5 Eurodollars: Policy Analysis

GUIDO CARLI

INTRODUCTORY REMARKS

Mr Van Lennep calls for co-operative action to tackle debtor country problems. (5/10/82)
Mr Regan says US banks can depend on help from the Government if debtor nations default. (6/10/82)
Mr Soloman calls for co-operation among governments and central banks to deal with the international financial situation. (10/7/82)
Mr Richardson warns that it would be self-defeating for banks to quickly reduce their exposure vis-à-vis debtors whose creditworthiness has changed. (21/10/82)
Professor Wallich on the problem of rescheduling as seen by the supervisor and the lender of last resort. (27/10/82)
Mr Leutwiler discusses the need for debt rescheduling operations. (28/10/82)
Mr Volcker offers a plan to reduce international financial strains. (16/11/82)

These are some of the pronouncements made over a very short period on the main policy issues dealing with the Eurodollar or, better, international lending activity, a topic which has been of concern for more than ten years and which I will discuss in my presentation.¹

The analytical framework of international lending activity is far from being settled. Existing regulatory policies, while not systematic, are basically oriented towards 'benign neglect'. Since August 1971 a new theme, the international monetary standard, has been added to other well known issues such as lack of regulation, supervision and lending of last resort. This has certainly had consequences which often need...

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clarification on both analytical and practical grounds. A brief historical survey of intervention by the authorities and their motives is appropriate, in order to clarify these issues and understand the current and prospective policies in this sector.

HISTORICAL DEVELOPMENT OF POLICY ISSUES

Decisions concerning the Eurodollar market may produce direct effects, if they are aimed specifically at regulating the market or they may bring forth indirect consequences. At the very beginning, there was the regulation of the external net position of Italian banks in the early 1960s. These regulations are, sometimes, looked upon as having triggered the expansion of Eurodollars. Indeed, they recycled official liquidity and created double counting or under certain circumstances, a process of multiplication of international means of payments.

Leaving aside some twenty years of similar interventions in the European Monetary Agreement (marks 1 and 2), we can perhaps see a decision that, while not exclusively justifiable in terms of Eurodollars, actually lays the foundations for its own *raison d'être* in that market.

The origin of the so-called Roosa bonds, which belong to the first category of decisions, can be said to lie in a deliberate intention to absorb the surplus of international liquidity. The bonds, named after Robert V. Roosa, the Treasury Undersecretary during the Kennedy administration, were introduced in October 1962 with the aim of transforming the sight dollar deposits of the industrialised countries' monetary authorities into medium-term non-negotiable securities (12 to 24 months) denominated in foreign currencies. They were issued in the currency of the country acquiring them and bore a yield equivalent to the average prevailing yield of other medium-term securities in the US market. The Roosa bonds were at first non-negotiable and unredeemable before due date; later this rigid rule was eased to meet the investment portfolio needs set by the statutes of central banks of their domestic legislations.

An intervention aimed at replenishing lost liquidity rather than absorbing a surplus can be detected in the action of the central banks, operating through the BIS, designed to finance, in the London market, the losses on pound denominated deposits suffered by a number of banks, as a consequence of the crisis that hit sterling in 1967. On that occasion the BIS was prepared to use its official dollar reserves, which were kept mostly in the US.