

SPECIAL REPORT

Testimony of Treasury Secretary William E. Simon Before the Senate Foreign Relations Committee

March 27 (IPS) — The following are excerpts from official transcripts of Secretary of the Treasury William E. Simon's testimony yesterday before the Senate Foreign Relations Committee on the proposed legislation authorizing U.S. participation in an international "safety net" mechanism to provide emergency bailout loans to near bankrupt West European nations. (See International Markets Newsletter). Reports of the Secretary's testimony and the subsequent revealing exchanges between Mr. Simon and various Senators have thus far been blacked out of the U.S. and Western European press.

...I will focus remarks today on two main questions of concern and whether the design adequately safeguards U.S. financial interests.

...Need...is more critical now than when first proposed ... but the prospects for its establishment are clouded by doubts abroad about our own interest and commitment ...

...Countries have succeeded thus far in avoiding resort to beggar-thy-neighbor and protectionist practices. But the challenge remains.

The support fund is a mutual insurance mechanism ... (protectionist practices) once started, such actions could quickly spread, with disastrous consequences ... It will provide assurance to an individual participant that if it cannot obtain needed funds elsewhere on reasonable terms — and on the condition that it accept energy and economic policy conditions designed to correct its problems — the needed financing will be available ...

...The market has done its job — and the total financing need within the OECD area was greatly, though temporarily, reduced last year by the world recession.

But adjustment has not proceeded rapidly enough or at an even pace within the OECD area.

While corrective action may now be underway, there may be a lag in the market's perception of that adjustment; and in these cases, adequate financing from existing sources may not be guaranteed. Recent exchange market disturbances provide a forceful illustration that a sense of complacency is not justified.

What is required is a judicious combination of internal adjustment, external adjustment, and financing. The provision of financing must be accompanied by energy and economic policies that get at the source of countries financial problems.

(Principal Features of the Financial Support Fund)

...It is an insurance mechanism. Countries must demonstrate that they have made the fullest appropriate use of alternative sources of financing. They must accept energy and economic policy conditions ... which will be set by finance ministers in the other participating countries.

Second, the U.S. will have a major voice, in many cases a decisive voice ... All decisions will require a two-thirds majority with a quota and voting share of 27.8 per cent. The U.S., along with one or two other countries, will be able to prevent loan proposals it does not favor. Loans above a country's quota and less than twice its quota will require a 90 per cent vote, and loans of larger amounts will require a unanimous vote ...

Third, the fund rests fundamentally on the sharing of risk ... the burdens of financing and risk will not fall to countries in a strong position at the time financing is needed.

Fourth, the support fund is not a foreign aid gimmick, or a soft loan facility ... Maturities will be medium-term, not beyond seven years. Interest charges will be based on market rates ...

Fifth, the support fund is designed to meet a transitional problem, and it is temporary in character. Its lending operations will expire after two years — and if a need for extension were to arise, we would seek new congressional authorization.

Finally, countries' financial commitments will be made available on a standby and not a paid-in basis ... Furthermore, it is likely that the fund will operate by borrowing in world financial markets on the strength of guarantees issued by its members, although countries will have an option under some circumstances of providing direct loans to the fund. We intend to meet U.S. obligations through the issuance of guarantees. The proposed legislation thus provides authority for the issuance of guarantees and for appropriations to be sought in the highly unlikely event of default by a borrower from the fund.

... The prospect of the fund has, in itself, contributed greatly to an atmosphere of intensified economic and financial cooperation. That atmosphere has prompted countries to avoid damaging restrictive action in the face of unprecedented difficulties, ... also ... contributed to the satisfactory resolution of complex and difficult issues involved in amendment of the IMF articles of agreement, which will shortly be the subject of legislation.

Action to establish the fund has become urgent in two respects. First there has been ... evidence of financing difficulties on the part of some countries. Second, action on ratification by other OECD count countries is at an advanced stage. Twelve countries, with quotas amounting to about 43 per cent of total, have already either ratified the agreement or have completed their legislative procedures and are expected to ratify shortly. Most other are in advanced stages of their legislative processes. But all are now looking to the U.S. ... I urge your strong support in this effort.

Q and A Exchange between the Senators and Simon

Senator Clifford Case (R-NJ): What are the fundamental causes of these problems?

Simon: Excesses in fiscal and monetary policies. These should be remedied. We should not just attack the result rather than the cause, as competitive devaluation would do.

Case: I just wonder if any kind of gadget like this between many nations can do the trick. I think anything that is big enough to handle the problem will be too big for us to deal with.

Simon: The safety net can provide a bridge for a period of adjustment. Adjustment will be sped up because of the stringent conditions.

Case: I don't expect to vote against it because I don't have an alternative, but I think its value must be mostly political. And there is a point beyond which it is not good to encourage Italy in her loose fiscal practices.

Simon: I don't believe in throwing money down the drain — that's why we have conditions.

