebuilt their reserves by about US $ 3 1/2 bn. and 5 bn. respectively. Meanwhile the average import coverage, at 20 weeks – with the national figures ranging from 4 to 6 weeks for Nigeria, Yugoslavia and the Philippines to nearly 70 weeks for Venezuela –, is almost as high again as in 1980 when it amounted to 22 weeks.

Of course, the relatively high import coverage figures for a number of debtor countries look better than they really are as they reflect in large measure the drastic cuts in their imports in the last couple of years. And the adequacy of reserve holdings of newly industrializing and developing countries must, in principle, also be judged in the light of their (increased) indebtedness, especially short-term, and their often very high and fluctuating interest payment obligations.

The decisive factor is, however, that for many countries access to the international credit markets has been virtually blocked as a result of the recent debt servicing problems. The international liquidity of these highly indebted developing countries has thus in fact been reduced to the diminished level of their actual reserve holdings and to the availability of further (organized) financial support by the banks and official creditors. In other words, the real cause for concern today is the distribution of liquidity rather than the somewhat vague and elusive question of global liquidity supply.

At this point I would like to conclude my empirical survey by commenting briefly on two major recent changes in the composition of global monetary

[3] Argentina, Brazil, Chile, Mexico, Nigeria, Peru, Philippines, Poland, Venezuela, Yugoslavia.

reserves. Firstly, there has been a change in the number and position of reserve currencies. In the seventies monetary authorities, especially of OPEC and other developing countries, became increasingly interested in holding foreign exchange reserves in currencies other than the US dollar, mainly in D-Marks, Yen, and Swiss Francs. To some extent this change in their international reserve policies no doubt reflected some countries' growing distrust of the dollar at that time. It is remarkable, however, that although the dollar's recovery since 1981 has strengthened its – unchallenged – position as principal reserve currency, there has been no reorientation of the system towards a pure dollar standard. At the end of 1983 the dollar accounted for 69 per cent of identified foreign exchange reserves, the D-Mark 12 per cent, the Yen 4 per cent and others (including unspecified holdings) 15 per cent.[4] So it would seem justified to call our present-day monetary system a multi-currency reserve system. There can be no doubt that this increases the international reserve potential, i.e. the scope for investment (and borrowing) possibilities of reserve holding authorities.

Secondly, the strong rise in the member countries' reserve position in the IMF – from SDR 11.8 bn. at the end of 1979 to SDR 40.7 bn. at mid-1984 – deserves our attention. This increase reflects the member countries' quota subscriptions to the IMF paid in reserve assets and – indirectly – the Fund's enhanced lending activities.[5] As a result, the reserve position in the IMF has assumed a much greater importance in our reserve system than the holdings of SDRs, the artificial liquidity created by the Fund. To date, a total of SDR 21.4 bn. has been allocated in the years 1970 - 72 and 1979 - 81. Of this some SDR 15.6 bn. were held by the IMF member countries at mid-year while SDR 5.8 bn. were held by the Fund itself. They had been transferred largely in connection with the Fund's quota increases. The proportion of total Fund-related reserves (reserve position in the IMF plus SDRs) to total non-gold reserves is currently about 15 per cent. This is lower than in 1970 (more than 19 per cent), but the significance of Fund-related reserves has increased markedly since 1980 when this ratio had dropped to just under 9 per cent.

---

[4] In this calculation the value of ECUs issued against US dollars is included in the US dollar holdings, whereas the value of ECUs issued against gold is excluded from the total.

[5] A country's reserve position increases as the IMF uses the respective country's currency within the framework of its lending activities or borrows from that country (the special arrangements with Saudi Arabia were one example).

IV. The Discussion on International Liquidity in Retrospect

The discussions on the working of the international monetary and reserve system and initiatives on reform closely reflected the actual development of the volume and structure of international liquidity as outlined above.

The Articles of Agreement of the IMF as signed in Bretton Woods contained no specific provisions for an orderly and controlled supply of international liquidity. The level of international reserves was largely dependent on international gold production (minus private purchases of gold) and on US balance-of-payments deficits. However, as Professor *Triffin* observed as early as 1959, gold production could hardly be expected to keep pace with monetary demand over the long run. Moreover, he argued, it would be dangerous to render the international monetary system hostage to the vagaries of South African gold production and the Soviet Union's gold sales policy. As in the past, the lion's share of any future additions to reserves would have to come from increased dollar holdings. Thus, the level of US dollar liabilities would become larger and larger in relation to the US gold stock. In *Triffin's* opinion, expressed at that time, this would sooner or later lead to large-scale conversions of dollars into gold and finally undermine the dollar's convertibility into gold, one of the pillars of the Bretton Woods System. Successful efforts to secure the gold value of the dollar by improving the US balance of payments, on the other hand, would deprive the world of its major source of liquidity. This was the famous "Triffin dilemma", namely that satisfying "adequate" growth of reserves by expanding dollar holdings was inconsistent with the basic philosophy behind the gold-dollar standard.

Consequently, the debate of the sixties dealt with two interrelated issues. The first was the optimal balance between real economic adjustment and the financing of external disequilibria. The second problem was how to achieve adequate growth of reserves. At least in the fifties and sixties, however, there was little concern expressed about and no particular thought given to a third topic, namely over-abundant reserves, i.e. how to avoid excessive growth of reserves.

