THE INTERNATIONAL MONETARY SYSTEM AND THE LESS DEVELOPED COUNTRIES

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Preface

This book examines the relationship between the international monetary system and the less-developed countries (LDCs). Chapters 3, 4, 5 and 6 look at some of the international monetary problems faced by LDCs (as regards balance-of-payments instability, inadequacy of reserves, and choice of adjustment strategy); the middle section of the book (Chapters 7, 8 and 9) examines the major channels of balance-of-payments financing available to LDCs; and the final chapters (10, 11 and 12) investigate various policy alternatives.

The book assumes an elementary knowledge of basic economics but no mathematical expertise. It is primarily designed for undergraduates who are studying either international economics or development economics or both, but it is hoped that postgraduates will find certain chapters of interest.

In writing the book I have been helped by the following colleagues and friends, who have read and commented on various chapters or sections: Heather Bird, John Burton, Lorenzo Perez, Maxwell Stamp, Tony Thirlwall and John Williamson. In particular, however, I owe a debt to Geoffrey Maynard and Danny Leipziger, both of whom read a substantial proportion of the book in its early stages. Their observations caused me to make a number of changes which I feel have improved the text. Since all the above-named people assisted me out of the goodness of their hearts, it is only fair that they should be exonerated from any responsibility for errors which have passed unnoticed.

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1 Introduction

Background

At the time of the Bretton Woods Conference in 1944, international monetary reform was fairly solidly the preserve of the developed countries of the world. The interests of less-developed countries (LDCs), if considered at all, were viewed as being in parallel with those of the developed countries, and not seen as warranting special treatment. Although, in the period between the establishment of the International Monetary Fund (IMF) in 1946 and the effective collapse of the par-value international monetary system in 1971, the activities of the Fund were constrained by its own Articles of Agreement, which define the IMF as a stabilisation rather than a development agency, a number of special facilities were introduced the prime objective of which was to assist less-developed member countries in dealing with particular aspects of their balance-of-payments problems. In 1963 the Compensatory Financing Facility (CFF) was introduced, to help members cope with the implications of a temporary shortfall in export receipts, whilst in 1969 the Buffer Stock Financing Facility (BSFF) was introduced, to help members cope with the implications of contributing to international commodity schemes. Other, ostensibly more minor, but in effect perhaps more significant, modifications were also beneficial to LDCs, such as the review of small quotas, and the softening of the IMF line on certain exchange practices.

Paradoxically, during the 1960s, when the IMF was demonstrating a growing awareness of the problems faced by developing countries, the Fund's influence with the developed countries seemed simultaneously to be declining. The developed countries were primarily concerned with two related international monetary issues: the supposed inadequacy of global international liquidity, and the deficiency of an international monetary system which heavily relied on the existence of a balance-of-payments deficit in the United States for the creation of international liquidity. Discussion about these two issues began under the auspices of the Group of Ten and culminated in the establishment of the Special

Drawing Rights (SDR) facility. LDCs were not involved in the discussions, and some developed countries saw no reason why LDCs should even participate in the SDR scheme once activated. Consistent with its previous attitude, however, the IMF argued that all member countries should be treated on equal terms, and when the SDR scheme was activated, in 1970, SDRs were allocated to LDCs and developed countries alike.

The SDR scheme, however, failed to prevent the breakdown of the Bretton Woods system, and it has been in the period since this collapse that international attention has become more sharply focused on the position of LDCs in the international monetary system.

After 1971, LDCs for the first time had the opportunity to participate fully in the reform of the international monetary system. At an institutional level, LDCs were well represented on the Committee of Twenty,[1] which established two technical working groups that specifically examined issues of direct relevance to LDCs: first, the idea of a link between the creation of SDRs and aid; and, second, alternative ways in which a transfer of real resources to LDCs could be engineered. The institutional momentum was maintained following the Committee's Final Report, with the setting up of a Joint Ministerial Committee of the Board of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (the 'Development Committee').

The post-1971 era has, however, witnessed not only the inclusion of LDCs in the discussions relating to international monetary reform, but also the proliferation of measures specifically designed to assist them. Both the CFF and the BSFF have been liberalised, and the Extended Fund Facility (EFF), Oil Facility (OF), Subsidy Account, and Trust Fund have been introduced.

These modifications to the activities of the IMF in relation to its less-developed member countries are, in some ways, quite strategic. The EFF, for instance, marks a more overt involvement with developmental policies in LDCs than was previously the case, whilst the OF represents a departure from the previous emphasis on the balance-of-payments implications of a fall in export earnings, as opposed to a rise in import payments. The modifications have, however, in no way exhausted the scope for international monetary reform, which is biased towards solving the balance-of-payments problems faced by LDCs.

