

**GRAHAM BIRD**

**WORLD  
FINANCE AND  
ADJUSTMENT**



**AN AGENDA FOR  
REFORM**

# WORLD FINANCE AND ADJUSTMENT

*An Agenda for Reform*

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MACMILLAN

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First published 1985

Published by  
**THE MACMILLAN PRESS LTD**  
Houndmills, Basingstoke, Hampshire RG21 2XS  
and London  
Companies and representatives  
throughout the world

Printed in Hong Kong

British Library Cataloguing in Publication Data  
Bird, Graham  
World finance and adjustment : an agenda for reform.  
I. Title  
332'.042      HG3881  
ISBN 0-333-31477-8  
ISBN 0-333-38877-1 Pbk

## WORLD FINANCE AND ADJUSTMENT

*By the same author*

THE INTERNATIONAL MONETARY SYSTEM AND THE  
LESS DEVELOPED COUNTRIES

THE QUEST FOR ECONOMIC STABILISATION: The IMF and  
the Third World (*with Tony Killick, Jennifer Sharpley and  
Mary Sutton*)

*To my family*

# Preface and Acknowledgements

My experience is that writing a book is not easy. The contraction of university resources and the related increase in teaching and administrative loads, combined with the expansion of family size, has meant that writing has had to be more and more tightly squeezed in between lectures, meetings, picking up children, dropping off children and a range of other activities. Although all this can make life much more fun, it does exact its toll. If the chapters in this book read at all coherently it must come close to being the eighth wonder of the world!

That the book has been completed reflects the debt I owe to a number of people who helped by providing me with time to write it and by commenting on various sections of it, or providing me with their views. Into the former category come my wife, Heather, my parents-in-law, Hazel and Gordon Gage, and Christine Elliott; into the latter category come Heather Bird, Gerry Helleiner, Nick Hope, Tony Killick, Tony Thirlwall, John Williamson and a number of IMF staff members who might be embarrassed if I mentioned their names. To my children Alan and Anne I owe the debt of making the financial incentive to write the book more relevant, and to my third child, on his way at the time of writing this book, but now arrived and named Simon, I owe the debt of providing me with an effective time-constraint!

I should also acknowledge the forbearance of my students over the years at the University of Surrey and at Tufts University in London, who have acted as guinea pigs for me to try out various ideas. In fact it has been in teaching international finance to them that I have become aware of the need for a book such as this one.

I must also thank Debbie Horwood for typing the chapters so efficiently. She has, fortunately for me, developed the skill of reading my handwriting better than I can. That the book has an index is thanks to Jane Redfearn, who compiled it in record time.

Guildford

GRAHAM BIRD

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# 1 Introduction

This is a policy-oriented book on international finance. Rather than attempting to be completely comprehensive, it sets out to provide a succinct treatment of some of the more important issues that have come to dominate discussions of international financial reform. Given the increasingly frequent calls that have been made for a new Bretton Woods conference to reform existing international financial arrangements, it seems appropriate to examine the items that would be on the agenda for such a conference, and this is the book's principal objective.

It is intended to fulfil two basic functions. The first is to act as a complement to the more conventional textbooks, which spend most of their time comprehensively analysing the operation of the international monetary system. By concentrating on the key policy issues this book will, it is hoped, bring such analysis to life. The second is as a text in its own right for those courses where the wish is to avoid excessive amounts of analytical rigour and modelling and concentrate on policy, or where, within the context of a broader course, it is felt desirable to cover some of the international financial issues that nowadays hardly ever seem to be out of the headlines. As such it may also be of some interest to policy-makers.

The book is written in a style that makes the material genuinely available to those with only a sparse background in economics. Indeed non-specialists should be perfectly able to cope with most of it. No mathematical formulations are used and economic jargon is kept to a minimum. However, readers who possess a sound grasp of international monetary analysis will find plenty of opportunities to apply it. To them it should be clear where a particular piece of analysis underlies the discussion in the text, even if this is not spelled out.

The book is not intended to be the sole textbook for a specialist final year undergraduate option in international financial economics, since some issues that should be included in such a text are neglected here, the analysis used is not always fully presented or followed through, and there is not a full set of references to the literature. On

the other hand, the book's contents should be directly relevant to such a course as well as to courses in international relations, economic development, monetary economics, and applied economics. This is not a book that students should find difficult to read – an important consideration, given the increasing amounts of knowledge they are expected to assimilate.