In line with *Triffin's* diagnosis of an existing lack of a suitable mechanism to expand international liquidity sufficiently, the subsequent deliberations centered on the creation of a new reserve asset. It should provide countries with required international liquidity independent of their own balance-of-payments position and that of the reserve currency countries and relieve the dollar, at least to some extent, of its responsibility as the major source of additional liquidity.

After intensive and prolonged deliberations the creation of Special Drawing Rights was agreed upon in Rio de Janeiro in 1967.[6] Essentially, SDRs can be regarded as artificial international paper money backed only by the undertaking of the IMF members to accept SDRs as a reserve asset.[7] According to the Fund's amended Articles of Agreement, allocations were to be contingent on a recognized long-term and global need for more liquidity.

It is a bit ironic that, at the same time as the first SDRs were allocated, namely from 1970 to 1972, foreign exchange reserves were expanding rapidly as a result of the substantial deterioration in the US balance of payments. True, SDRs could also be cancelled, at least in theory. Politically, however, this was not a realistic proposition and would also have contradicted the declared aim of increasing the SDR's role in the system.

So the subsequent liquidity discussions of the early seventies had to deal with the problem of excessive liquidity growth besides the improvement of the adjustment mechanism. The major forum for discussion was the "Committee of Twenty" which was set up by the IMF in mid-1972 under the chairmanship of our distinguished collegue Sir *Jeremy Morse,* then Deputy Governor of the Bank of England. In line with its assignment, the committee initially adopted a "grand-design" approach to reform, aiming essentially at the preservation of the par-value system by imposing conditions conducive to achieving a better balance between adjustment and financing.

According to those early plans, parity changes would become more frequent in the revised system. The intervention mechanism was to become more symmetrical, and the volume of global international liquidity was to be kept under effective control through the institution of an asset settlement system based on the SDR as primary reserve asset. This meant depriving the United States of its special role as a "world banker" that could pay any external obligations by the creation of its own fiat money. According to the concept the inflationary bias of the system would be eliminated through these changes.

---

[6] In line with the gold-dollar standard the SDR was defined in terms of gold and valued at the par value of the US dollar, i.e. it was equal to one dollar until the first devaluation of the US dollar in late 1971.

[7] There was a long sophisticated dispute over whether the SDR was international money or credit. This controversy has since become irrelevant given today's broader concept of liquidity. At the time Otmar Emminger used to characterize the SDR as being like a zebra: one could regard it as a black animal with white stripes or as a white animal with black stripes. The credit element was seen in the reconstitution provision which required each country to maintain an average balance of SDRs of at least 30% of its allocation over a five-year period. Reconstitution was abolished in 1981, strengthening the monetary character of the SDR.

Retrospectively it is interesting to take notice of two suggestions which were considered in detail by the Committee. First, because of concern that the new system might have a deflationary effect it was urged that the adjustment process be symmetrical, i.e. the countries in surplus would also have to adjust, presumably by revaluing their currencies and taking expansionary measures. Second, in order to assure such symmetrical adjustment, the Americans proposed a system of "reserve indicators" with a "norm" or base level for each country. If acountry's reserves increased or decreased disproportionately and reached various indicator points, that would signal a need for adjustment and the country would be expected to adopt policy measures aimed at correcting its surpluses or deficits. Thus we find two elements which reflected Keynesian attitudes: the fear of a deflationary bias and the confidence in the working of quantitative concepts for economic policy-making.

The events of 1973 – namely the general introduction of floating exchange rates, the oil price explosion and the resulting severe balance-of-payments disturbances – confronted the world financial community with new immediate challenges and greatly influenced the work of the Committee in the later stages and its final report presented in June 1974. In the programmatic part of the so-called "Outline on Reform" which indicated the "general direction in which the Committee believe(d) that the system could evolve in the future", it upheld, among other things, its recommendation that the SDR should become the principal reserve asset whereas the role of gold and of reserve currencies was to be reduced. Moreover, it proposed that a substitution account be established with the IMF in order to convert excess balances of reserve currencies into SDRs. In another section of its report under the heading "immediate steps" the Committee addressed matters such as the valuation of the SDR, which has to be based on a basket of currencies, the establishment of the Interim Committee, guidelines for floating and an IMF oil facility. All these proposals for immediate steps were promptly realized in the course of 1974.

Not surprisingly under the then prevailing circumstances the Jamaica Agreement of 1976 amounted, more or less, to a legalization of the practices that had evolved since 1973. In particular, floating exchange rates were officially allowed, with the IMF being given the somewhat vague task of a surveillance of exchange rate policies. Gold was demonetized and the official gold price abolished.

However, many of the well-conceived proposals of the Committee of Twenty for more far-reaching reform have not been realized. In particular, the SDR has not become the principal reserve asset despite some further

attempts at increasing its attractiveness, e.g. through higher yields and the change in the currency basket to the five major international currencies. Obviously, the strong preference for "natural" currencies, was greatly underestimated. To this day, artificial basket currencies – which comprise the ECU in the European context – have not prevailed over the stronger national currencies. This notwithstanding, the basic ideas of the Committee of Twenty, namely about the symmetry of obligations and effective control of liquidity, are still valid. Indeed, these ideas have had a certain influence on the construction of the European Monetary System, particularly as far as symmetry and timely exchange rate adjustments were concerned.

