Southern demands, Northern resistance...

Unsustainable debt burdens in the Third World combined with chronic shortages of external finance have prompted demands by developing countries for major reforms in the world monetary and financial system. This study, intended mainly for the non-specialist, gives the background to this growing controversy which is at the heart of the North-South debate. Following an overview of the political issues and the evolution of the principal multilateral institutions, the International Monetary Fund and the World Bank, the structure and operations of these institutions are discussed. The increasingly important role played by private multinational banks in providing external finance to the Third World is also highlighted.

Deborah M.R. Coyne completed an M.Phil. degree in international relations at Oxford University, England. She is a practising lawyer in Toronto.

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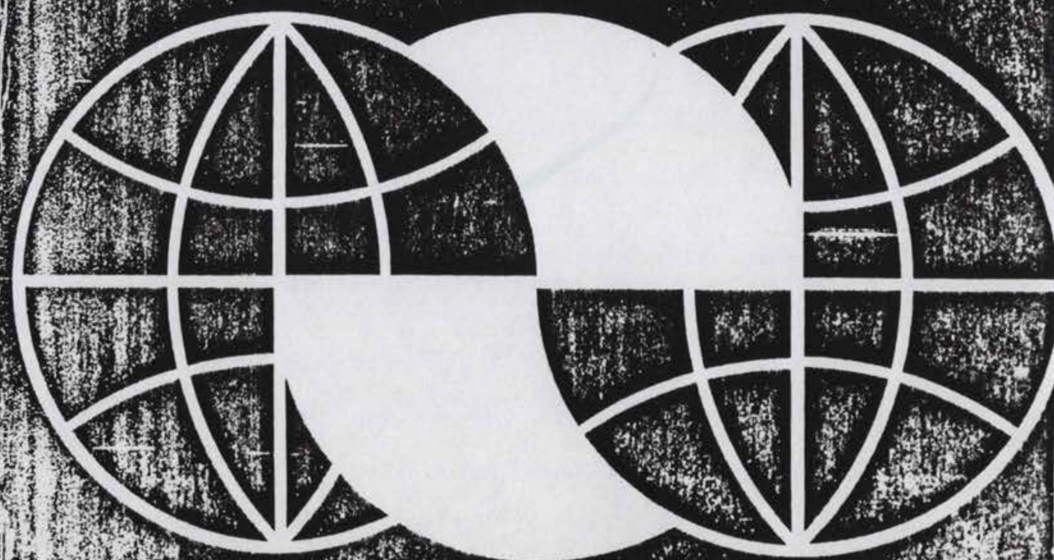
Monetary and Financial Reform

The North-South Controversy

Deborah M.R. Coyne



Monetary and Financial Reform

The North-South Controversy

Deborah M.R. Coyne
for the
North-South Institute

The North-South Institute

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Foreword

Only a few years ago, the subject-matter of this paper would have been considered marginal by many observers of international economics and politics. Today, it is almost too central. Concern over the stability of the world financial and monetary systems, and over the impact of developing countries on that stability, is the everyday grist of the popular media.

This change is exceedingly important but also exceedingly complex and fast-moving. Power and bargaining relationships are evolving. Many actors are at work, directly and through proxies, in shifting combinations. The process is driving home the clearer realities of interdependence.

Against this kind of background, 'North-South controversy', in its traditional terms, can easily seem somewhat artificial and dated. Indeed, the study before us is basically retrospective and deals with a number of historically set positions as well as a few more current developments. While the study should be read in this context, and while the author makes no claim to presenting a comprehensive analysis of this rapidly-changing picture, the Institute does believe that she clearly traces, for a non-specialist reader, some important roots and enduring issues that must figure in any eventual reform of the world monetary and financial systems.

The Institute was pleased to be able to sponsor the publication of this work by Deborah Coyne as a contribution to awareness and understanding of these issues. We gratefully acknowledge the comments of two external reviewers on earlier versions of the manuscript. We also wish to acknowledge the in-house roles played by Bruce Campbell and Douglas Williams, Research Officers, Roger Young, Senior Research Officer, and Maxwell Brem, Senior Editor, in steering this project, at different stages, from conception to publication.

Bernard Wood
Director

1 Introduction to the Issues

The decade of the 1970s will probably be recorded as the one in which the North-South cleavage in international relations attained equal importance with that of the traditional East-West divide. The cataclysmic events of the early 1970s, most notably the abandonment of the gold exchange standard by the United States in 1971, the resultant abandonment of the fixed exchange rate regime, and the quadrupling of oil prices by the Organization of Petroleum Exporting Countries (OPEC) in 1973, served to alter significantly the structure and mechanisms of the international political economy. New actors and institutions emerged, old ones gained in prominence, others receded into the background.

Perhaps the most eloquent expression of this climate of change was found in the call for a New International Economic Order (NIEO) at the Sixth Special Session of the United Nations in April 1974. The Declaration and Programme of Action called on all states, *inter alia*, to work towards a new international economic order based on:

> ... equity, sovereign equality, interdependence, common interest and cooperation among all States, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations.[1]

For many observers, this strident call marked a watershed of history. But its precise meaning as well as its implications for the international political economy were by no means clear. A myriad of questions arose. Did the 'new order' imply a major restructuring of the international political economy, or merely an incremental improvement in the existing structure and mechanisms? Did the terms 'developed' and 'developing', 'North' and 'South' have any useful empirical content given the increasing heterogeneity among nations? And how should the industrialized countries respond to this political offensive by the developing countries? More particularly, should the Northern strategy focus on the selective cooptation of the newly-rich oil exporting states and newly industrializing countries so as to defuse the growing confrontation, or should the developed states seek more meaningful cooperation with developing countries in general?

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[1] United Nations General Assembly, Resolutions of the Sixth Special Session: "Declaration on the Establishment of a New International Economic Order", and "Programme of Action on the Establishment of a New International Economic Order", 3201(S-VI) May 1, 1974, as in B.P. Menon, *Global Dialogue: The New International Order* (Oxford: Pergamon Press, 1980), p.87.

The North-South Divide

In the 1980s, uncertainty surrounding the North-South dimension of international relations has continued. Indeed, there are many who assert that the North-South dichotomy is obsolete and irrelevant in today's complex world. Whereas 'North' may refer to all rich (non-communist) industrialized countries with an average annual per capita income of more than $2,000, 'South' subsumes a wide variety of well over 100 states at many different levels of development, ranging from 'oil exporters' and 'newly industrializing countries' (the latter increasingly referred to as NICs) to the United Nations'-designated 'least developed countries' or the World Bank's 'low-income developing countries'.[2] Several oil-rich states are beginning to rival the North in terms of their control over economic resources, while the NICs are recording the fastest growth in their share of the world's manufacturing output. The least developed or low-income country groupings have the lowest per capita national incomes and/or the bleakest development prospects.

Despite these disparities within the South itself, the terms 'North' and 'South' are nonetheless far from devoid of psychological, political and economic content and are able to assist our understanding of international relations.[3] As long as the industrialized North, with only 30 percent of the world's population, has over 80 percent of the income and wealth, relations between developed and developing states, regardless of differences within the latter, are still viewed predominantly as a bipolar struggle between rich and poor, strong and weak, have and have-not states.

The broad purpose of this volume is to examine a particular aspect of North-South economic relations, namely the debate over the structure and operation of the international financial and monetary system. In order to stay within manageable limits, the study will focus on the two major multilateral financial institutions — the International Monetary Fund (IMF) and the World Bank — and their respective roles *vis-a-vis* the financing requirements of developing countries.

At issue, in general terms, is the inadequate flow of financial resources from North to South to finance not only trade deficits (the foreign exchange gap) and general developmental programs (the domestic savings or investment gap), but also, more recently, the cost of servicing foreign debts.

On the one hand, many governments and observers from the South argue that basic changes in the framework of international financial and monetary arrangements are now required in order to accelerate the

[2]See Appendix, Classification of Countries.

[3]See generally, R D. Hansen, *Beyond the North-South Stalemate* (New York: McGraw-Hill, 1979); for a contrary view, see M. Camps and C. Gwin, *Collective Management. The Reform of Global Economic Organizations* (New York: McGraw-Hill, 1981), Chapter 1.

flow of financial resources in such volume and on such terms as to promote both self-sustaining economic development and a more equitable distribution of the world's resources. On the other hand, many governments and observers in the North argue that narrowing the income gap between rich and poor states and promoting economic development requires more than mere transfers of resources. The achievement of such goals is predicated not only on a healthy, efficient world market economy, but also on fundamental internal political and economic reforms within the developing countries themselves to ensure that the benefits of any international economic interaction trickle down to all citizens.[4]

This controversy over the international financial and monetary order crystallized and assumed momentum in the early 1970s. By that time, it had become evident that international efforts to promote economic development and, in particular, to eliminate absolute poverty had palpably failed. In fact, not only had few less-developed countries reached the 'take-off' point,[5] but also the overall income gap between North and South had widened. Thus, when the OPEC states were successful in quadrupling oil prices in 1973 and radically shifting the balance of economic power in their favour, all developing countries seized the opportunity to advocate major changes in the international economic order.

A prominent component of the NIEO manifesto in 1974 dealt with the role of the multilateral financial institutions in maintaining and shaping this economic order.[6] The South called for more effective participation of all states in economic decision-making and the active involvement of the IMF, World Bank and other international bodies in narrowing income differentials between rich and poor states. These demands reflected the South's goal to use the multilateral financial institutions as major conduits for the transfer of financial resources from rich to poor states. Traditionally, these institutions have provided less than 10 percent of total net transfers to developing countries and are still seen by the North as merely a supplement to bilateral aid efforts and a catalyst for private capital flows.

From the North's perspective, the primary function of institutions such as the IMF is to contribute to a stable, efficient financial and monetary system which will facilitate unimpeded transfers of capital, goods and services. In this way, an optimal allocation of scarce resources will be

[4]N.H. Leff, "The New Economic Order — Bad Economics, Worse Politics", *Foreign Policy* 24 (Fall, 1976), pp. 216-217; and comments by Margaret Thatcher and Helmut Schmidt in Friedrich Ebert Foundation (ed.), *Towards One World. International Responses to the Brandt Report* (London: Maurice Temple Smith Ltd., 1981), pp. 104-116.

[5]The term is used in W.W. Rostow, *Stages of Economic Growth* (2nd ed.), (London: Cambridge University Press, 1971).

[6]Much has been written on the substantive demands of the NIEO. See, for example, J.N. Bhagwati (ed.), *The New International Economic Order: The North-South Debate* (Cambridge, Mass.: MIT Press, 1977); K.P. Sauvant and O. Jankowitsch (eds.), *The New International Economic Order: Changing Priorities on the International Agenda* (Oxford: Pergamon Press, 1980).

assured, and both global economic growth and overall welfare will be maximized. The industrialized countries therefore reject proposals to use the international financial institutions as vehicles for a major transfer of resources from North to South for general development purposes. In their view, the IMF and World Bank are mandated to provide a particular type of external finance: respectively, short-term loans for balance of payments purposes, and longer-term loans mainly for specific projects. This complements the other traditional sources of external finance for development, such as direct foreign investment and suppliers' credits, official government-to-government loans, bilateral aid and official development assistance (ODA).[7]

The industrialized countries further resist the idea of democratizing the institutions. A system of voting weighted according to contributions to the capital base is considered essential by the North to protect creditors' interests and ensure prudent loan operations.[8]

In light of these diametrically opposed positions, a virtual stalemate has emerged on the question of major reforms. And yet developments since the mid-1970s have given new impetus to the South's demands for major changes.