Senator Stuart Symington (D-Mo): I began becoming suspicious about all these guarantees years ago. . . As we know, the Federal government is in worse shape than New York City, but it can start the printing presses. A New York banker said this to me, and we all know what he means. And I disagree that southern Europe will go Communist without the safety net.

And West Germany is putting up less than half of what's asked from the U.S. But her reserves are the strongest. I think that giving guarantees are similar to spending money — especially things like the soft-loan window (which he likened this to for the advanced sector). Is there any guarantee that the U.S. contribution will not be another foreign aid bailout — this time for relief of developed countries?

Simon: The U.S. quota is 27.8 per cent. . . And this fund is limited to a two-year life (we'll have to go back to Congress if we want an extension).

Symington: Why isn't the Common Market able to take care of itself?

Simon: This involved many non-Common Market nations. And there is aid granted within the Common Market. This is a supplement, and, unlike with bilateral, this has very strict economic and energy conditions to make nations adjust to the new economic conditions that exist in the world.

This fund has strict policy measures dictated by the Committee of Financial Ministers and they will be strict, I can assure you.

Symington: Page 9 of (Undersecretary of the Treasury Charles Robinson, who also testified) Robinson's speech worries me — "We must be prepared to stabilize . . . problems in any OECD country. . ." We do not have a mandate to police the world. We have enough problems here. We are now going to a potential bailout of the industrialized nations.

I just don't see how we can go to the American taxpayer and ask them to support this.

Senator Jacob Javits (R-NY): Do the economic considerations alone justify the net?

Simon: Yes.

Javits: Is the mere fact that a nation could resort to this fund going to help them in their credit rating with other lenders?

Simon: Of course.

Javits: What is the actual risk (i.e. what is the history of defaults against U.S.-guaranteed loans)?

Simon: (Consults with aides) To my knowledge, none has ever done so.

Javits: What's happening in nations that are financially sick?

Simon: I'm confident that they are taking necessary measures, but the net makes these measures a priority — they must meet the conditions before they can ask for help from the net.

Javits: Even if we had to make good on this guarantee, the value of keeping nations like Italy as a going concern would well be worth even the whole \$6 billion, no?

Simon: I couldn't agree with you more. But it is inconceivable that the whole bailout fund would ever be risked. The U.S. has the ability to set the very stringent conditions. I don't think there is even a remote possibility that a country would default.

Javits: Once net is applied to for a loan, very strict measures go into effect. Robinson points out that IMF trust funds already do more than this for the underdeveloped nations.

Senator Charles Percy (R-III): What do countries do when they can't pay their debts?

Simon: They try to reschedule. I don't like this.

Percy: What would the effect on the U.S. be of several OECD defaults?

Simon: I can hardly conceive of this, but it would be disastrous.

Percy: Will the fund strengthen our bargaining position for instance in the Conference on Economic Cooperation that is going on?

Deputy Assistant Secretary of State for International Finance and Development Paul H. Boeker: Oh, cooperation and solidarity among developed nations is very important — maybe not directly to our effectiveness in the Conference . . . but certainly in dealing with the oil producers.

Percy: (stressing that he now approves the net in a "real spurt of self-interest") I shared with Senator Case at the beginning real misgivings but I want to say to Simon and the State Department that we have had more help in understanding this one concept than in anything I can remember. I agree the U.S. should participate in support of the Fund because of our interests, and it is essential to U.S. foreign economic policy.

OECD nations are the backbone of democracy. We must stick together, must prove that we can see crises in advance.

The health of the U.S. economy is dependent on the health of the world economy. In Illinois, we would be crippled without export markets, and 75 per cent of our trade is with the OECD. This is an insurance policy.

And again, isn't it great that the State Department and the Treasury are so united around one policy!

Simon: This mechanism acts, rather than reacting.

Concluding Remarks

Case: I still want to sound a somewhat sour note, though. Because of foreign policy considerations, I think I may vote for this thing. But I just question if these things, like the IMF, have been really good things, or did they just delay stopping loose practices. We may have to do these things to prevent the collapse of the capitalist system, but I don't like these things. I wonder if the Ex-Im Bank has been a good thing. I wonder if these things couldn't be more a cause of inflation, than just the tired old stories of too much government spending. But we are up against the gun in places like Italy. So I'll vote for this — even though this will just postpone disaster.

Simon: I agree with your feelings. But the IMF, Bretton Woods system were not failures — men were failures . . . giving up fixed rates — this meant money, jobs, political stability.

But here, we are not creating something permanent, and the measures required are particularly stringent.

Case: Do you really think that given the political situation in Italy, any government that could stay in power could meet the conditions?

Simon: I just returned from two and a half days of discussions in Italy. I absolutely believe that politically, this government (the Moro government) could stay in power and meet these stringent conditions because people understand what's necessary.

Case: I'm dubious, but I want this thing to succeed.

Javits: The genius of our society is the power to command credit. I believe that that power will keep us free. But the opposition is deadly. I'm for anything that will give us that edge.

Senator John Sparkman (D-Ala): I think the safety net thing is a very fine thing to undertake.