In the late seventies the dollar's weakness and the increasing diversification of exchange reserves into currencies other than the dollar were considered a major international monetary problem. Diversification, it was feared, would increase the volatility of exchange rates between the reserve currencies and make monetary policy more difficult. In 1979 the Bundesbank, e.g. argued that "the limitation of the reserve role of the Deutsche Mark is ... not only in the German interest; it seems to be desirable from an international point of view as well".[8]

It was against this background that the IMF tried to revive the idea of a substitution account as a means by which monetary authorities could shift away from dollars without affecting exchange rates.[9] With the SDR assuming a larger role, so the argument went, the development toward a multicurrency reserve system could be restrained and the dollar relieved of its responsibility as the most important reserve currency. Obviously, the introduction of the substitution account would have meant a large step forward – so to speak in a "second assault" – to make the SDR the principal reserve asset of the international monetary system.

Despite these widely perceived advantages of the substitution scheme the negotiations collapsed in spring 1980. A major reason was that no agreement could be reached on a guarantee of the value of the dollar assets placed in the account. The strong performance of the dollar in March and April 1980, when US interest rates sky-rocketed, had in all likelihood also weakened the feeling of urgency with which officials viewed the establishment of a substitution account.

---

[8] Deutsche Bundesbank, Monthly Report, November 1979.

[9] The way the account was designed was very simple in theory: monetary authorities outside the United States would deposit dollars in the account on a voluntary basis and would be credited with a corresponding amount of SDRs. The IMF, responsible for administering the account, would place the dollars received in the US financial markets, earning interest on them. In turn it would pay interest to the holders of the SDR-denominated claims on the account.

Since then the dollar has gone from strength to strength and confirmed its position as the principal reserve currency. Nevertheless, the multi-currency system remained firmly established and will, in my opinion, continue to do so with the Yen eventually assuming a greater role in line with Japan's strong position in the world economy. As things stand, the multi-currency reserve system has gained considerable acceptance as a fact of life, so to speak. It has become clear that the potentially greater exchange rate risks of such a system are the price to be paid for currency convertibility and for the higher degree of independence central banks have gained in their management of domestic money supply.

To my mind, the multi-currency reserve standard should, on balance, even have a stabilizing effect on the overall monetary system. Since any country whose currency has acquired a reserve currency status has to be very much concerned about maintaining confidence in its currency, stabilization policies have become more important than ever before for these countries; they find themselves in a kind of stability contest in which losers would have to fear substantial withdrawals of funds. This hypothesis is supported by the fact that the alternative reserve currency countries, i.e. Germany, Japan and Switzerland, have been especially determined – and successful – in combatting inflation despite the strong dollar. Therefore, it is perhaps not surprising to find that the Bundesbank, too, has come to accept the international role of the Deutsche Mark. In early 1984 it stated that "the scale on which foreign monetary authorities are at present holding Deutsche Mark as reserves is unlikely to pose any major problems for Germany".[10]

Last but not least, there is the lesson we have learnt from the strong deterioration of the external debt situation of many LDCs after the turn of the decade. These countries would be much better off, indeed, if they had borrowed in currencies reflecting the regional pattern of their external trade rather than almost exclusively in US dollars, i.e. if we had had a more broadly based multi-currency system in the past.

V. The Management of International Liquidity Today

What can be done, under the world economic and monetary conditions of today, to improve the supply and distribution of liquidity or the mechanics of the international reserve system? And what should be the guiding principles in this undertaking?

---

[10] Deutsche Bundesbank, Monthly Report, January 1984.

Article XVIII of the Fund's Articles of Agreement lays down the criteria according to which – through allocation or cancellation of SDRs – the IMF is to steer the volume of world reserves: "The Fund shall seek to meet the long-term global need, as and when it arises, to supplement existing reserve assets in such manner as will promote the attainment of its purposes and will avoid economic stagnation and deflation as well as excess demand and inflation in the world."

With criteria so broadly worded – but who could put it in a more precise manner? – the Fund is faced with an exceptionally difficult task. How can the long-term global need for additional liquidity be established? Apart from the difficulties already mentioned of correctly valuing reserve holdings at any given time (and borrowing capacity for reserve purposes), there are no proven rules, no objective yardsticks, of what the appropriate volume of world international liquidity would be. It is easier to make qualitative statements:

Excessive reserves provide leeway for overly expansive economic policies. They would represent, for a number of countries at least (especially when there is a strong political pressure to accelerate the pace of development), a dangerous temptation to spend or overspend either by drawing down reserves or by increased recourse to the credit markets. Developments up to the beginning of the eighties show all too clearly how urgently-needed adjustment processes were circumvented and inflationary tendencies reinforced in this way.

Insufficient reserves may, on the other hand, harbour the danger of economic policies in many countries (also in big ones) that are primarily aimed at conserving or accumulating reserves, but overly restrictive in view of long-term adjustment needs and such macroeconomic goals as steady growth and high employment. The IMF Article XVIII is probably right to mention the danger of deflation, though, in my opinion, in our open system of liquidity supply the inflationary danger caused by excessive international liquidity must as a rule be regarded as much greater.

So the right path has to be found between "excessive" and "insufficient" supply of international liquidity, indeed a classical case of Scylla and Charybdis. A traditional rule of thumb says that a country's reserves should equal 25 per cent of its annual imports, i.e. that reserves should cover 13 weeks' imports; such a rule, however, can at best be a rough guideline. In today's real world a country's optimum volume of reserves is determined by a bundle of factors with different weights in each case: in addition to the size of the country's foreign trade sector, the variability of its revenues and

expenditures in visible and invisible trade (for example commodity prices and oil prices!) and the risks of strong fluctuations in capital flows also play a role. As a rule, a country whose economic policy concept accords priority to a steady exchange rate development or which is a member of a fixed-rate arrangement like the EMS needs higher reserves than a country which thinks it can afford more equanimity vis-à-vis the external value of its currency.