The Rise of Debt Crises

During the 1970s, glaring deficiencies in the system of development finance became manifest, particularly after the oil price shocks of 1973 and 1979 which intensified the need of developing countries for external finance.

In the 1960s and early 1970s, most transfers to developing countries consisted of official bilateral aid flows — primarily grants and concessional loans. Private finance, mainly direct foreign investment and suppliers' credits, amounted to about 20 percent of net capital flows. As a result of the deep Western recession, ODA transfers have stagnated and by 1982 they represented a mere 0.38 percent of the GNP of the Western donors,[9] well below the 0.7 percent target set in 1968 in the euphoric days of the First Development Decade.

As shown in Table 1.1, increased lending by private foreign banks considerably offset the decline in ODA flows in the second half of the 1970s. There was also a dramatic growth in the rate of private foreign

[7] Official Development Assistance (ODA), according to the Development Assistance Committee of the OECD, consists of official transfers with a grant element of more than 80 percent made either through bilateral channels or to multilateral institutions.

[8] R.N. Cooper, "Prologomena to the Choice of an International Monetary System", *International Organization* 29 (Winter 1975), pp. 92-97; and see generally, M. Camps, *Collective Management*, Chapter 3. An excellent general discussion of the question of voting structures is found in S. Zamora, "Voting in International Economic Organizations", *American Journal of International Law* 74 (1980), pp. 566-609.

[9] Organisation for Economic Co-operation and Development, *Development Co-operation Efforts and Policies of the Members of the Development Assistance Committee. 1983 Review* (Paris: OECD, 1983), Table B4, p. 188.

Table 1.1
Net Resource Receipts of Developing Countries, 1970-82
($ billions, 1981 prices)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Official Development Assistance	21.3	22.2	21.5	24.7	29.1	32.0	30.2	28.8	33.5	33.8	36.2	36.6	35.0
Bilateral	18.5	19.0	18.5	20.9	24.1	26.2	24.5	22.2	26.4	27.2	28.7	28.7	27.4
Multilateral	2.9	3.2	3.0	3.8	5.0	5.9	5.7	6.6	7.2	6.6	7.6	7.9	7.6
Grants by Private Voluntary Agencies	2.2	2.2	2.3	2.7	2.2	2.1	2.0	2.0	2.0	2.1	2.2	2.0	2.4
Non-Concessional Flows	28.2	28.7	29.1	38.7	34.9	52.5	51.8	61.2	69.1	61.1	54.7	69.3	57.8
Export Credits	6.9	8.3	4.8	4.5	5.6	8.6	12.1	13.1	14.2	11.2	13.2	13.3	11.7
Other Official Flows	3.3	3.6	3.4	5.0	7.8	7.5	6.7	7.5	8.7	8.6	8.6	8.8	11.4
Direct Investment	9.5	8.0	9.2	9.2	3.3	17.4	12.3	13.5	13.8	14.2	10.2	16.1	11.2
Bank and Bond Borrowing	8.5	8.7	11.6	20.0	18.1	19.0	20.7	26.1	32.4	27.1	22.7	31.0	23.5
Total Receipts	51.8	53.1	52.8	66.1	66.2	86.5	84.0	92.1	104.6	96.9	93.2	107.9	95.2

Source: OECD, *Development Co-operation, 1983 Review*, Paris, 1983, Table III-2, p. 52.

investment, although the momentum was not sustained, and since 1975 growth in levels of investment has fallen behind the rate of inflation.[10] More than 80 percent of such foreign investment was channelled to the more advanced middle-income developing countries which have brighter export and development prospects. These same countries also benefited most from the new flows of private bank lending.

The surprising success of the middle-income developing countries in tapping international financial markets as shown in Table 1.2 has since backfired, and the borrowers face severe debt servicing problems. But while the debtor nations' need for finance has never been greater, their creditors, the multinational banks, have reduced the volume and maturity composition of loans and widened the interest spreads. With more than $660 billion in short- and long-term external debt outstanding by 1983,[11] non-oil exporting developing country debtors pose a certain threat to world financial stability if there is a major default. External finance is urgently required merely to service existing debt, let alone supply new development needs.

Meanwhile, for the less creditworthy, low-income developing countries hit by the slowdown in the growth of aid flows, prospects remain bleaker than ever. They must compete for limited aid funds with richer developing countries no longer able to rely on commercial finance.

New Receptivity to Change?

The South's desire to reduce its reliance on fickle financial flows — whether bilateral ODA, direct foreign investment or private bank lending — lies behind the South's renewed emphasis on channelling a greater quantity of finance on a more automatic and less conditional basis through the international financial institutions. Demands such as those contained in the Brandt Commission reports of 1980 and 1983 call for a more integrated approach to development finance, perhaps subjecting the IMF and World Bank to the jurisdiction of the United Nations, as well as for massive multilateral resc·urce transfers and a general reorientation of the international financial and monetary order toward issues of economic development and greater distributional equity.[12]

[10] World Bank, *World Development Report*, 1981, pp. 51-52, where it is also noted that the form of direct foreign investment has changed. Intra-company loans supplement equity participation, and many transnationals satisfy their financing needs by borrowing directly in the Eurocurrency market or from local banks, rather than obtaining loans from parent-firms.

[11] International Monetary Fund, *World Economic Outlook*, Occasional Paper No. 21, Washington, D.C., May 1983, Table 32, p. 200.

[12] Independent Commission on International Development Issues (ICIDI), *North South: A Programme for Survival* (The Brandt Report), (Cambridge, Mass.: MIT Press, 1980), pp. 221-282; and W. Brandt *et al.*, *Common Crisis North South: Cooperation for World Recovery* (London: Pan Books Ltd., 1983), pp. 40-100.

Table 1.2
Non-Oil Developing Countries: External Debt, 1973-83[1] ($ billions)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Total Outstanding Long-Term Debt of Non-Oil Developing Countries	111.8	138.1	163.5	194.9	235.9	286.6	338.1	388.5	452.8	499.6	571.6
By Type of Creditor											
Official Creditors	51.0	60.1	70.3	82.4	98.7	117.5	133.0	152.9	172.4	193.2	218.7
Governments	37.3	43.4	50.3	57.9	67.6	79.1	87.2	98.7	108.6	120.4	135.3
International Institutions	13.7	16.6	20.3	24.8	31.0	38.4	45.8	54.2	63.8	72.8	83.3
Private Creditors	60.8	77.9	95.1	114.8	137.3	169.1	205.1	235.6	280.4	306.4	353.0
Unguaranteed Debt	29.3	36.0	40.8	45.9	51.4	56.4	67.3	77.5	96.7	103.9	113.7
Guaranteed Debt	31.5	42.0	52.4	66.6	85.9	112.7	137.8	158.1	183.7	202.2	239.3
Financial Institutions	17.3	25.6	36.7	49.0	59.1	79.5	102.9	121.6	144.5	159.5	193.8
Other Private Creditors	14.2	16.3	17.6	19.8	26.8	33.2	34.9	36.5	39.2	42.7	45.5
By Analytical Group											
Net Oil Exporters	20.4	26.0	34.1	42.4	53.3	61.2	70.5	79.4	96.5	108.1	129.0
Net Oil Importers	91.4	112.1	129.4	152.5	182.7	225.4	267.6	309.1	356.2	391.5	442.6
Major Exporters of Manufactures	40.8	51.7	60.9	73.1	85.2	108.1	127.7	145.2	170.6	184.3	212.4
Low-Income Countries	25.4	29.7	33.2	38.3	46.5	53.1	59.5	67.0	73.0	80.1	90.8
Other Net Oil Importers[2]	25.2	30.6	35.3	41.1	51.0	64.2	80.4	96.9	112.7	127.1	139.4
By Area											
Africa	14.2	17.7	21.9	26.9	35.0	42.1	49.6	55.1	60.5	67.1	75.0
Asia	30.0	34.6	39.8	46.4	57.9	67.4	76.1	88.4	100.8	115.1	131.7
Europe	14.5	17.2	20.0	23.4	28.7	38.2	49.0	57.5	63.4	69.2	73.8
Middle East	8.7	10.3	13.3	16.1	20.3	24.7	28.4	32.9	35.4	39.3	43.7
Western Hemisphere	44.4	58.2	68.6	82.0	94.0	114.3	135.1	154.7	192.6	208.9	247.4

[1] Excludes data for the People's Republic of China prior to 1977.
[2] Middle-income countries that, in general, export mainly primary commodities.
Source: IMF, *World Economic Outlook*, Occasional Paper No. 21, Washington, D.C., May 1983, Table 32, p. 200.

The North still opposes such sweeping proposals and permits only incremental changes to the structure and operations of the IMF and the World Bank while respecting their separate economic jurisdictions. But there are signs now of a willingness to consider more far-reaching changes, particularly concerning the role of private financial institutions. Faced with the prospect of having to bail out private Northern banks to avert a collapse of the international financial system, industrialized countries are prepared to discuss initiatives aimed at increasing the involvement of the international institutions to avoid such a situation in future.

In May 1983, at a meeting of ministers and officials from the member countries of the Organisation for Economic Co-operation and Development (OECD), France called for an international conference on monetary reform with the aim of returning to fixed exchange rates.[13] This was opposed by the United States, although, subsequently, at the May 1983 Williamsburg summit, the Western leaders agreed to consider a world monetary conference to examine ways to improve the international monetary system. The United States has also proposed that the IMF expand its role by strengthening links with the General Agreement on Tariffs and Trade, the major trade policy organization, in recognition of the interrelationships between trade and finance policies. Particular reference was made to the fact that developing countries will be unable to service their foreign debts unless they can generate adequate export earnings. The urgent need for reform of international financial arrangements has also been the subject of a recent Commonwealth Study Group report, *Towards a New Bretton Woods: Challenges for the World Financial and Trading System*, and has been discussed by Commonwealth heads of government and finance ministers.

These proposals are significant insofar as they contemplate a major restructuring of financial and monetary relations. It remains to be seen, however, to what extent opinion may converge between North and South on the specific roles and responsibilities of the international financial institutions toward economic development.

The rest of this study examines the North-South dimension of the international financial and monetary order, beginning in Chapter 2 with an overview of the evolution of the North-South debate and the gradual orientation of the IMF and the World Bank toward the development concerns of their less affluent members. In Chapters 3 and 4, the structure and operations of the Fund and the Bank will be analyzed from the perspectives of both North and South, with special attention to the contribution that these institutions have made to

[13] "Exchange rate policies create major divisions among OECD nations", *The Globe and Mail* (Toronto), May 13, 1983, p. B3.

economic development and to a more equitable distribution of financial resources among states. Finally, Chapter 5 will focus on the emergence of private multinational banks as major vehicles for financial transfers to certain developing countries. The implications of this phenomenon for global financial stability and international economic management, particularly with respect to the IMF and the World Bank, will be highlighted.

2 Money, Finance and North-South Politics

In the 1960s and 1970s, the international monetary and financial system, established after the Second World War at Bretton Woods, came under increasing stress. At the same time the less developed nations, which had been excluded at Bretton Woods, stepped up their demands for change. This chapter reviews the principal developments that occurred during this period in the evolution of the North-South dimension of the international financial and monetary order.