In Chapter 2 of this book the relationship between the IMF and its less-developed member countries is traced both analytically and historically. Chapter 7 presents a statement of the avenues through which the IMF makes financial assistance available to LDCs, and Chapter 8 evaluates these sources of finance. Attention is concentrated on the IMF because, until the 1970s, LDCs had little recourse to commercial borrowing. The significance of non-IMF sources of finance is, however, discussed in Chapter 9.

Balance-of-Payments Problems and International Monetary Issues in LDCs

Many of the balance-of-payments problems encountered by LDCs result from export instability, the causes and consequences of which are investigated in Chapter 3. Changes in the terms of trade of LDCs, as well as recent changes in LDCs' trading and balance-of-payments positions, are examined in Chapter 4. The commodities problem, of which export instability and declining terms of trade are two aspects, has in the 1970s become a central issue in discussions between the developed and less-developed countries about a new international economic order. Various aspects of the commodities problem are examined in Chapter 10, which in particular, looks at ways in which the international monetary system may be used to help solve the commodities problem, through the provision of compensatory finance, and the financing of buffer stocks.

When faced with a balance-of-payments deficit a country may either attempt to adjust its economy in a way which reduces or removes the deficit, or finance it. In most cases adjustment requires a reduction in real domestic expenditure, and thus it is often, understandably, a course of action which countries – especially, perhaps, developing countries – are reluctant to adopt. Alternatively, deficits may be financed through either the decumulation of international reserves or international borrowing. The choice of appropriate balance-of-payments policy in LDCs is discussed in Chapter 6.

Following the rise in the price of oil in 1974, oil-importing LDCs were confronted with balance-of-payments problems of much increased severity. The combined annual current-account balance-of-payments deficit for these LDCs was over $30,000 million in each of the years 1974, 1975 and 1976. Different LDCs have reacted to the deficit in different ways; although it should be noted that the different reactions can frequently be explained by differences in the range of policy options available. In many of the poorest LDCs, for instance, the option of commercial borrowing has simply not existed, and thus the countries concerned have been forced to reduce the volume of their imports, draw down their reserves, draw on the IMF under its various facilities, particularly the OF, and rely on inflows of official capital. Perhaps not surprisingly, these countries have been unable to achieve even a modest rate of economic growth over recent years. Better-off oil-importing LDCs have been able to maintain development only by resorting to private borrowing, especially through the Eurocurrency market. For oil-importing LDCs in general, the period since 1974 has brought with it an increase in international indebtedness, an increase in debt–service ratios, and a fall in the real value of reserves. These developments emphasize questions concerning the adequacy of multilateral concessionary financial assistance to LDCs; the adequacy of LDCs' access to IMF facilities; the wisdom, for LDCs, of using the Eurocurrency market; the adequacy of international reserves in LDCs; the optimal adjustment strategy in LDCs; and the homogeneity of LDCs in terms of their international monetary problems.

The question of concessionary aid lies outside the scope of this book, although, in a situation where countries possessing per capita incomes of below $200 per annum have had to accept zero growth for a number of years, and a reduction in imports to a level some 20 per cent below their level in the late 1960s, there would appear to be a *prima facie* argument that official concessionary aid to these countries is inadequate – especially since such LDCs cannot gain access to private loans, or afford to borrow on commercial terms. Certainly the Development Committee has reached this conclusion, and it is currently investigating ways in which the flow of concessionary aid to LDCs can be increased. The remaining questions mentioned above do fall inside the terms of reference of this book and all of them are examined in the chapters that follow.

The adequacy of IMF facilities (Chapter 8) is a matter that has both quantitative and qualitative aspects. Despite the expansion in LDCs' IMF quotas over recent years, the ratio of quotas to imports has fallen, and drawings on the Fund remain largely conditional and subject to relatively short repayment periods, which may be inappropriate where structural changes are required.

Considerable use of the Eurocurrency market (Chapter 9) has been made by a limited number of high- and middle-income LDCs. The long-term viability of this source of balance-of-payments financing is, however, open to debate, in part because of the risks of default and lack of confidence; and it would probably be better if, instead of being based on short-term Eurocurrency credits, commerical borrowing were based on long-term bond issues.

As to the adequacy of international reserves (Chapter 5), oil-importing LDCs have, over recent years, experienced both a decline in their percentage share of total world reserves, and zero growth in reserves; indeed, in 1975 their reserves actually fell by SDR 4 million. This, along with certain supplementary factors, such as the fall in the ratio of reserves to imports, the adoption and extension of import controls, the increase in the size of the balance-of-payments deficit, and reluctance to make proportionately greater use of adjustment, would seem to indicate that the adequacy of reserves in oil-importing LDCs has declined.