The adequacy of world monetary reserves, therefore, is dependent on many national factors, which can change markedly over time. In regard to the efficiency of the overall system, an assessment of adequacy depends on what is considered to be the permissible level of temporary disequilibria in international trade and payment flows, i.e. on the optimal relationship between adjustment and financing. And, as already indicated, a distinction must be drawn between global liquidity supply and questions of distribution. So the concept of "global adequacy" can only be very roughly defined. I fully agree with *John Williamson* of the Institute for International Economics when he says in his recently published study "A new SDR allocation?"[11]: "It would be foolish to pretend that statistical studies can provide a precise assessment of the need (or demand) for reserves." (It is all the more surprising that he still reaches very precise quantitative conclusions.)

Under these difficult circumstances any decision about an increase or reduction of conditional or unconditional global liquidity is largely a matter of judgment. Developments have to be taken into account which go beyond pure quantitative considerations, such as the possible effects of a proposed increase of liquidity on inflationary expectations. The expected development of exchange rates also comes into play. For instance, Mr. *Pöhl* recently expressed his opposition to a new issue of SDRs because he fears "that the present apparent shortage of world liquidity as the U.S. draws in funds to finance its huge current account deficit may turn into a glut if dollar interest rates fall or confidence in the U.S. currency diminishes".[12]

If this should happen at any given time it could, indeed, be expected that a number of industrial countries would rebuild their dollar reserves. But who knows whether and when it will happen!? It seems impossible, therefore, to draw pertinent conclusions and take decisions influencing the future supply of international liquidity based on such necessarily imprecise

---

[11] *John Williamson*, A New SDR Allocation, Institute for International Economics, Washington 1984, p. 35.

[12] Cf. Financial Times, September 9, 1984, "Bundesbank opposes new issue of SDRs" by *Jonathan Carr*.

assumptions. In the final analysis, the relevant IMF decisions will depend to a great extent on whether the general trend of the world economy points in an upward or downward direction, but there will always be a strong political element in this kind of decision-making.

The IMF's scope for action on and control of liquidity bears, however, no relationship to its comprehensive objective in the Articles of Agreement which I have quoted. It can exercise direct influence only on the relatively small volume of SDRs (through a majority of 85 per cent of the votes in the Board of Governors) and, at least in part – via its quota resolutions and its lending policy –, on reserve positions in the IMF, even though what often happens here is simply a swap for other reserve assets.

The IMF has no influence whatsoever on the changing value of official gold holdings, which – in terms of US dollars – is determined almost exclusively by the fluctuations in the market price of this metal. More important, decisions causing an increase or decrease and affecting the distribution of foreign exchange reserves, i.e. the most dynamic part of monetary reserves, are taken primarily at national level, including decisions to raise funds on the international credit markets.

In the industrialized nations with convertible currencies reserve changes are mainly due to deliberate intervention in the event of payments imbalances – at least in those cases where a certain minimum volume of reserves is available. In practice, the development of foreign exchange reserves is largely dependent on the state of the US dollar and the strength or weakness of the other reserve currencies. That is why the monetary and fiscal policies in major countries, particularly the USA, play a decisive role in the development of world monetary reserves.

Reserve changes take place in an entirely different framework in the less developed nations whose currencies are not used in international transactions. In most of these countries the maintenance – one could even say the defence – of adequate foreign exchange reserves is a central element in national economic policy, which, as a general rule, clearly limits the room for manoeuvre as far as stimulation of growth is concerned. This means at the same time that externally influenced reserve changes (e.g. falls in the prices of important export goods, increasing interest rates on external debt) have a heavy bearing on economic policy decisions, especially, of course, in the case of countries which traditionally have no access to the international credit markets.

This brings me to the role financial markets play as a major factor influencing international liquidity. Are there any limits to this additional

source of supply? One may say that the highly elastic credit supply on the international credit markets is limited in general more by considerations of quality of the borrower, i.e. the banks' perception of risks in sovereign lending, than by the scope of available funds. As *Henry Wallich* once wrote: "The supply of international liquidity ... has become virtually open-ended, subject to creditworthiness".[13] For the individual country the role of the Euromarkets as a contingent source of liquidity thus depends primarily on its ability to preserve confidence through a sound stability-oriented economic policy stance.

The question of a possible exhaustion of the Euromarkets which was often asked in earlier years – dependence of Euromarket liquidity on the size of US current account deficits or of OPEC surpluses – is hardly raised any more today. Reality has been the best proof – at least thus far – that those fears were not justified. Yet, events have shown that temporary liquidity crises can indeed occur in which the credit taps are turned off for weaker borrowers.

As a consequence of all this, I would like to argue that safeguarding an adequate supply of international liquidity is to a great extent a matter of national responsibility. But, of course, there is also an international task in this area in line with the IMF Articles of Agreement. As already stated, this task is twofold since on the one hand an oversupply of unconditional international liquidity harbours the virus of inflation; and on the other hand a given volume of reserves and of borrowing capacity may for certain countries no longer be sufficient to ensure their compliance with external payment obligations and/or a tolerable pace of adjustment. This is the "liquidity-related" core of the present debt crisis and of the attempts to solve it.