Bretton Woods and After

The Bretton Woods System established in 1944[1] refers to the postwar economic order based on free flows of capital, goods and services, and freely convertible currencies, initially at fixed par values. This order was a reflection of the American vision of a free, non-discriminatory world market economy in which the United States could exploit its full productive potential. To sustain this order, international financial and monetary relations had to be regulated in such a way as to create an environment conducive to a free multilateral trading system and to preclude a recurrence of the interwar monetary chaos and emergence of mercantilist trading blocs.

The Bretton Woods System represented the first serious effort to constitutionalize global economic relations and to devise comprehensive rules to govern international financial and monetary relations. Two institutions, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) or World Bank, were established to implement these rules. The fact that two institutions were created rather than one reflected the decision to separate monetary and financial matters. Short-term balance of payments difficulties and problems relating to inadequate liquidity to finance world trade would be dealt with by the Fund, whereas long-term problems associated with reconstruction and development would be financed by the Bank.

The structure of both the Fund and the World Bank were designed to ensure American (and British) dominance and, given that most of the states which now constitute the Third World were st[illegible] colonies, it is not surprising that the institutions were not concerned with issues of economic development.[2] Indeed, it was immediately evident that both institutions had too little resources and too little authority either to manage the international economy or to serve adequately the reconstruction needs of the newly-independent states.

As a result, the United States alone assumed the role of the world's money manager and banker. The U.S. dollar emerged as the acknowledged international reserve and transaction currency, and U.S. deficits provided the liquidity to support the multilateral free trading system. U.S. Marshall Plan aid met the immediate reconstruction needs of Europe, and foreign investments by U.S.-based multinational corporations played a major role in the economic development of Europe and some less developed countries.

The 1960s: Growing Pressures

The year 1960, however, marked an end to the effective eclipse of the IMF and World Bank[3]. In that year alone, 17 former colonies acquired political independence and took their seats in the United Nations. They also took up membership in the IMF and World Bank. Suddenly, the two institutions acquired a new and increasingly demanding constituency. In the course of the 1960s, these bodies gradually adapted their structures and operations to the new pressures with which they were confronted from within and without.[4]

The industrialized countries, of course, continued to retain strict control over the financial institutions and therefore the pace and extent of any change. But real changes nevertheless took place.

The resources of the Fund were increased beginning with the third quinquennial review of quotas in 1959, a step which permitted the IMF to expand its balance of payments assistance.[5] The principles and procedures associated with IMF stand-by arrangements became routinized and the so-called conditionality of IMF loans gradually crystallized. In 1963 a compensatory financing facility (CFF) was established primarily to help stabilize the volatile export earnings of developing countries, although such assistance was limited to rather narrow circumstances. The funds available from the CFF were then significantly increased in 1966. In 1969, a buffer stock financing facility (BSFF) was

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[1] Useful general discussions of the Bretton Woods System and the conflicting definitions can be found in F. Hirsch *et al.*, *Alternatives to Monetary Disorder* (New York: McGraw-Hill, 1977); B.J. Cohen, *Organizing The World's Money: The Political Economy of International Monetary Relations* (London: The Macmillan Press, 1977); and R.N. Cooper, "Prologomena to the Choice of an International Monetary System", pp. 63-98.

[2] For an examination of the IMF's role with respect to development, see Joseph Gold, "... To Contribute Thereby to ... Development ...': Aspects of the Relations of the IMF With its Developing Members", *Columbia Journal and Transnational Law* (Fall 1971), pp. 267-306.

[3] Note, however, that the IMF did play an important role in the 1950s in restoring currency convertibility on current account as of 1958.

[4] A useful discussion of the evolution of the Bretton Woods System in the 1960s is found in the collection of essays in A.L.K. Acheson *et al.*, *Bretton Woods Revisited — Evaluations of the IMF and IBRD* (London: The Macmillan Press, 1972). See also S. Strange, *International Monetary Relations*, Volume 2 of A. Shonfield (ed.), *International Economic Relations of the Western World 1959-1971* (London: Oxford University Press, 1976).

[5] For a more detailed discussion of the IMF structure and operations, see Chapter 3.

set up to benefit developing countries in their attempts to create reserve stocks for their primary commodity exports. Finally, the IMF was instrumental in ensuring that the distribution of the newly created international reserve currency — the special drawing right (SDR) — was universalized to include the developing country members.

In a similar manner, the World Bank adapted itself as it became obvious that the developing countries could not cope with the terms and conditions of regular IBRD loans. Two development-oriented affiliates were established — the International Finance Corporation (IFC) in 1956 and the International Development Association (IDA) in 1960 — to increase the flows of long-term concessional project finance to less developed countries.

But despite these changes and the increased concern of the IMF and World Bank with economic development, they still played a minor role in the total financial flows to developing countries during the 1960s.[6] As in the immediate postwar years, their resources were inadequate for them to operate as effective financial intermediaries. In the absence of a Marshall aid equivalent, direct foreign investment by multinational corporations and bilateral foreign aid remained by far the major external sources of finance.

It was during the 1960s that the four major forums within which the developing countries have sought to promote their solidarity took shape, thereby preparing the way for the dramatic developments of the 1970s. These forums are UNCTAD, the Group of 77 (G-77), the Non-Aligned Movement and the United Nations General Assembly. In response, the industrialized countries of the North have coordinated their positions within their own forums, namely the Group of 10, the Organisation for Economic Co-operation and Development (OECD) and, more recently, the Western economic summits. It is useful to trace this ongoing process of action-reaction through to the present day in order to illustrate the growing salience of the North-South alignment in economic affairs and the impact this has had on international financial and monetary relations.

The Role of UNCTAD

UNCTAD (the United Nations Conference on Trade and Development) was formed in 1964 under the guiding hand of a prominent Argentinian, Raul Prebisch, and was effectively the first institutionalization of the North-South axis. The efforts of Prebisch and others focused on using UNCTAD as a "vehicle for communicating the

[6] See generally, L.B. Pearson et al., *Partners In Development: Report of the Commission on International Development* (Washington D.C.: IBRD and Praeger Publishers, 1969).

political demands of less developed countries in an inc[illegible]e political system".[7] Through UNCTAD, developing countries hoped to make use of an organization which, unlike the IMF and World Bank, afforded them influence by sheer weight of numbers. It was thought that by means of periodic conferences of all United Nations members, and the ongoing activities of a Trade and Development Board elected by the conference, pressure could be brought to change existing norms relating to trade and development which were created before the developing countries emerged as a force of political significance.

The first three UNCTADs — Geneva in 1964, New Delhi in 1968 and Santiago in 1972 — accomplished very little in terms of financial and monetary relations, and the ability of UNCTAD to mobilize the South and enhance its collective bargaining power appeared extremely doubtful.[8] Most efforts were concentrated on exhorting industrialized countries to increase the level of official development assistance (ODA) as a percentage of their GNP and to improve mechanisms for the transfer of resources to developing countries. Some credit, however, can be attributed to UNCTAD with respect to the decisions to liberalize the compensatory financing facility of the IMF in 1966, to distribute the SDR on a universal basis in 1969, and to include developing countries in the monetary reform negotiations which commenced in 1972.

UNCTAD's limited impact on the international financial and monetary order was symptomatic of the general impotence of developing countries within the international economic order. And the other forums used to foster solidarity among developing countries experienced similar frustration. For example, the Group of 77 which emerged at the inception of UNCTAD and represented the three constituent regional groups of Latin America, Africa and Asia — the developing country component of UNCTAD — initially coordinated its activities closely with that body and shared in its disappointments. Likewise, two other forums — the UN General Assembly and the Non-Aligned Movement — had little to say about economic development during the 1960s, being preoccupied with the process of decolonization and political self-determination.

[7] R.N. Gardner (ed.), *The Global Partnership* (London: Praeger Publishers, 1968), p.99. The subsequent discussion is based on a number of useful sources: Joseph Nye, "UNCTAD: Poor Nations' Pressure Group", in R.W. Cox and H.K. Jacobsen (eds.), *The Anatomy of Influence — Decision-Making in International Organizations* (New Haven: Yale University Press, 1974); R.S. Walters, "International Organization and Political Communication: The Use of UNCTAD by Less Developed Countries", *International Organization* 25 (Autumn 1971), pp. 818-835; G. Corea, "North-South Dialogue at the United Nations: UNCTAD and the New International Economic Order", *International Affairs* 53 (Spring 1977), pp. 177-187; R. Krishnamurti, "UNCTAD as a Negotiating Institution", *Journal of World Trade Law* 15 (1981), pp. 3-40.

[8] See, for example, Sidney Dell, "An Appraisal of UNCTAD III", *World Development* 1 (May 1973), pp. 1-13, and M. Lipton, "UNCTAD Schmunctad? Why Not Start Again from Scratch?" in *IDS Bulletin* 6 (1973), Institute of Development Studies at the University of Sussex, pp. 116-130.

OPEC and Southern Assertiveness

The years 1971 to 1974 mark a watershed in the North-South divide. First, with the abandonment of the gold exchange standard by the United States in August 1971, by which the U.S. government had been committed to exchange any amount of gold at the rate of $35 per ounce, it became evident that the postwar financial and monetary order based on U.S. political, economic and military dominance could no longer be sustained. Yet no alternative arrangements were clearly emerging. The G-77, which now consisted of well over 100 states, responded to the challenge by streamlining and routinizing its activities.[9] For example, an effective *ad hoc* group, the Group of 24 (G-24), consisting of eight finance ministers from each of the three regional groups, was set up to argue the South's case in monetary reform negotiations with the IMF.

A second important development in this period was the apparent blossoming of East-West detente. This permitted the Non-Aligned Movement to shift its focus away from efforts to resist absorption into great power rivalry, and to transform itself into an effective economic pressure group.[10] The goals and strategies of the Non-Aligned Movement and the G-77 now began to converge, and an informal division of labour was established whereby the Non-Aligned Movement would initiate new economic ideas which the G-77 would then carry to the United Nations in the form of General Assembly resolutions. By the time of the 'OPECalypse' in 1973, the South was well situated through the activities of the G-77, the Non-Aligned Movement, UNCTAD and the General Assembly to take advantage of the sudden shift of economic power and wealth to the oil exporters.

The action by OPEC states in quadrupling the price of oil in 1973-74 was widely supported by the South, despite the crushing financial costs that had to be borne by most oil-importing, less developed countries. It cannot be doubted that the OPEC move served as a major catalyst for a concerted effort by the South to alter the financial and monetary order in its favour.

The groundwork for such an initiative had in fact been laid even before the OPEC action by the Non-Aligned Movement at its Fourth Summit in Algiers in the summer of 1973. At this meeting, most of the details of what was ultimately piloted through the Sixth Special Session of the General Assembly by the G-77 as the Declaration and Programme of Action on the Establishment of a New International Economic Order were hammered out.

[9] Much of the discussion of the G-77 is based on an excellent article by C. Geldart and P. Lyon, "The Group of Seventy-Seven", *International Affairs* 57 (Winter 1980-81), pp. 79-101; and, more generally, Robert A. Mortimer, *The Third World Coalition in International Politics* (New York: Praeger Publishers, 1980), and K.P. Sauvant, *The Group of 77: Evolution, Structure and Organization* (New York: Oceana Publications, 1981).