Given that LDCs have generally not, in recent years, taken much action to adjust their economies, the deterioration in their balance-of-payments position and the size of the associated financing problem is likely to force them in the future, to undertake a close examination of adjustment policy (Chapter 6). In particular, the exchange-rate policy of many LDCs (Chapter12) would seem worthy of scrutiny, since evidence suggests that in a significant number of cases policies have been pursued which are not necessarily appropriate.

With regard to homogeneity, LDCs do not, except in a fairly narrow sense, constitute an homogeneous group in terms of their international monetary problems (this theme recurs in many of the following chapters). At any one time there are likely to be a number of dichotomies within the LDC group. For instance, following the oil-price rise the problems of oil-exporting and oil-importing countries became sharply contrasted, with oil-exporting countries having to decide what to do with their balance-of-payments surpluses and oil-importing countries having to find ways of financing or correcting their deficits. Within the oil-importing group of countries there also developed a sharp distinction between, on the one hand, those high- and middle-income LDCs which had access to unconditional commercial borrowing, and which were therefore able to maintain at least positive economic growth, and, on the other hand, the low-income LDCs which had to rely almost exclusively on the IMF as a source of balance-of-payments financing assistance, and which were therefore subject to the conditions imposed by the Fund: in these countries the rate of economic growth stagnated.

Alternative Policy Approaches

Although there is an undeniable relationship between the operation of the international monetary system and economic growth in LDCs, the proper nature of this relationship is a subject of some dispute. Which policies are advocated depends very much on which view is taken of the proper relationship between the international monetary system and development. One policy approach builds on the notion that there is no conflict of interest between developed and less-developed countries. This approach maintains that, from an international monetary point of view, what is best for developed countries is also best for LDCs. The policy implications of this approach are that national and international authorities should concentrate on establishing the most efficient international monetary system, irrespective of distributional or equity considerations. Policies which assist the growth of national incomes and trade in developed countries will, it is suggested, be of indirect, but significant, importance to LDCs.[2]

A second policy approach rejects this line of argument and maintains that the international monetary system should be constructed so as to yield direct, and in some cases exclusive, benefits to LDCs. The benefits derived by LDCs under such an approach would be achieved at a balance-of-payments or resource cost to developed countries, thereby specifically involving a degree of redistribution. Direct policies might be based on the existing international monetary framework, or they might involve substantial modification to this framework. Into the former category would fall plans designed to modify the quota formula in order to increase the size of LDCs' quotas, and also those to extend various facilities in the IMF, such as the CFF. Into the latter category would fall plans involving the introduction of an SDR–aid link (Chapter 11).

In any case, the heterogeneity of LDCs' international monetary problems suggests that grouping all LDCs together is inappropriate from the point of view of policy, which therefore has to take a more disaggregated approach. This indeed has already been recognised, inasmuch as international concern and, to some extent, international monetary reform have been focused on the least-developed countries, which have been the most seriously affected by world economic developments.

LDCs and the Reform of the International Monetary System

As international monetary reform is an exercise in political economy, LDCs should perhaps be prepared to forgo, for the time being, first-best reforms which may currently be politically infeasible, and instead settle for feasible second- or third-best reforms which generally improve their position in the international monetary system and which may act as stepping-stones to first-best reforms in the future. Clearly, changes which benefit LDCs at a visible cost to developed countries, are less likely to be accepted by the latter than are those which do not impose costs on them. Unfortunately, from the point of view of LDCs, it is frequently the reforms which impose the greatest costs on developed countries which yield the greatest benefits for LDCs. Thus, many of the most far-reaching reforms require from the richer countries in the world a genuine and actual commitment, rather than a merely verbal commitment, to the transfer of resources. The approach of LDCs to international monetary reform should perhaps represent a balance between endeavouring to introduce reforms specifically designed to assist them, and coming to terms with certain features of the existing system.

The SDR–aid link, which is discussed in Chapter 11, constitutes one LDC-specific reform. The version of the link which LDCs would find most beneficial, i.e. one involving a competitive interest rate for holders of SDRs and a subsidised concessionary rate for LDC users, is probably the one least likely to be accepted by developed countries, since it would involve them in the extra cost associated with interest-rate subsidisation. In current circumstances, and in the light of the IMF's Second Amendment, it may be to the advantage of LDCs to concentrate on that version of the link which does not rely on new SDR emissions but which ties the link to reserve-currency amortisation.[3] Also, at a time of world recession, the expansionary aspects of the link, which could be expected to lead to higher levels of employment, real output and exports in developed countries, could be used to strengthen the case for it. It is also true that the recycling of oil revenues, which has taken place both directly and, through the mediation of the Eurocurrency market, indirectly, has helped not only to protect development in LDCs but also to maintain employment and exports in developed countries. LDCs might further exploit areas of common interest with developed countries. Commodity stabilisation, for instance, might yield benefits not only for less-developed producing countries but also for developed consuming countries; and the international monetary system could be modified to assist in the financing of stabilisation schemes.