How, then, can the first danger be avoided? Control of international liquidity means, after all that has been said, control of a magnitude which is not clearly defined and whose volume and distribution are determined by a number of factors and a multitude of independent policy decisions. For some, this means that only radical changes would be helpful. One suggestion put forward repeatedly, especially in the USA, is that of a return to a gold standard where the volume of international liquidity would be clearly limited in quantitative terms. To be brief, in my opinion this is a nostalgic wish which is hardly compatible with today's highly developed money and financial markets and which overestimates by far the flexibility to adjust in all countries.

---

[13] *Henry C. Wallich*, Forces that Drive International Monetary Evolution, in: W. Ehrlicher, D. B. Simmert (Eds.), Geld- und Währungspolitik in der Bundesrepublik Deutschland, Supplements to Kredit und Kapital, Vol. 7, Berlin 1982, p. 25.

Almost equally unrealistic, in my view, at least in the foreseeable future, is the idea of a world central bank (possibly a more advanced version of the IMF) with exclusive responsibility for the issuing of a reserve medium (possibly SDRs) to which there would have to be no alternatives. In this context another proposal (by *Johannes Witteveen,* among others) which was widely discussed during the seventies perhaps deserves mention, namely the idea to oblige all countries to keep at least a certain proportion of their reserves in SDRs.

Who in the free world, one must ask, could ensure that such obligations are met? And would it really be desirable to entrust a world central bank with so much power? How, again, could this power be kept under control?

We must, as I see it, accept the fact that a radical reform of the system is not feasible today as it was not feasible in the seventies. If I see it correctly, we all agree that decisions concerning the volume and currency composition of foreign exchange reserves must remain subject to national discretion and that the world's financial markets benefit from the greatest possible degree of freedom. Consequently, we cannot quarrel with the fact that only very limited influence can be exerted on the development of international liquidity.

There are many who advocate a greater quantitative role of SDRs in overall reserve holdings. As long as this can be accomplished without creating inflationary dangers, by means of a gradual allocation, there is certainly little ground for objection. IMF influence on world monetary reserves might be strengthened in the longer run. But it would be an illusion to believe that we could in this way achieve any significant control of international liquidity: for the foreseeable future SDRs will represent only an additional reserve medium which will hardly crowd out the others, particularly not the big investment and reserve currencies. This is especially true as long as there are no doubts about the fundamental strength of the US dollar.

The second approach to an improved management of international liquidity which has been and is still being discussed is directed towards control of the Euromarkets. Such control, if possible, would, of course, affect both private and official liquidity, that is to say a dampening influence on the Euromarkets would also affect the availability of credit to sovereign borrowers. We are familiar with the misgivings that have frequently been expressed about the supposedly unbridled process of money or credit creation on the Euromarket (although there are different schools of thought on whether or not any credit creation takes place). Quite recently, for instance, *Helmut Schlesinger* complained about "the lack of any genuine control through monetary policy" as a shortcoming of this market. And he warned:

"If countries cannot mutually agree on mechanisms to limit excessive monetary growth on the Euromarket, then it is to be feared that the lessons now being paid for will have been in vain".[14]

I fully agree with *Schlesinger* inasmuch as the mistakes of the past must not recur, and that there has to be intensive discussion about ways to avoid repeating them. However, past plans to curb the expansion of Euromarket liquidity through uniform mandatory minimum reserve requirements have not materialized for good reasons. The broad international agreement that would be needed to rule out a shift of Eurocurrency business to unregulated markets is probably beyond reach. Even if it could be attained, it would still leave the substantive institutional problem unsettled, by whom and according to which criteria necessary changes in reserve ratios should be decided.

The only practical approach to curbing excessive Euromarket expansion, which in my opinion is sensible and deserves the support of the banking community, is the endeavour towards more effective internationally-coordinated control of the banks' credit expansion potential through the national banking supervisory authorities. Here, considerable progress has already been achieved on the basis of the work of the Cooke Committee with regard to establishing norms for the consolidation of balance sheets and capital/assets or capital/liabilities ratios. This work ought to be completed as soon as possible so that distortions of competitive positions of banks in the various countries can be eliminated. One ought to add, however, – and this should not be interpreted as an egoistic plea of the banks – that care must be taken not to hamper the efficiency of the Euromarkets, which is essential for world trade and investment, by "applying the brakes" too rapidly and too strongly.

Notwithstanding all efforts to achieve improved supervisory control, the self-discipline of banks in international lending will be decisive. Though I do not at this moment share *Schlesinger's* fears, expressed in the same speech, about an acute danger of excessive lending, it cannot be excluded that the prevailing strong competition and the Eurobanks' "natural" desire for asset growth could again lead to such a development in the future. (As we often say to ourselves, we shall avoid repetition of past mistakes but make new ones!)

In the final analysis, control of international liquidity, as far as it is at all possible, will never be sufficient to achieve the underlying aim of greater

[14] *Helmut Schlesinger*, Internationale Finanzprobleme und nationale Geldpolitik, address delivered at the Centre International d'Etudes Monétaires et Bancaires in Zürich, in: Deutsche Bundesbank, Auszüge aus Presseartikeln, No. 48, 1984, p. 5 and 6.

stability in the world monetary and economic system. What will count more in the end is that the world economy can be kept on the right path by means of consistent stabilization policies in all countries. The familiar phrase "stability begins at home" once again applies here.