[10] On the Non-Aligned Movement, see generally, P. Willets, *The Non-Aligned Movement* (London: Frances Pinter Ltd., 1978), and H. Singh (ed.), *The Non-Aligned Movement in World Politics* (Westport, Conn.: Lawrence Hill and Co., 1977).

The North's immediate response to the OPEC action and the manifestation of increased Southern solidarity was confused, to say the least. Despite a number of relevant coordinating forums, notably the Development Assistance Committee (DAC) and a special Working Party on the Financial Aspects of Development Assistance within the OECD, as well as the Group of 10, differing degrees of dependence on Middle East oil dictated divergent responses. For example, at the Washington Energy Conference in February 1974, the United States was evidently convinced that Southern solidarity would not last and was implacably hostile to dealing with OPEC in any way. By contrast, Europe, in particular France, was exceedingly reluctant to maintain such a confrontational stance, and ultimately France refused to join in the formation of the oil importers' International Energy Agency.

In 1974, the United States reluctantly agreed to participate in a tripartite conference on energy consisting of OPEC, the advanced industrialized countries, and the oil-importing developing countries. The Conference on International Economic Cooperation (CIEC), co-chaired by Canada and Venezuela, dragged on for two years, commencing in early 1975 and coming to a "confused and battered end" on June 3, 1977.[11]

Perhaps the most interesting aspect of the CIEC was the willingness of the OPEC states to capitalize on their new-found economic clout to further other objectives of developing countries. For example, it was at OPEC's insistence that the agenda was expanded to deal with not simply energy but matters relating to money and finance, raw materials and development. But few concrete results were achieved other than a few promises by the industrialized countries. These included a $1 billion Special Action Programme for lower-income countries, an agreement to underwrite a proposed Common Fund to finance buffer stocks of raw materials, and a promise to increase the volume of official development assistance in real terms.

Thus, the high expectations of the early period of Southern assertiveness were soon deflated. Not only was CIEC ultimately of little consequence, but also the Seventh Special Session of the United Nations in September 1975 produced little except a commitment to further liberalize the compensatory financing facility of the IMF.[12]

It was soon manifestly clear that the industrialized countries were determined to avoid any form of global negotiations or global blueprints with respect to North-South economic issues and that any initiatives in this sphere would be confined to piecemeal incremental changes in functional areas and in specialized forums which the industrialized countries could clearly control and dominate. Thus, for

[11] An excellent discussion of CIEC is found in J. Amuzegar, "A Requiem for the North-South Conference", *Foreign Affairs* 55 (October 1977), pp. 136-159, and R.A. Mortimer, *The Third World Coalition*, Chapter 6.

[12] B. Gosovic and J.G. Ruggie, "On the Creation of a New International Economic Order: Issue Linkage and the Seventh Special Session of the UN General Assembly", *International Organization* 30 (Spring, 1976), pp. 309-345.

example, the money and finance discussions at the CIEC were effectively pre-empted by the concurrent monetary reform negotiations taking place within a Committee of 20 of the IMF — obviously the preferred forum of the industrialized countries.

The composition of the Committee of 20 did reflect a certain effort by the industrialized countries to assure adequate representation of the developing countries. Nine of the 20 members were appointed by developing countries, and their positions on such issues as the link between the distribution of SDRs and development assistance, and the question of a return to a system of fixed and infrequently changed exchange rates, were effectively coordinated by the Group of 24 (a sub-group of the G-77). Indeed, collectively, the developing countries held a veto over any amendment of the Fund Articles. Unfortunately, however, this blocking power could only prevent decisions, not compel them, and the developing countries ultimately had little positive impact on formulating or implementing the new rules (or non-rules) governing financial and monetary relations contained in the Jamaica Agreement in 1976.[13]

In concluding the Jamaica Agreement, the industrialized countries nonetheless responded to some concerns of developing countries. For example, although the Jamaica Agreement legitimized *ex post facto* the 'system' of generalized floating exchange rates existing since March 1973, and firmly rejected the idea of an SDR-aid link,[14] it did implement the recommendation of the Seventh Special UN Session to liberalize the compensatory financing facility. The Agreement also established a special Trust Fund to alleviate the financial burdens of least developed countries, to be funded by the proceeds from the sale of IMF gold. In addition, the resources of the Fund were increased by 45 percent and the developing countries' share of total quotas was raised from 26 to 32 percent.

The industrialized countries' control of the extent and pace of change, particularly in the sphere of financial and monetary relations, has continued to the present. The annual economic summits of the seven main Western leaders and the meetings of the OECD provide ongoing opportunities to coordinate strategy. As will be seen, some positive steps have occurred, for example the establishment in 1977 of a Joint IMF-World Bank Development Committee as a cautious response to the South's demands for a more integrated approach to development

[13]The literature on the monetary reform negotiations is prolific. Useful sources are J. Williamson, *The Failure of World Monetary Reform, 1971-74* (London: Thomas Nelson and Sons Ltd., 1977); A. Kafka, *The International Monetary Fund: Reform Without Reconstruction?* Essays in International Finance No. 118, Princeton University (October 1976); E.M. Bernstein *et al.*, *Reflections on Jamaica*, Essays in International Finance, No. 115, Princeton University (April 1976); Tom de Vries, "Jamaica, or the Non-Reform of the International Monetary System", *Foreign Affairs* 54 (April 1976), pp. 577-605; W.R. Cline, *International Monetary Reform and the Developing Countries* (Washington: Brookings Institution, 1976).

[14]The SDR-aid link is discussed in Chapter 3.

finance. But any such changes have been incremental and *ad hoc*, sufficient to extinguish only the greatest sources of tension and relieve the more inequitable situations.

The obstacles to overcoming the North-South stalemate, however, are not simply related to the fact that economic dominance resides in the North. It is increasingly evident that growing heterogeneity within the South, in levels of development and economic wealth and power, also militates against Southern unity.[15] For example, despite the auspicious beginning during the CIEC, the newly rich states have proven to be remarkably conservative in wielding their new-found economic power. At UNCTAD IV in 1976, the major sovereign debtors, Brazil and Mexico, were quick to dissociate themselves from the more extreme proposals for generalized debt relief for fear of damaging their valuable credit standing in the Euromarkets. Then, at UNCTAD V in Manila in May 1979, and at the Sixth Non-Aligned Summit in Havana in September 1979, a serious rift between OPEC and the non-oil developing countries ominously surfaced on the issue of oil prices and external deficits.

Indeed, it would seem that the North has successfully pursued a policy of 'selective co-optation'. This has involved accommodating those more advanced developing countries which are capable of interfering with Northern foreign policy and domestic goals.[16] Thus, for example, Saudi Arabia was given a permanent seat on the Board of Executive Directors of the IMF and has noticeably not pressed for any significant changes in the IMF structure and operations.

Stalemate in the 'North-South Dialogue'

Since the late 1970s, the 'North-South dialogue' has lurched from forum to forum with little discernible progress and growing disillusionment on the part of participants.

Despite the evident lack of support for reforms, the South renewed the pressure for global negotiations in the late 1970s. In 1979, the matter was presented by the G-77 to the UN Committee of the Whole which had been created by the General Assembly in December 1977 as a follow-up forum to the CIEC. Subsequently, an eleventh Special Session of the General Assembly was convened for the purpose of launching a round of global negotiations on international economic cooperation and development. The Special Session was held in New York in August 1980, one month after the seven Western leaders had announced at the Venice economic summit their intention "to approach in a positive spirit the prospect of global negotiations in the framework

[15]See discussion in R.D. Hansen, *Beyond the North-South Stalemate* Chapter 7; Robert Mortimer, *The Third World Coalition*, Chapter 7; and generally, Robert Rothstein, *Global Bargaining: UNCTAD and the Quest for a New International Economic Order* (Princeton: Princeton University Press, 1979).

[16]C. Fred Bergsten *et al.*, *The Reform of International Institutions* (New York: The Trilateral Commission, 1976).

of the United Nations, and the formulation of a new International Development Strategy". At Venice, the Western leaders also indicated support for increasing the capital of the World Bank and for the Sixth Replenishment of the International Development Association.[17]

When the Special Session was held, however, the industrialized countries again resisted the concept of centralized and integrated negotiations and, particularly on monetary and financial affairs, consistently opposed any erosion of the autonomy of the multilateral financial institutions.[18] The hard line was confirmed at the Ottawa Summit of July 1981, when global negotiations were firmly placed on the back burner with reference being made only to negotiations in "appropriate forums". While restating a commitment to cooperate with the developing countries "in a spirit of mutual interest, respect and benefit, recognizing the reality of our inter-dependence", the seven leaders significantly omitted any reference to the "element of fundamental equity" which the South considers to be essential to any enduring North-South relationship.[19]

Subsequently, the North-South Summit on International Cooperation for Development which ultimately took place at Cancun in October 1981 undoubtedly did represent a novel step in the evolution of North-South economic relations. But it made little progress beyond the hortatory comments in the communique of the Ottawa Summit. The doctrinal rift between the Reagan Administration's focus on the marketplace and the South's call for a more interventionist international economic order was highlighted even more vividly.

Similarly, there were few concrete achievements at the sixth session of UNCTAD, held in June 1983 in Belgrade. Not only was there no agreement on matters of substance, but the United States disassociated itself from the very general consensus statement adopted at the close. The conference's outcome was all the more disappointing because of the pragmatic approach evident in the thoroughly-prepared positions of the South.

Thus, the two major groups of states — the North and the South — remain at loggerheads over most issues: the viability of the present international economic order, the need for reform of the international institutions, global negotiations, and questions of development strategy. On present evidence, there is no cause to believe that the stalemate will be broken.

[17] The Declaration of the Venice Summit, June 1980, and Declaration of the Ottawa Summit, July 1981, are found in the *Third World Quarterly* 3 (October 1981), pp. 698-708.

[18] See generally, Robert K. Olson, *U.S. Foreign Policy and the New International Economic Order: Negotiating Global Problems, 1974-1981* (London: Frances Pinter Ltd., 1981).

[19] Altaf Gauhar, "From Venice to Cancun", *Third World Quarterly* 3 (October 1981), pp. xxii-xxvi.

3 The International Monetary Fund

The International Monetary Fund and the World Bank are major elements of the international financial and monetary order. It is through these organizations, in particular the IMF, that important rules governing international financial relations are both formulated and enforced. And it is through these institutions that the present order is adapted to meet the changing needs of its member states. These institutions reflect in both their structure and operations the division between rich and poor, North and South, and the struggle which this has engendered over the shaping of the international political economy.

The industrialized countries have repeatedly insisted that the IMF and the World Bank are designed to serve totally different purposes and that their respective economic jurisdictions must be kept strictly separate. The differences between the two can be summarized as follows:

> The balance of payments is the business of the Fund, development is the business of the Bank. The Fund's financial activities are short to medium term, the Bank's are longer term. The Fund's policies are concerned with fitting demand to supply, the Bank's policies with changing the source and pattern of supply. The Fund concentrates on the macroeconomic policies of its members, the Bank on policies of narrower scope. The Fund deals with the "financial" economy, the Bank with the "real" or "physical" economy.[1]

At its inception, the Fund was not intended to be associated with the financial needs of less developed countries at all. Indeed, in 1944, most Third World countries were still colonies and it was due only to the efforts of the Indian delegation at Bretton Woods that the IMF Articles of Agreement even mentioned the contribution that the Fund could make to development by pursuing its goal of facilitating the expansion and balanced growth of international trade.