The lack of analytical rigour should perhaps be underlined. There are no mathematical models derived and very few diagrams presented, partly because there are already a number of international economics textbooks which go over this material and there seemed little point in duplicating it here, but also because the policy orientation of the book does not easily lend itself to this sort of approach. Often having spent a long time setting up a model and analysing its implications, one then has to recognise that while looking rigorous it is actually of limited assistance in analysing the real world. To have included a formal presentation of all the models that are implicitly drawn upon would have made the book excessively long, and would have robbed it of what are perhaps its principal attractions. Besides, considerable insight into the complexities and excitement of international financial economics can be gained without the need for equations galore.

The layout of the book is as follows. Part I sets the scene. Chapter 2 catalogues the performance of the world economy in the last ten or fifteen years and discusses the various explanations of events that have been put forward. Chapter 3 charts and analyses the evolution of the international financial system, pointing to the significant changes that have occurred since the end of the 1960s and the disarray that currently exists. Chapter 4 builds on this to present an agenda upon which discussion of reform might be based. The remainder of the book then picks up the items on this agenda.

Part II concentrates on liquidity issues. Chapter 5 looks at the ways in which reserves may be created, discusses the role of gold, dollars, SDRs and multiple reserve assets, and examines the question of the adequacy of international reserves. However, countries can finance expenditure not only by running down their reserves but also by borrowing, and the importance of the short-term capital market has become a central feature of the world economy in the 1970s and 1980s. Chapter 6 analyses this market and discusses in particular the role of the commercial banks in providing balance of payments financing. In addition to the private sector, the chapter discusses the role of the official sector in the shape of the International Monetary

Fund. Although commercial international financial flows are important, the part played by concessionary flows should not be ignored. Chapter 7, therefore, examines the question of foreign aid. Part II concludes with a chapter which investigates a central problem associated with borrowing, namely debt.

Part III moves on to examine international adjustment. Chapter 9 provides a relatively lengthy treatment of the need for and choice of adjustment policy within individual countries. However, it also broadens out this discussion to examine international adjustment in a global context. Of course one of the principal changes in the world monetary system has been the move over from essentially fixed to more flexible exchange rates since 1973. Chapter 10 provides an assessment of the different exchange rate regimes. Again the choice of exchange rate regime must be an important item on any agenda for reform.

Part IV looks at certain aspects of the political economy of international financial reform. Chapter 11 discusses the interests of different countries and country groupings but concentrates in particular on the interests of developing countries, since this has been an important theme in the north-south discussion that has been a feature of the 1970s and 1980s. Chapter 12 examines the role of the principal institutions operating in the international financial sphere. Again to reflect the current debate, the chapter concentrates on the IMF, but also makes references to the World Bank and the commercial banks.

There is no concluding chapter presenting a summary statement of the reforms that 'should' be made. However, there can be little doubt that in the preceding chapters certain preferences show through from time to time. Instead it is part of the exercise that the reader should be allowed to draw her or his own conclusions.

Although the chapters are interrelated, they can all be read as independent units. This is a book that can either be read as a whole or dipped into as inclination dictates. Additional notes at the end of the book elaborate on or qualify certain points raised in the text, but these have been kept to a minimum to avoid interrupting the 'flow' of the chapters and on the suspicion that such notes are usually ignored in any case. Each chapter is also provided with a 'further reading' list (see p. 332). Given the contents of the book and its intended market this would seem to be more useful than providing a long list of references which might look impressive but would probably be of rather limited relevance to the reader. Experience with what can

realistically be expected of undergraduates has resulted in these sections being rather brief and therefore far from comprehensive.

One final point needs to be made. Given the unavoidable lag in publication, much of the data in this book and some of the institutional arrangements referred to will be considerably out of date by the time it arrives on the bookshelves. The intervening period may or may not alter the relevance of some of the arguments put forward. Rather than just passively reading the book, readers should actively take it upon themselves to update the empirical and institutional sections and look carefully at what changes have taken place. Fortunately sources are plentiful and fairly easily accessible, and this task should not be too onerous.



# Part I

## The Background to Reform