In this connection, the frequently cited IMF "surveillance" should receive greater weight. More recently, the Fund has, in its regular consultations, already paid increased attention to member countries' external borrowing, reserve and debt management policies. Over and above that it should in my view take a critical look at the general economic, monetary and financial policies of both weak and strong countries. It was the Fund's own members that gave it this task. It is up to the governments not to allow their own intentions to become obsolete through neglect. And the more efficient international coordination is, the greater the consideration given to the international repercussions of national economic policies, the easier it will be to find adequate solutions to the problems of the distribution of international liquidity. At this juncture, this means more than anything else: solutions to the problems of the highly indebted developing countries.

VI. The Debt Crisis and International Liquidity

Certainly, the international debt crisis is at the centre of today's liquidity discussions. Much has been said and written on the causes of the debt problem and I do not need to elaborate on them here. As far as the relationship between international liquidity and overindebtedness is concerned two fundamental points ought to be stressed immediately.

Firstly, as I stated before, there is no indication whatsoever that the debt problems were due to a global lack of liquidity in recent years. Rather they can be traced back to an oversupply of liquidity, an overrecycling of oil surpluses in the seventies. As *de Larosière* expressed it recently in Geneva, "weak domestic policies and delays in adjustment measures were to a large extent made possible by relatively easy access to foreign borrowing under favourable conditions".[15]

Secondly, I do not see much virtue in arguing whether the overindebtedness of a good number of countries is a liquidity or a solvency problem. The one can quickly turn into the other, and we will only know at a much later stage what we had to deal with. That the overindebted countries are suffer-

[15] *Jacques de Larosière,* Address before the Economic and Social Council of the United Nations, Geneva, July 5, 1984, in: Deutsche Bundesbank, Auszüge aus Presseartikeln, No. 57, 1984, p. 1.

ing from an acute lack of liquidity and that they feel an urgent need to rebuild their reserves is true almost by definition.

How can the liquidity requirements of these countries best be served? A global increase in international reserves through a new allocation of SDRs would of course provide the debtor countries with some of the liquidity they need. But it hardly makes sense to increase overall liquidity just because a limited number of countries lacks reserves.

Indeed, the lion's share of any such allocation would benefit countries which have no liquidity needs whatsoever. The share of the "problem countries", i.e. those countries which have undergone debt reschedulings or have substantial payments arrears, in total IMF quotas amounts to only 15 per cent, so that they would receive just SDR 1.5 bn. from an allocation of SDR 10 bn., for example. Even the proposal of *John Williamson* of the Institute for International Economics[16] to allocate SDR 34 bn. as of January 1985 and a further SDR 9 bn. as of January 1986 (i.e. in the last two years of the current "basic allocation period") would mean a total of not more than SDR 6.45 bn. for the overindebted countries. For Brazil, for example, this would add up to an allocation of about SDR 0.7 bn., which would certainly be helpful, but too small an amount to change Brazil's situation to any meaningful degree and to bring lasting relief.

The more effective the liquidity help to problem countries is to be, the more SDRs would have to be allocated. It is therefore understandable that the developing countries have been demanding an annual allocation of no less than SDR 15 bn. during the five-year period that began January 1, 1982. While it is true that allocations of SDRs are not per se inflationary since they enter the system without a simultaneous creation of national money, such a generous addition to reserves would nevertheless be dangerous. As indicated above it could lead to more expansionary policies in a number of countries and thus endanger the success achieved over the last few years in the fight against world inflation. For this very reason, most governments of industrialized countries have been and are strongly opposed to all proposals for substantial new allocations of SDRs.

In this context, the old "link" proposal which was reiterated by the "Group of 24" this spring ought to be mentioned, even though it is not under serious consideration at present. The basic idea behind the "link" was (and is) to incorporate allocations of SDRs into a new concept of development assistance by distributing these new SDRs solely or to a very large degree to the developing countries. In my view the case for an introduction of such a

[16] *John Williamson*, A New SDR Allocation, op. cit., p. 35 - 38.

"link" is not convincing; it would tend to encourage overambitious development programs and to delay external and domestic adjustments that are indispensable for sound long-term economic growth and development. Today one may say that the Euromarkets have in fact accomplished a good deal of what the proponents of the "link" had intended, but unfortunately also of what its opponents had feared.

As far as the newly created reserves were spent on imports, the "link" would amount in effect to a transfer of resources from the industrial to the developing countries. Therefore, it could be regarded as a way of avoiding the difficult process of budgetary appropriations for development aid by the responsible parliamentary bodies in industrial countries. But such circumvention could hardly be called an advantage. The same (quantitative) effect could be achieved in a more meaningful and responsible way if the industrial countries (and possibly the rich OPEC countries) were to increase their quota contribution to the World Bank and IDA and their development aid. This would also allow the aid to be tied to specific projects or programs. There is even the danger that in hard-pressed parliaments of industrial countries the "link" could serve as an argument for reducing LDC aid in other forms, on the contention that international money creation would now take care of the LDCs and the highly indebted countries. Indeed, the most important objection to the "link" is that it would blur the dividing line between development aid and international liquidity creation with potentially far-reaching adverse effects on the overall monetary system and the world economy.

To sum up the argument, it is my opinion that boosting international liquidity through a substantial allocation of SDRs – with or without the "link" – cannot be regarded as a suitable means of overcoming the debt crisis. SDR allocations could even be dangerous if they diverted attention from the real issues. That is not to deny that there is a clear and recognized need for medium-term "bridging finance" in order to "buy time" and make the adjustment process tolerable for the troubled debtor countries. As is well known, the provision of such "fresh money" by the commercial banks and official creditors has in all cases been tied to Fund-assisted stabilization programs. In my view, it is therefore important – and clearly preferable to an allocation of SDRs – that a substantial cut in member countries' enlarged access to Fund resources was avoided at this year's Annual IMF Meeting.