The main concern of the founding fathers of the leading figures at Bretton Woods, notably J. M. Keynes of Britain and Harry Dexter White of the United States, was to establish an effective international organization that would enforce a fixed exchange rate regime and that would have sufficient authority and resources to ensure that member states took appropriate measures to deal with deficits and surpluses on their balance of payments.[2] The purposes of the Fund are succinctly set out in Article I of the Articles of Agreement as follows:

[1] J. Gold, "The Relationship Between the International Monetary Fund and the World Bank", *Creighton Law Review* 15 (1981-82), p. 518.

[2] A good general description of the Anglo-American debate is found in R.N. Gardner, *Sterling-Dollar Diplomacy in Current Perspective* (rev. ed.), (New York: Columbia University Press, 1980).

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

In the discussion which follows, it will be shown that, notwithstanding any original conception to the contrary, the International Monetary Fund has nevertheless contributed in some degree to economic development and has become inextricably tied up in the web of North-South relations. First, the power structure and administration of the Fund will be analyzed. Then, its operations will be examined relative to two issues: the creation and distribution of international liquidity, and the provision of conditional balance of payments finance. A third operational issue, that of the role of the Fund in surveilling the regime of floating exchange rates, will not be discussed directly.[3] It is sufficient to note that developing countries are too weak to use the new system, and therefore must peg their currencies to that of their major trading partner or to the SDR. Moreover, the new system does nothing to rectify the asymmetrical burden of adjustment that rests on deficit countries, particularly oil-importing developing countries.

[3]For an analysis of the effects of floating exchange rates on developing countries, see generally a series of articles by J. Gold on "The Second Amendment to the Fund' Articles of Agreement: A Survey", *Finance and Development* 15 (March 1978), pp. 10-14; 15 (June 1978), pp. 15-19; 15 (September 1978), pp. 24-30; and see G. K. Helleiner, *International Economic Disorder* (Toronto: University of Toronto Press, 1981), pp. 130-165.

Northern Dominance: Quotas and Voting Struc...

At the heart of the power structure of the Fund is the system of quotas. The size of a member's quota dictates voting strength and the necessary contribution to the Fund's general resources. Quotas also determine the amount of credit that each member is entitled to obtain and the degree of conditionality associated with it. And since the First Amendment to the Fund Articles in 1969, the size of the quota regulates the distribution of the international reserve currency — the special drawing right (SDR).

Quotas are notionally assigned on the basis of a member country's relative economic weight (measured in terms of such factors as size of exports and imports).[4] But it is widely acknowledged that many quotas are totally unrealistic and require adjustment, particularly since distortions are directly reflected in the distribution of voting strength.

In calculating voting strength, 250 basic votes are distributed to each member and then an additional vote for each 100,000 SDR of the quota. The quotas have been increased and/or adjusted at each quinquennial review since 1959. After the Sixth General Review of Quotas in 1976, the less developed countries (including the oil exporters, the quotas of which were doubled) controlled 35.8 percent of the voting power.[5] This represented an increase of 10 percentage points since 1947. But most of this increase had in fact occurred prior to 1965 and was primarily attributable to an influx of less developed country members. Subsequently, following the Seventh General Review of Quotas in 1979-80, the relative position of less developed countries improved somewhat as a result of an overall quota increase of 50 percent for most members and special additional increases for 11 members.

In recognition of present economic and political realities, the Executive Board of the IMF, at the urging of countries such as Kuwait, Japan, Brazil and Korea, agreed to a major review of relative quota shares and the economic criteria against which quotas are calculated. In December 1982, it was announced that, pursuant to the Eighth General Review of Quotas, quotas would be increased in such a way as to raise the general resources of the IMF from SDR 61 billion to over SDR 90 billion. This was implemented in December 1983 after members representing more than 70 percent of total IMF quotas consented to the increase. As well, all member country quotas did not increase equally. Forty percent of the overall increase was distributed to members in proportion to their previous individual quotas, and the remaining 60 percent was distributed selectively in accordance with the relative position of each member in the world economy. As a result of this change, the relative quota

[4]In 1944, the distribution of quotas was worked out according to a loose formula based on certain trade weighted factors. In reality, this was merely an *ex post facto* rationalization of a prior agreement between the United States and Britain that ensured their control of the Fund. This control has persisted to the present day despite major shifts in the distribution of economic power.

[5]R.M. Jeker, "Voting Rights of Less Developed Countries in the IMF", *Journal of World Trade Law* 12 (1978), pp. 218-228.

share of developing countries (including oil exporters) and their vote share fell to 32.7 and 39.5 percent respectively.

The voting structure, summarized in Table 3.1 remains heavily skewed in favour of the industrialized countries, particularly the United States and Britain which together can veto any proposal requiring a special 85 percent majority. Even with the doubling of the Saudi Arabian quota effective April 1981 which entitled Saudi Arabia to appoint a permanent director to the Executive Board, and the recent further quota increase, Saudi voting power is limited, and the Saudi quota is the sixth largest after those of the United States, Britain, Germany, France and Japan.

Table 3.1
IMF Quotas and Voting Structure as of December 1983[a]

	Quota (SDR/millions)	% share of quota	% share of vote
Western Industrial Countries (All OECD, excluding Greece, Portugal, Turkey)	56,089 (37,410)	62.3 (61.3)	60.4 (58.6)
Major Oil Exporters (12 countries)	10,393 (6,662)	11.5 (10.9)	11.4 (10.8)
All Other Countries	23,553 (16,988)	21.2 (27.8)	28.1 (30.6)

[a] Figures in parenthesis show the position prior to the coming into effect of the Eighth General Review of Quotas.

Source: Compiled from: "Present and New Quotas in the Fund", *IMF Survey*, Vol. 12, No. 23, December 5, 1983, and information from the Department of Finance, Ottawa.

In order realistically to assess the degree of dominance of the industrialized countries in the IMF, it is necessary briefly to review its administrative structure and the means by which the evident preponderance of voting strength is translated into IMF operations and activities.

Two bodies are formally responsible for decisions: the Board of Governors and the Executive Board. The Board of Governors is a deliberative assembly which meets once a year in a joint annual meeting with its counterpart in the World Bank. Each state is represented by one governor but voting is on a weighted basis as noted above. The governors deal only with basic questions such as the admission and expulsion of members, revision of quotas and the election of executive directors.

The Executive Board is of much greater importance. It deals with all matters not specifically dealt with by the governors and sits in permanent session in Washington, D.C. It consists of six appointed directors from those countries with the largest quotas, and 16 elected directors who represent groups of member countries. The Executive Board's

current membership is shown in Table 3.2. Elections to Executive Board, which have never been contested, are conducted informally before each annual meeting. The board then selects a managing director who by convention (and because the president of the World Bank is always a U.S. citizen) is always a European.

Voting in the Executive Board also takes place on a weighted basis. However, it is interesting to note that, although a majority of votes is normally required for any decision, since the second amendment to the Fund's Articles in 1978 there are 53 different categories of decision which require a special majority of either 70 or 85 percent. Examples of decisions requiring an 85 percent majority are the allocation and cancellation of SDRs, changes in quotas and an increase or a decrease in the number of directors to be elected.[6] Most decisions by the board are in fact rarely put to a formal vote and instead are made through consensus in a deliberate attempt to avoid confrontation. The focus on conciliation indicates a realization on the part of even the dominant members of the Fund that economic and political changes in the world have made it necessary to take the interests of more members and groups of members into account.

Theoretically, the developing countries now have some considerable weight in the Fund since they elect 10 of the 16 executive directors and, with approximately 43 percent of the vote, they can command a veto in any matter requiring a special majority. In addition, developing countries elect half of the 22 member Interim Committee — a body created in 1974 following the suspension of the Committee of 20 on monetary reform.

The function of the Interim Committee is to advise the Board of Governors on matters relating to the "management and adaptation of the adjustment process and developments in global liquidity, (and) developments in the transfer of real resources to developing countries". The IMF Articles of Agreement as amended in 1978 provide for the eventual establishment of a permanent Council at the ministerial level which would have actual decision-making powers, but any progress towards such a change has so far been blocked. The Interim Committee has undoubtedly served as a valuable mouthpiece for developing countries, particularly since they have been able to control the selection of the chair. For example, in May 1981, developing countries were able to appoint their choice of chairman, Allan MacEachen of Canada, and reject the developed countries' choice, Geoffrey Howe of Britain.

There are many who argue that, in light of all the changes in the Fund involving administration and voting procedures, the Fund is now facing a crisis of identity. More specifically, since the abolition of a fixed exchange rate system and with it the need to provide facilities to enable industrial countries to maintain fixed currency parities, the Fund is

[6] J. Gold, *Voting Majorities in the Fund: Effects of the Second Amendment of the Articles*, IMF Pamphlet Series No. 20, 1977.

Table 3.2
IMF Executive Directors and Voting Power as of February 1, 1984

Director From	Representing	Total Votes	% of Fund Total
United States[a]	United States	179,433	19.47
Britain[a]	Britain	62,190	6.75
West Germany[a]	West Germany	54,287	5.89
France[a]	France	45,078	4.89
Japan[a]	Japan	42,483	4.61
Saudi Arabia[a]	Saudi Arabia	32,274	3.50
Venezuela	Venezuela, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Spain	44,229	4.80
Canada	Canada, Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Ireland, Jamaica, St. Lucia, St. Vincent	38,069	4.13
Netherlands	Netherlands, Cyprus, Israel, Romania, Yugoslavia	40,425	4.39
Italy	Italy, Greece, Malta, Portugal	38,307	4.16
Australia	Australia, South Korea, New Zealand, Papua New Guinea, Philippines, Seychelles, Solomon Islands, Vanuatu, Western Samoa	32,979	3.58
Libya	Libya, Bahrein, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Pakistan, Qatar, Somalia, Syria, United Arab Emirates, North Yemen, South Yemen	29,324	3.18
Belgium	Belgium, Austria, Hungary, Luxembourg, Turkey	40,178	4.36
India	India, Bangladesh, Bhutan, Sri Lanka	28,208	3.06
Norway	Norway, Denmark, Finland, Iceland, Sweden	32,338	3.51
Guinea	Guinea, Botswana, Burundi, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Nigeria, Sierra Leone, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe	26,297	2.85
Indonesia	Indonesia, Burma, Fiji, Laos, Malaysia, Nepal, Singapore, Thailand, Vietnam	26,759	2.90
Brazil	Brazil, Colombia, Dominican Republic, Ecuador, Guyana, Haiti, Panama, Surinam, Trinidad and Tobago	27,582	2.99
Iran	Iran, Afghanistan, Algeria, Ghana, Morocco, Tunisia	21,691	2.35
China	China	22,524	2.44
Chile	Chile, Argentina, Bolivia, Paraguay, Peru, Uruguay	24,159	2.62
Niger	Niger, Benin, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Congo, Djibouti, Equatorial Guinea, Gabon, Guinea-Bissau, Ivory Coast, Madagascar, Mali, Mauritania, Mauritius, Rwanda, Sao Tome and Principe, Senegal, Togo, Upper Volta, Zaire	18,068	1.96
Total		906,822[b]	

[a] Appointed directors, all others are elected.
[b] Excludes the votes of Egypt, Democratic Kampuchea, and South Africa which did not participate in the 1983 Regular Election. Their combined votes equal 1.60% of total votes.