Whilst reform proposals such as the SDR–aid link, which purposefully adapts the international monetary system in order to expand the amount of aid going to LDCs, constitute fairly fundamental changes in the role of the international monetary system – or, more narrowly, the IMF – other, less fundamental reforms could be made which would, nonetheless, assist LDCs in coping with their balance-of-payments difficulties, or, indeed, reduce the incidence of such difficulties. LDCs would gain from any expansion of existing IMF facilities and any liberalisation of the conditions attached to these facilities, such as lengthening the repayment period on drawings. A further beneficial modification would be the orientation of financing assistance towards the protection of development plans. Such an idea has been discussed in the past under the proposal for Supplementary Financing Measures. A modification of this type would embody the closer co-operation between the IMF and the IBRD (International Bank for Reconstruction and Development, the World Bank) which some commentators feel would be appropriate.

Commercial borrowing by LDCs is currently hampered in a number of ways. On the borrowing side, many LDCs find it difficult to gain access to world capital markets, and are in any case reluctant to build up the related debt obligations. On the lending side, commercial lenders lack confidence in the ability of LDCs to repay their debts. One possible reform would be for richer countries to subsidise the commercial interest rates paid by LDCs, as is to some extent done under the Subsidy Account in relation to borrowing under the OF; another would be for those same countries to guarantee the repayment of long-term loans by LDCs. A possible advantage of the guarantee system from the point of view of developed countries is that guarantees would probably be activated only rarely. Thus, even though a guarantee system might yield LDCs relatively fewer benefits than a subsidy system would, it may have a better chance of acceptance.

With regard to flexible exchange rates, it is probable that the view of LDCs will remain ambivalent. For, whilst floating may enable developed countries to pursue more stable, expansion-oriented policies, it may also reduce the likelihood of future SDR allocations; to LDCs then, the opportunity cost of generalised floating could be high. It would, however, appear to be in the best interests of LDCs to adapt to the existing environment of flexible rates rather than to hanker after a fixed-rate system. They could minimise the costs and maximise the benefits associated with floating by developing adequate forward-exchange facilities, by choosing their currency peg carefully, and even by making more aggressive use of the exchange-rate instrument. In the circumstances in which many LDCs find themselves, however, universal exchange-rate variations may be inappropriate and the selectivity offered by some form of multiple exchange-rate system possibly warrants further investigation, even though such arrangements have never found favour with the IMF.

Many of the international monetary problems which face LDCs are merely monetary manifestations of more basic structural and trading problems.[4] The balance-of-payments positions of LDCs in general could no doubt be substantially improved through greater aid, which would permit industrial diversification, and through trade reforms, which would permit LDCs greater access to the markets of developed countries. What is needed first of all, however, is for the developed countries firmly to commit themselves to helping the poor countries of the world. A concerted and complementary programme of aid expansion and trade reform, along with international monetary reform, could then follow.

2 Relations between the IMF and LDCs

The principal economic objective of most LDCs is almost certainly that of stable development, or of development linked with stability. Development is desirable because it permits an improvement in a nation's standard of living. It involves policies relating to the various factors of production: land, labour, capital and entrepreneurship. Stability means the minimisation of deviations around a certain trend. Aspects of stability include the eradication or dampening of cycles in economic activity, the control of inflation, and the avoidance of balance-of-payments disequilibria.

Although in many circumstances the objectives of development and stability are mutually reinforcing, occasions can and do arise when they conflict. Thus it may be that balance-of-trade or current-account balance-of-payments deficits have to be endured (and financed) in order to protect a particular development programme, or that inflation cannot be removed or reduced without pursuing a range of monetary and fiscal policies which would be injurious to economic growth at least in the short run. Where conflicts of this nature emerge, a choice has to be made concerning the extent to which the one objective will be sacrificed in favour of the other. Casual empirical observation would suggest that, when such a choice has to be made LDCs normally prefer to maintain development rather than stability. This is perhaps hardly surprising when one bears in mind the very low levels of per capita national income which exist in many LDCs.

The objectives of the IMF are clearly stated in its original Articles of Agreement. Article 1 states that the purposes of the Fund are:

(i) To promote international monetary co-operation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of