It has to be said again that there is no way to spare the debtor countries the necessary adjustment measures. This is the one and only way to establish the basis for regaining creditworthiness on international financial markets and increasing flows of long-term capital from non-bank sources, in par-

ticular direct investment. Indeed, one of the lessons of the debt crisis is that it would be irresponsible to base the development process once again to a large extent on medium-term bank credits. What the debtor countries and, in fact, all countries of the Third World need most is long-term capital. This capital will have to come from private investors and, especially in the case of the less advanced countries, from official sources in the form of bilateral or multilateral development aid, e.g. from the World Bank or regional development institutions. By comparison, the successful reconstruction of Europe's economy after World War II would probably not have been possible without the substantial inflow of long-term capital under the *Marshall Plan*. (At that time the IMF even took a decision that countries receiving *Marshall Plan* aid could not draw on the Fund.)

In my view, we must continue with the present method of dealing with the debt problem, i.e. to seek a reasonable balance between (largely conditional) financing and adjustment. Much of this approach rests on the involvement of a strong and active IMF endowed with the necessary financial resources. After the recent quota increases, the enlargement of the General Arrangements to Borrow (GAB) and the credit provided by some central banks, including the Saudi Arabian Monetary Agency, the IMF's financial resources should be sufficient for the foreseeable future. But the debtor countries' requirements for Fund assistance will in all likelihood remain high for some time to come and a future need to increase the IMF's resources cannot be excluded.

Whether and when this will occur, will, of course, depend decisively on the future course of the world economy. Should such a need arise, we can expect, from past experience, that the necessary process of approval for quota increases will not be an easy one. I am not only thinking of possible political obstacles in the US Congress. Another reason for resistance could be that an ever larger part of the international reserves of the countries with usable currencies is tied up in Fund-related reserves.[17]

To some observers IMF recourse to private financial markets would be an obvious solution to this problem. In my view, however, such a step could only be a last resort. It could create the illusion that the Fund's financial

---

[17] The Bundesbank, for example, has pointed out that after the quota increase plus the enlargement of the GAB funds the maximum financial commitments of the Bundesbank towards the IMF amount to DM 32 bn., approximately 40% of total net reserves. Pointing out that it has "further potential obligations in other areas of monetary cooperation (for example within the EC)", the Bundesbank says "that it must limit itself in taking on further commitments" (Monthly Report, September 1983).

resources are practically unlimited and lead to increasing calls on its funds, thus weakening financial discipline. It is also essential that the character of the IMF as a forum and instrument of official international cooperation be clearly maintained. In my opinion, the strong IMF member countries have therefore no alternative but to put aside their concern with the composition of their reserves and endow the Fund with a sufficient volume of liquidity, if and when the need should arise. They must accept the fact that their reserve positions in the Fund increase with IMF loan operations.

Currently the debt problem is entering what might be called its second phase. The most visible sign is, of course, the agreement on principles for the multi-year restructuring between Mexico and the Bank Advisory Group, still to be approved by the more than 500 creditor banks. To comment on the various aspects of the new concept – interesting as they are – would surpass the scope of this paper. I would, however, like to draw attention to two elements which are particularly relevant to the subject matter to be discussed here.

Firstly, the envisaged restructuring contains no provision of organized "fresh money" by the creditor banks. The liquidity supply of Mexico is thus again largely determined by its autonomous borrowing potential besides the current account performance. Whether the country has been able to regain enough confidence to cover its future liquidity requirements in the market will therefore be an important test ahead.

Secondly, there is the proposed option for non-US banks to convert a proportion (up to 50 per cent) of their dollar-denominated credits into their home currencies over time. If widely used, the possibility of such currency conversions would support the described tendency in our monetary system towards a multi-currency structure.

On an overall view, one may say at this juncture that the debtor countries' further adjustment will increasingly have to be accomplished within a more forward-looking growth-oriented strategy largely based on rising export earnings. The renewed import growth needs to be supported by a steady improvement in their international liquidity position. At the same time a shift towards more sustainable patterns of developing countries' investment and external financing must be achieved in order to avoid renewed tensions or disruptions in the flow and supply of international liquidity. This process will confront the world financial system with new challenges that can only be effectively met if all participants – on the debtor and creditor side – continue to cooperate with prudence and perseverance.