Source: IMF, *Directory, Members, Quotas, Governors, Voting Power, Executive Board, Officers*, Washington D.C., February 1, 1984.

becoming p[illegible]minantly an instrument to help developing countries cover their chronic payments deficits.

Developing countries, however, deny that their influence has had any meaningful impact on the orientation of the Fund or its operations, since they are unable to compel decisions by the Executive Board. Moreover, the Interim Committee, which they can control, has no real power in making IMF policy; its role is to recommend.

Perhaps more importantly, the developing countries cannot prevent abuses of power by the industrialized countries, which frequently use their control of the IMF to serve foreign policy goals. It is well known that the French and British executive directors will lobby extensively to secure favourable treatment for some of their former colonies.[7] Similarly, the U.S. has not hesitated to promote controversial loans to countries of geopolitical significance such as El Salvador and Jamaica in 1981 and South Africa in 1982.

The degree of industrialized country dominance is perhaps best illustrated by examining the Fund's role in, first, the creation and distribution of international liquidity and, next, the provision of conditional balance of payments finance.

The Argument over SDRs

The Fund's role in the creation and distribution of international liquidity has remained a contentious North-South issue since the birth of the special drawing right (SDR) in 1969. The SDR was intended to supplement and eventually replace the U.S. dollar as an international reserve currency and to deal with the imminent shortage of international liquidity which was expected to arise when the U.S. payments deficit was finally eliminated. Initially, the Group of 10 industrial countries decided that the SDR would be distributed only among themselves, given their overwhelming predominance in world trade, and, indeed, as measured by all aggregate economic indicators. It was only after vigorous negotiating between a Group of 10 representative and an IMF negotiating team that the scheme ultimately was universalized to include all IMF members.

Even before the decision to create the SDR, the developing countries within UNCTAD began to moot the idea of a non-neutral distribution of SDRs, instead of, as at present, distribution on the basis of quotas. This so-called 'SDR-aid link' involves a distribution of SDRs on the basis of a need for liquidity. This need is calculated as a function of the variability of a country's balance of payments, the ability to obtain finance from other sources, the structure and terms of external debt, the costs of adjustment and so forth.[8] It is evident that, on these

[7]M. Guitan, "Fund Conditionality and the International Adjustment Process", *Finance and Development* 17 (December 1980), pp. 23-28; 18 (March 1981), pp. 8-12; 18 (June 1981), pp. 20-24.

[8]See generally, G. Bird, *The International Monetary System and the Less Developed Countries* (London: The Macmillan Press, 1978), Chapter 11; and Y.S. Park, *The Link Between Special Drawing Rights and Development Finance*, Essays in International Finance No. 100, Princeton University, September 1973.

criteria, developing countries would be entitled to the [illegible]gest proportion of any SDR issue in the light of their chronic impo[illegible] [illegible]urpluses and debt servicing requirements.

According to proponents of the SDR-aid link, the present distribution on the basis of quotas is regressive. Quotas, which are merely artificial constructs, reflect the relative political bargaining power of IMF members and were primarily designed to determine the extent of drawings from the General Resources Account. Hence, an SDR distribution on this basis is biased in favour of those who already have a large access to Fund credit by virtue of their large quotas.

The desire of developing countries to implement some form of SDR-aid link has remained a prominent element in the North-South dialogue on financial affairs. As John Williamson has observed, the SDR is one of the few instruments available for pursuing greater global equity and a redistribution of world resources.[9] It has the advantage of providing a more automatic source of concessional finance, something which is of pressing importance in light of the stagnation in the voluntary transfers of official development assistance and other traditional sources of external finance.

A variety of link proposals were seriously considered by the IMF Committee of 20 on monetary reform and in other forums, notably UNCTAD IV and V, in the 1970s. In addition, the link was endorsed in the Brandt Report as an important means of increasing the quantity and quality of development finance. Among the proposals was one which foresaw the issuance of SDRs to a relevant coordinating agency such as the International Development Association; yet another proposal would associate an SDR-aid link with the consolidation of the so-called dollar overhang (dollars accumulated in the reserves of foreign treasuries) into a Substitution Account in the IMF. All of the proposals envisaged that the SDR would become the central reserve currency in a reformed international monetary system.

Opponents of an SDR-aid link[10] generally argue that a link is incompatible with the notion of the SDR as the primary reserve asset. More specifically, insofar as such a link would result in the creation of more liquidity according to developmental needs rather than actual international financial requirements, confidence in the SDR would be undermined. This argument reflects the view that the function of the IMF is not related to development finance. In addition, opponents of the link believe that a non-neutral distribution of SDRs would have inflationary consequences due to the increased demand for imports on the part of developing country recipients.

The proponents of the link reply that all their proposals are predicated on a prior decision that an issue of SDRs is required to meet world

[9]J. Williamson, "SDRs — The Link", in J. Bhagwati (ed.), *The New International Economic Order: The North-South Debate* (Cambridge, Mass.: The MIT Press, 1977), pp. 91-93.

[10]For example, H.G. Johnson, "The Link That Chains", *Foreign Policy* 16 (Fall 1972), pp. 113-120.

liquidity nee and that a determination of world liquidity needs would be based on strictly financial calculations such as trends in the ratio of world reserves to imports. Finally, the proponents assert that any putative inflationary impact would be insignificant.

However, even if developed countries were to concede in principle the need for an SDR-aid link, its possible future seems rather bleak. First, it is highly unlikely that further SDRs will be created for some time, in light of both the perceived conditions of excess liquidity and the recent issue of SDR 12 billion over the 1978-81 period. Second, and more importantly, the form and quality of the SDR has been significantly altered so that it is now less suitable as a distributive mechanism. In the fall of 1980 the basket of currencies comprising the SDR was reduced from 16 to five, and the interest rate payable was raised to 100 percent of the weighted average of market interest rates on the five currencies.[11] This effectively eliminated any benefit to the developing countries who were net users of SDRs and paying less than the market rate of interest on such use.

The decision to streamline the SDR reflects a long-term aim of the IMF toward an SDR-based monetary system, and toward enhancing the IMF's role in managing liquidity. In this light, the South faces almost insuperable difficulties in advocating the special drawing right as a non-neutral redistributive mechanism. The only possible leverage would be the economic power of the newly-rich oil exporting states. But Saudi Arabia, in particular, shows little inclination to support this Southern initiative. Ironically, it was the Saudis who were partly responsible, albeit indirectly, for the timing of the decision to alter the SDR, since the IMF was then negotiating for a massive loan from the Saudis to be denominated in SDRs. This required that it be rendered at least as desirable as its constituent currencies. The unwillingness of OPEC states to entertain radical restructuring of the international monetary system is illustrated further by the refusal of the Saudi executive director to support recent proposals by developing countries for an infusion of SDR 15 billion (approximately $15.7 billion) into the system.[12]

Thus, short of any effective leverage on the part of developing countries, the question of the creation and distribution of international liquidity will remain a simmering issue between North and South. The SDR meanwhile constitutes a mere 5 percent of total international liquidity and the U.S. dollar continues its role as the key currency in the financial and monetary order.

[11] The five currencies are the dollar, the deutschmark, the yen, the pound, and the Swiss franc. The interest rate on the SDR is determined quarterly by reference to a combined market interest rate, which is the weighted average interest rate on specified short-term obligations in the money markets of the five countries whose currencies are included in the SDR valuation basket. For the period July-September 1982 the rate of interest of the SDR was 12.01 percent per annum.

[12] At the meeting of UNCTAD VI in Belgrade in June 1983, an injection of some $30 billion worth of SDRs was proposed. *The Economist* (June 11, 1983).

Balance of Payments Assistance

A second main area of contention relative to Northern dominance in the Fund involves the question of conditional balance of payments assistance. Such assistance is often crucial to the successful financing of balance of payments deficits, a chronic problem for many less developed countries. As has been noted, a primary purpose of the Fund is to provide short-term financing to deal with payments deficits, arising normally from an excess of imports over exports but, more recently, also from the escalating cost of servicing foreign debt.

As in the case of the distribution of international liquidity, the quota of each member determines the quantity and quality of such short-term finance. All drawings from both the General Resources Account and special facilities of the Fund are related to some percentage of the quota, and the extent of any drawing determines the 'conditionality' associated with the loan. In order to understand fully the complaints of developing countries, it is necessary first to elaborate the unique and complex mechanisms by which an IMF member can acquire resources from the Fund.[13]

Access to Fund Resources

As described earlier, each member must pay into the Fund the equivalent of its assigned quota mainly in its own currency, but also partly in reserve assets such as the the U.S. dollar or SDR. These subscriptions comprise the ordinary resources of the Fund and, at present, amount to some SDR 90 billion. The Fund has from time to time supplemented its ordinary resources (quota subscriptions, SDRs and some gold) by using resources borrowed from member governments, such as Saudi Arabia, to fund temporary special facilities described below.[14] With the prospect of massive new drawings by Mexico, Brazil and other Latin American debtors, there is speculation that the IMF may have to borrow in the private markets to supplement its resources still further, as well as make use of a recently expanded line of credit under the General Arrangements to Borrow (GAB).

Should a country suffer a balance of payments deficit, this normally implies a shortage of foreign exchange reserves to pay for an excess of imports over exports or to service foreign debt. To acquire the needed foreign exchange, the country will approach the Fund and, in effect, 'purchase' those currencies it requires with its own currency. This transaction will result in a change in the composition of the Fund's resources, but not the overall quantity. Within a specified period of time, the member must reverse the transaction by 'repurchasing' its own currency originally paid in, in exchange for the currencies which it originally 'borrowed'. A service charge is payable on purchases and

[13] See generally, *IMF Survey, Supplement on the Fund*, Vol. II, (September 1982) and IMF, *International Financial Statistics Yearbook*, Vol. XXXV, 1982.

[14] See, for example, S. Griffith-Jones, "The Impact of the Massive 1981 Saudi Arabian Loan to the IMF", Discussion Paper No. 170, Institute of Development Studies at the University of Sussex, December 1981.

interest is levied on any balances of the member's currency which the Fund holds, as a result of the transaction, in excess of the assigned quota.

Drawings from borrowed resources are, of course, more expensive. They are also subject to the regular service charge, but the interest charged on the use of such resources is equal to the rate of interest paid for obtaining the funds plus a margin of 0.2 percent. Some provision has been made to reduce this additional cost to the lower-income countries with per capita incomes of less than $680 (in 1978 dollars). These countries (some 23 in number) have qualified for the *supplementary financing interest subsidy* made available through the voluntary contributions of more affluent IMF members.[15]

Deficit countries may also apply to the Fund to convert their SDR balances into usable currencies. The Fund then will assign the credit balances of SDRs to those countries which it judges are most able to provide the necessary usable currencies.

Facilities of the Fund

By way of overview, members use Fund resources for general balance of payments purposes through so-called 'tranche' drawings, and for specific purposes through certain permanent special facilities — the *compensatory financing facility (CFF)* and the *buffer stock financing facility (BSFF)*. In addition, there are various temporary facilities — the two *oil facilities* established between 1974 and 1976, the *supplementary financing facility* that operated between 1979 and 1981 and the *policy on enlarged access* to the Fund's resources, which entered into force in 1981 to replace the supplementary financing facility. The terms and conditions of a member's access to the higher level of Fund resources are contained in short-term *stand-by arrangements* between the Fund and the member, or longer-term *extended arrangements*.

A *reserve tranche* drawing is any drawing which has the effect of increasing the Fund's holdings of the member's currency to no more than its assigned quota. (The presumption of course is that by virtue of another transaction, perhaps even with another member, the balance of the borrowing member's currency in the General Resources Account had earlier dropped below its quota level). Reserve tranche drawings can be made automatically and without any conditions or indeed any cost since, in this one instance, the service charge and periodic charges are waived.[16]

[15] *IMF Survey* (August 16, 1982), p. 352.

[16] Under the original arrangements governing quota subscriptions, 25 percent of the quota was paid in gold and only 75 percent in the member's currency. In the absence of any transaction involving the member's currency, the Fund effectively held an amount of each member's currency equal to 75 percent of its quota. Thus, borrowing by the member, which brought the Fund's holding of the currency up to 100 percent was really equivalent to making available resources equal to the member's gold contribution. Now, the first 25 percent of the quota subscription can consist of reserve currencies, but the same explanation applies *mutatis mutandi*

Additional 'tranche' drawings assume a situation wh[illegible] he Fund is holding a quantity of the member's currency equal to its assigned quota. Further purchases can be made in four so-called 'credit tranches', each equal to 25 percent of the quota, to which varying degrees of conditionality attach. For example, a drawing under the first credit tranche will raise the Fund's holdings of the member's currency to 125 percent of its assigned quota. In these circumstances, low conditionality attaches. The member must present a program which reflects reasonable efforts to overcome balance of payments difficulties. No performance criteria or instalment purchases are specified.

By contrast, as the member draws from the three upper credit tranches, and the Fund's holdings of the member's currency rises to 200 percent of the assigned quota, closer scrutiny of the borrowing member's use of the resources is imposed. In general the IMF will require that the member give substantial justification of its efforts to overcome balance of payments difficulties. This is contained in a Letter of Intent to the IMF from the member government which is the first step towards the conclusion of a formal stand-by arrangement. The stand-by arrangement will establish a certain performance criteria, generally macroeconomic targets, and drawings will be made in instalments subject to the achievement of such targets. The transaction is of a short-term nature, usually one year, and repurchases (to reverse the transaction) are made within three to five years.

The IMF has, however, responded to complaints from developing countries regarding the severity of such short time limits relative to the long-term structural nature of their deficits. In September 1974, shortly after the first oil price shock, an *extended fund facility (EFF)* was established which permits resources to be provided for longer time periods and in larger quantities than under the regular credit tranche drawings. The borrowing country has to demonstrate the existence of a serious payments imbalance relating to structural maladjustments in production, trade and prices or that it is unable to pursue active development policies because of a weak balance of payments position. Resources can be borrowed up to a maximum of 140 percent of the member's quota under the extended arrangement mentioned earlier for a period of three years. But the Fund's cumulative holdings of the member's currency resulting from the use of the EFF and regular tranche drawings cannot exceed 265 percent of its quota. Repurchases are to be made in twelve equal instalments within four and one-half to ten years.

Longer-term support is also available through the enlarged access policy implemented in early 1981 to replace the supplementary financing facility, the resources of which were fully committed (although not yet fully disbursed) in 1979-81. Resources are made available to support either stand-by arrangements negotiated in the context of drawings from the upper credit tranches, or extended arrangements under the EFF. The maximum amount available is flexible. Under recently revised guidelines, a member may draw up to 102 percent of its quota

under a on ar arrangement (or 125 percent in exceptional circumstances) and up to 306 percent (or 375 percent) under a three-year arrangement.

It must be remembered, of course, that any drawings from borrowed resources are subject to a higher periodic charge in order to reimburse the net cost of borrowing to the Fund. To dilute this cost somewhat, present guidelines also specify the apportionment of any amounts available under a stand-by or extended arrangement between ordinary and borrowed resources. Repurchases to reverse transactions involving borrowed resources must be made over a period of three and one-half to seven years.

Drawings under the two permanent special facilities are also expressed in terms of quotas but are subject to relatively mild degrees of conditionality. Compensatory financing from the CFF is available to members who demonstrate simply a temporary export shortfall for reasons beyond their control. Until recently the CFF was little used, since the formula for calculating the qualifying shortfall is very restrictive. However, with commodity prices plummeting during the latest world recession, many more countries have become eligible for CFF funds. Since May 1981, special additional drawings are also available if a member suffers a temporary excess in the cost of cereal imports. A member is able to draw the equivalent of 83 percent of quota for either export shortfalls or cereal import excesses, subject to a combined maximum of 105 percent of quota for both types of drawings. Since January 1984, drawings equal to less than 50 percent of a member's quota carry few conditions, while larger drawings are somewhat more conditional.

A similarly low degree of conditionality attaches to drawings under the buffer stock financing facility provided the member demonstrates that the payments imbalance is related to its participation in the financing of an international buffer stock of primary products. Outstanding purchases can reach a maximum of 45 percent of the member's quota. The use of resources under the CFF and BSFF is on a short-term basis only and repurchases must be made within three to five years. It is important to note, though, that such drawings are additional to the maximum amount that a member can draw under a stand-by or extended arrangement.

Clearly there are severe limits to the amount of money a member can borrow from the Fund due to the size of its quota and to the overall constraints on the Fund's resources, both ordinary and borrowed. A small oil-importing developing country with a commensurately small quota, facing a huge oil-induced current account deficit, can rapidly reach these limits and become subject to the full rigors of IMF surveillance. What then is the nature of this 'conditionality' which is an integral part of any stand-by or extended arrangement?

The Conditionality Issue

The concept of conditionality is the key to understanding the South's complaints regarding the Fund's operations.[17] It consists of those policy measures which the Fund staff require to be included in a domestic stabilization program (designed to promote balance of payments adjustment) before the staff will recommend that the drawing be approved by the executive directors. Performance criteria are usually established, and subsequent instalments of any drawing are contingent on the successful achievement of specified targets.

The Fund's conditions appear to reflect a particular monetarist approach to balance of payments adjustment; that is, the belief that monetary aggregates, notably the money supply, are the primary determinant of changes in total spending and, hence, can be manipulated to produce a direct impact on the balance of payments and reduce the current account deficit.[18] However, monetary policy instruments, such as controlling the money supply, are not well developed in less developed countries. In addition, the private sector is generally less important than the public sector in terms of the demand for credit. Thus, in devising a stabilization program, the Fund has had to focus as well on adjusting fiscal policy instruments in combination with stricter control of bank credit by means of higher interest rates.

The member country is usually required to implement a domestic deflationary program involving major reductions of the government deficit through reduced public spending, increased taxes and moderated wage increases or wage controls. In addition, the government is required to eliminate or reduce price controls, subsidies and other forms of market distortions. Finally, the exchange rate is generally depreciated (particularly where demand restraint alone is not sufficient to correct the balance of payments problem) and foreign exchange and import controls are phased out. The intended result is an improvement in the competitiveness of export and import-competing industries which will reduce current account deficit levels.

Unfortunately, IMF programs have not often achieved their objectives and certainly not without a great deal of political and social unrest as a result of the severe deflation and depressed living standards.[19] The so-called IMF riots in Peru in July 1977 and Jamaica's acrimonious election campaign in 1980, which Prime Minister Manley fought on an

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[17] G. Bird, *The IMF and the Developing Countries: Evolving Relations, Use of Resources and the Debate Over Conditionality* (London: Overseas Development Institute, 1981); see also a series of articles by M. Guitan, "Fund Conditionality and the International Adjustment Process", *Finance and Development* 17 (December 1980), pp. 23-28; 18 (March 1981), pp. 8-12; 18 (June 1981), pp. 20-24.

[18] See the discussion in P. Daniel, "The New Recycling: Economic Theory, IMF Conditionality and Balance of Payments Adjustment in the 1980s", *Monetarism and the Third World, IDS Bulletin* 13, No. 1 (1981), pp. 27-37.

[19] T. Killick, "The Impact of IMF Stabilization Programs in Developing Countries", Working Paper No. 7, Overseas Development Institute, March, 1982; and see generally, W.R. Cline and S. Weintraub (eds.), *Economic Stabilization in Developing Countries* (Washington, D.C.: Brookings Institution, 1981).

anti-IMF pl... rm following his fiery rejection of IMF loan conditions, are well documented.

The major criticism is not simply that the IMF ignores social and distributional issues and unjustifiably disrupts long-term development plans and domestic priorities, but also that the Fund is wrong about the cause of the balance of payments deficits crippling many developing countries.[20] It is argued that the Fund erroneously regards the deficits as the result of domestic economic mismanagement and endogenous factors relating to the over-expansion of demand and spiralling inflation, whereas in most cases the deficits are primarily attributable to exogenous factors beyond the control of developing countries. These factors include higher oil prices, increases in the costs of other essential imports due to inflation in the industrialized countries, lower export earnings as a result of Northern protectionism, the worldwide recession and the concomitant slowdown in Northern imports. In other words, the deficits are structural and correspond to structural surpluses elsewhere. And just as those surpluses require long-term adjustment measures, so do the deficits.

In response to these and other criticisms, the Fund's 1979 Review of Guidelines for Conditionality acknowledged the need to lengthen the period of time over which stand-by drawings may be made and included the following statement: "The Fund will pay due regard to the domestic social and political objectives, the economic priorities and circumstances of members, including the causes of their balance of payments problems."[21] In addition, as noted earlier, the Fund substantially increased its resources and, hence, its lending operations particularly with respect to medium-term credit.

More recently, it appears that the Fund is beginning to place greater emphasis in its adjustment programs on supply-side measures aimed at expanding the productive potential of members and dealing with persistent structural problems.[22] This involves greater concern with agriculture, infrastructure, energy and relatively quick-yielding investments in the manufacturing sector. However, demand management, demand-switching policies and the setting of fiscal and credit targets still remain the principal concern of the Fund.[23]

It remains to be seen how far the IMF is willing to go in relaxing the stringent demand-oriented thrust of its stabilization programs. Certainly, if the loan of $3.9 billion to Mexico in December 1982 is any

[20] S. Dell and R. Lawrence, *The Balance of Payments Adjustment Process in Developing Countries* (Oxford: Pergamon Press, 1980).

[21] J. Gold, *Conditionality*, IMF Pamphlet Series No. 31 (December 1980).

[22] A. Crockett, "Issues in the Use of Fund Resources", *Finance and Development* Vol. 19, No. 2 (June 1982), pp. 10-15.

[23] The issue of hardening conditionality figured prominently in the Group of 24 communique after the 1982 IMF-World Bank annual meeting. It deplored the increasing resort to preconditions, the shift from three-year to one-year stabilization programs, the heavy emphasis on demand management, and the narrow monitoring of performance criteria. *IMF Survey*, Vol. 11, No. 18 (September 20, 1982).

indication, very little has changed. Known conditions ... e agreement include: the reduction in the public sector deficit from ...5 percent of GDP in 1982 to 8.5 percent in 1983, 5.5 percent in 1984 and 3.5 percent in 1985; the elimination or reduction of subsidies on food, petroleum and electricity prices; the trimming back of public institutions (106 out of 740 state-owned companies and agencies are to be closed down); and a major devaluation of the currency (the peso had fallen to one-sixth of its U.S. dollar exchange rate at the beginning of 1982, from 26 to the dollar to 168 currently).[24] Mexico's stabilization program has already produced severe adverse effects on imports, growth, investment, real wages and employment levels. Similar conditions were attached to an extended arrangement with Brazil for some $4.9 billion, and to a stand-by arrangement with Argentina for $2.1 billion.