Zusammenfassung

Fragen der internationalen Liquidität – aus heutiger Sicht

Hauptgründe für die aktuelle Auseinandersetzung mit Fragen der internationalen Liquiditätsversorgung sind die allgemeine Sorge über die internationale Schuldenkrise, das Unbehagen über die unstete und unvorhersehbare Entwicklung der Weltwährungsreserven in Abhängigkeit von der Stärke oder Schwäche des US-Dollar sowie schließlich die negativen Erfahrungen mit den starken und oft erratischen Wechselkursausschlägen. Auch im Rahmen der Diskussion um eine von manchen geforderte generelle Reform des derzeitigen Währungs-„Systems" wird das Liquiditätsthema relevant. Nach einigen definitorischen Ausführungen zum Begriff der internationalen Liquidität, der heute wegen der maßgeblichen Rolle der internationalen Kreditmärkte sehr viel weiter als früher gefaßt werden muß, werden vier Problemkreise behandelt: Erstens wird untersucht, was die Herausbildung eines Multireservewährungssystems und die wachsenden Rückgriffsmöglichkeiten auf die internationalen Finanzmärkte für die Entwicklung des Angebots an internationaler Liquidität bedeutet haben. Dabei wird die große Flexibilität der Liquiditätsversorgung herausgestellt. Zweitens werden die Ergebnisse der Diskussion über eine „angemessene" Ausstattung der Welt mit internationaler Liquidität analysiert. Es wird betont, daß es sich bei den derzeitigen Mängeln nicht um Fragen der globalen Versorgung, sondern um Verteilungsprobleme handelt. Drittens werden die Möglichkeiten einer verbesserten Steuerung der internationalen Liquidität erörtert. Vor allem wird die Notwendigkeit, aber auch die Problematik einer Kontrolle der Euromärkte beleuchtet; die „surveillance"-Aufgabe des IWF wird unterstrichen. Schließlich werden die Liquiditätsprobleme der hoch verschuldeten Entwicklungsländer und Möglichkeiten einer Abhilfe behandelt. Die einzig sinnvolle Lösung wird in einer Fortsetzung des eingeschlagenen Weges der Anpassung und überbrückender auflagengebundener Liquiditätshilfen mit dem Ziel einer Rückgewinnung der Kreditwürdigkeit der Länder an den Märkten gesehen. Um erneute Liquiditätsanspannungen zu vermeiden, muß die Investitions- und Außenfinanzierung der Entwicklungsländer künftig stärker auf die Zufuhr von langfristigem Kapital abgestellt werden.

Summary

Problems of International Liquidity – the Current Viewpoint

The chief reasons for the present ventilation of problems of international liquidity supplies are the general worry about the international debt crisis, the uneasiness about the inconstant and unpredictable development of international foreign exchange reserves and their dependence on the strength or weakness of the US dollar, and lastly the negative experience with marked and often erratic exchange rate changes. The liquidity theme is also relevant for the debate on a general reform of the present monetary "system", which some people call for. Following some definitive remarks on the concept of international liquidity, which must now be understood in a much broader sense than formerly on account of the decisive role of the international credit markets, four sets of problems are dealt with: First, an examination is made of

what the formation of a multi-reserve-currency system and the growing possibilities of recourse to the international financial markets have meant for development of international liquidity supplies. In this connection, the great flexibility of liquidity supplies is emphasized. Secondly, an analysis is made of the results of the debate on an „appropriate" supply of international liquidity for the world. It is stressed that the present shortcomings involve not questions of global supplies, but distribution problems. Thirdly, the possibilities of improved control of international liquidity are discussed. Above all, light is thrown on the necessity and also the problems of control of the Euromarkets; the surveillance function of the IMF is underlined. Lastly, the liquidity problems of the gravely indebted developing countries and possible remedies are dealt with. The only sensible solution is considered to be keeping to the adopted course of adjustment and bridging, conditional liquidity assistance with the object of restoring the creditworthiness of such countries on the markets. To avoid renewed strains on liquidity, the investment and external financing of the developing countries must be geared more closely in future to the provision of long-term capital.

Résumé

Questions de la liquidité internationale – d'un point de vue actuel

Les raisons principales de la discussion actuelle de questions de l'offre de liquidité internationale sont l'inquiétude générale que cause la crise internationale de l'endettement, le malaise que provoque l'évolution inconstante e imprévisible des réserves monétaires mondiales, dépendantes de la force ou de la faiblesse du dollar américain ainsi que, finalement, les expériences négatives avec les oscillations importantes et souvent erratiques des taux de change. Le sujet de la liquidité est également important dans le cadre de la discussion d'une réforme générale du « système » monétaire actuel, exigée par beaucoup. Après quelques définitions relatives à la notion de la liquidité internationale qui doit être conçue aujourd'hui beaucoup plus largement qu'autrefois à cause du rôle déterminant des marchés financiers internationaux, l'auteur, traite les quatre problèmes suivants: tout d'abord, il examine ce qu'ont signifié pour l'évolution de l'offre de liquidité internationale la formation d'un système monétaire de multi-réserves et les possibilités croissantes de recours aux marchés financiers internationaux. La grande flexibilité de l'approvisionnement en liquidité y sera mise en évidence. En deuxième lieu, l'auteur analyse les résultats de la discussion sur un approvisionnement « équitable » du monde en liquidité internationale. Il insiste sur le fait que les lacunes actuelles ne concernent pas des questions de l'approvisonnement global mais qu'il s'agit de problèmes de répartition. En troisième lieu, les possibilités d'une meilleure régulation de la liquidité internationale sont discutées. L'auteur montre avant tout la nécessité, mais aussi les problèmes d'un contrôle des euromarchés. La tâche de « surveillance » du FMI y est soulignée. Enfin, l'auteur traite les problèmes de liquidité des pays en voie de développement fortement endettés et des possibilités d'y remédier. La seule solution considérée comme utile est celle d'une continuation de la voie déjà entreprise de l'adaptation es des aides transitoires de liquidité, grevées d'une charge, afin que les pays regagnent la solvabilité sur les marchés. Pour éviter de nouvelles tensions de liquidité, le financement des investissements et le financement extérieur des pays en voie de développement doivent être à l'avenir davantage ajustés à l'apport de capital à long terme.