Cash Crisis in the IMF?

The issue of conditionality will remain high on the North-South agenda and will intensify in importance as more and more countries are forced to borrow from the Fund. Indeed, in contrast to the period after the first oil price shock in 1973, when the Fund was mainly used by low-income developing countries, the IMF is now a major source of finance, at least in a catalytic sense, for the more advanced developing countries facing huge payments deficits and dire shortages of foreign exchange to service increasingly unsustainable debt burdens.

Between 1973 and 1983, net Fund credit financed a mere $39.1 billion of the $609.7 billion aggregate current account deficits of oil-importing developing countries, as shown in Table 3.3. More than 65 percent of such credit was effectively unconditional, being restricted to lower credit tranche drawings and the oil facilities. The explanation for this lies in the success of many middle-income developing countries in tapping the Eurocurrency markets and obtaining vast amounts of 'unconditional' finance through the recycling activities of the multinational commercial banks. This will be discussed at greater length in Chapter 5. It is sufficient to note here that since the second oil price shock of 1979-80, the escalation of interest rates and the severe world recession which has reduced export earnings, these debtor countries are no longer able to generate the necessary income to service their debt. By 1982 the interest payments of all developing countries were more than three times their 1978 level, since practically all the private bank portion of debt (95 percent) has been contracted at variable interest rates.[25]

At the same time as these Third World debtors desperately need more external finance, their erstwhile creditors, the multinational banks, have significantly reduced lending activities and now insist that any

[24] "The Ripples from Mexico Are Crossing the Rio Grande", *The Economist* (November 20, 1982), and "Foreign Exchange", *The Globe and Mail* (Toronto), February 25, 1984, p. B12.

[25] OECD, *Development Co-operation 1982: Review*; Paulo Neuhaus, "Floating Interest Rates and Developing Country Debt", *Finance and Development* 19 (December 1982).

Table 3.3
IMF Contribution to Net Resource Receipts
($ billions)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Total
Current Account Deficit of Non-Oil Developing Countries	11.3	37.0	46.3	32.6	28.9	41.3	61.0	89.0	107.7	86.8	67.8	609.7
Use of IMF Credit and Short-term Borrowing by Monetary Authorities	0.2	1.6	2.4	4.6	0.4	0.3	0.4	1.8	5.9	10.7	10.8	39.1

Source: IMF, *World Economic Outlook*, Occasional Paper No. 21, Washington, May 1983, Table 25, p. 194.

rescheduling or provision of new credit must occur in co. , .nction with the negotiation of an IMF stand-by arrangement. Accordingly, resort to the Fund by these middle-income countries has increased, mainly in the form of highly conditional tranche drawings and extended arrangements, thereby straining the limits of IMF resources.

During 1979-81, the IMF approved 88 arrangements involving $24.4 billion, of which 73 ($23.7 billion) were from the upper credit tranches under stand-by or extended agreements. This compares to 54 such arrangements in 1976-78 involving only $8.1 billion, of which 29 ($7.5 billion) were highly conditional drawings. Net purchases by members increased from SDR 1.9 billion in 1980-81 to SDR 5 billion in 1981-82, and for the first time the Fund's commitment involved a higher proportion of borrowed resources (SDR 6 billion) than ordinary resources (SDR 4.5 billion).[26]

In helping to bail out the clients of the multinational banks, the IMF is rapidly approaching a crisis in its own finances. Loans to Mexico, Brazil and Argentina alone amount to some $12 billion. By early 1983, the IMF estimated that it had committed all of its borrowed resources and all but SDR 10 billion of its own resources. In the circumstances, the executive directors accelerated the negotiations over the eighth review of quotas and reached agreement in late 1982 on a 47.5 percent increase in quotas from a level of SDR 61 billion to over SDR 90 billion. Of course, this increase is somewhat misleading since it is not wholly comprised of usable currencies and took effect only in December 1983. In the meantime, the Group of 10 industrialized countries, led by the United States, have made available to the IMF SDR 17 billion ($17.8 billion) from the General Arrangements to Borrow. Additional financial support has been provided by Saudi Arabia and the Bank for International Settlements. Finally, the managing director has given clear signals regarding closer cooperation with the private commercial banks. The Mexican agreement was made explicitly conditional upon additional bank financing of some $5 billion for the Mexican government, thereby rendering private credit and IMF loans highly interdependent. Moreover, IMF contingency borrowing from the private markets may be considered, although the measure has met with resistance from Washington and Bonn.

Conclusion

It cannot be doubted that the role of the IMF, its structure and operations have been radically altered since its inception in 1944. The Fund is inextricably involved in issues of economic development and the distribution of financial resources from North to South. This fact is highlighted perhaps most clearly by the increasing activities and influence of the Joint IMF-World Bank Development Committee. Established in 1977, its mandate is to coordinate efforts to further the

[26] *IMF Survey*, Vol 11, No. 17 (August 30, 1982), p. 269.

transfer of resources to developing countries. Additional initiatives such as lengthening the terms of and expanding access to IMF balance of payments finance, and relaxing conditionality, further reveal a growing sensitivity to the interests of developing countries. Finally, the IMF appears to be entering a new phase in its relations with the private sector. Increased coordination with multinational banks which provide balance of payments finance, and an enhanced supervisory role for the Fund, seem to be likely trends for the future.

Despite such changes, however, control of the Fund still rests firmly with the industrialized countries, and the issue of the conditionality of IMF finance exists as a reminder of this. Until developing countries are given sufficient weight in Fund decision-making to eliminate the perception of the Fund as a tool of Northern governments, it would seem that the IMF will remain a focal point for North-South tensions.

4 The World Bank Group

The World Bank, or International Bank for Reconstruction and Development (IBRD), like the IMF (and more recently the multinational commercial banks), has been a major actor in the political economy of North-South relations. At Bretton Woods in 1944 a strict division of labour between the two institutions was stipulated. On the one hand, the IMF would provide short-term balance of payments finance to assist countries in maintaining the par value of their currencies without having to resort to undesirable deflationary measures. On the other hand, the IBRD would provide long-term loans to assist countries in reconstructing their economies after the devastation of World War II and to promote long-term structural change. Perhaps the only formal provision connecting the two institutions is the requirement in the IBRD Articles of Agreement for concurrent membership.[1]

But, as in the case of the IMF, the World Bank had insufficient resources and was eclipsed by the American Marshall Aid program. It too then turned its attention to the developing countries and adapted accordingly.[2] As it became clear in the 1950s that the new clientele of the World Bank could not afford regular IBRD loans, the terms of which reflected the cost of borrowing on the U.S. and international capital markets, two affiliates were created to better serve their development needs. These were the International Finance Corporation (IFC), established in 1956, and the International Development Association (IDA), established in 1960 which, together with the original IBRD, form what is known as the World Bank Group.

Northern Dominance: Power Structure and Administration

The power structure of the IBRD resembles that of the IMF quite closely. Like the IMF, it is formally a specialized agency of the United Nations but, in practice, has asserted and maintained its autonomy. The Bank's member countries subscribe to the capital base in varying proportions. Voting takes place on a weighted basis according to subscription. Every member is allocated 500 basic votes and then one vote for each $100,000 share in the capital. Both the IFC and the IDA have similar voting structures, each member having 500 basic votes and one vote for each $5,000 subscription.

[1]There is no similar provision in the IMF Articles.

[2]See generally, E.S. Mason and R.C. Asher, *The World Bank Since Bretton Woods* (Washington, D.C.: Brookings Institution, 1973), p. 52 ff.

This struct ensures that control rests in the hands of the major contributors to the World Bank — the developed industrialized countries, particularly the United States. As Table 4.1 indicates, industrial countries hold 63.3 percent of the votes, while in stark contrast, all the countries of OPEC combined hold only 6.6 percent. Indeed, India's proportion is more than twice that of Saudi Arabia.

Table 4.1
World Bank Votes and Capital Subscriptions as of June 30, 1983

	Votes (%)	Subscription (%)
Industrial Countries	**63.3**	**67.0**
United States	19.6	21.0
Japan	6.6	7.0
West Germany	6.6	7.0
United Kingdom	5.0	5.3
France	4.6	4.8
Italy	3.8	4.0
Others	17.1	17.9
Developing Countries	**33.9**	**30.4**
OPEC	6.6	6.4
China	4.5	4.8
India	4.4	4.6
Others	18.4	14.6

Source: World Bank, *The World Bank Annual Report 1983*, Washington, D.C., 1983, IBRD Appendix F, pp. 182-84.

This rather skewed power structure reflects an equally skewed distribution of capital subscriptions. The most recent capital increase implemented in 1982, which raised the capital base of the Bank from $39 billion to $75 billion, did little to improve the situation, since the OPEC states did not significantly increase their proportionate contribution. The OPEC states in fact have shown little desire to play a bigger management role. They appear to prefer limiting their involvement to certain specific initiatives, notably the Third Window — an intermediate financing facility which operated in 1975 and 1976 — and a proposed energy affiliate much discussed in 1980-81 in which OPEC could hold one-third of the votes. Apart from this, the oil exporters have used their leverage directly only to pursue certain narrow political goals, such as withholding certain contributions to authorized capital or loans to pressure the industrialized countries to admit the Palestine Liberation Organization as an observer at Bank meetings.[3]

Thus, the weighted voting scheme continues to favour the North and ensures its dominance within the Bank. This is further illustrated by the administrative structure of the Bank.[4] Like the IMF, the administration consists of two bodies — the Board of Governors the Board of Executive Directors. The Board of Governors comprises the finance ministers of each member state and meets once a year in a joint annual meeting with the IMF Board. The Board of Executive Directors sits continuously and makes both policy and operational decisions. Five of the 21 executive directors are appointed by the largest subscribers to the Bank's capital — the U.S., Britain, France, Germany and Japan; the other 16 representing the remaining members, are elected, although one seat is reserved for China since her entry in April 1980. With weighted voting, it is clear that the industrialized countries effectively control the operation of the Bank. And although most Board decisions are made by consensus rather than vote, the formal voting structure is an ever-present reality which conditions any putative consensus.

[3] "Saudis Soft Loan to World Bank", *International Herald Tribune*, March 26, 1982.

[4] A good discussion of the structure and operations of the World Bank Group is found in a series of essays in J.P. Lewis and I. Kapur (eds.), *The World Bank Group, Multilateral Aid and the 1970s* (London: Lexington Books, 1973); see also, Escott Reid, *Strengthening the World Bank* (Chicago: Adlai Stevenson Institute, 1973)

Northern dominance is also evident within the World Bank staff, which is not subject to national personnel quotas. Not surprisingly, the upper ranks of the staff are dominated by Americans. However, the present staff of approximately 2,600 now represents over 100 different nationalities.

A more significant source of Northern control is the fact that the World Bank president is always a U.S. citizen, a fact which increases the perception of U.S. dominance in the management of Bank operations and in ensuring that the Bank remains 'headquarters-oriented' and highly centralized in Washington. The president indeed has extensive powers. It is he and not the executive directors who formally initiates proposals for loans and credits. The Board of Executive Directors then merely accepts, amends or rejects them.

But as illustrated by the presidency of Robert S. McNamara (1968-81), this does not necessarily mean that the Bank is a mere tool of the U.S. government. McNamara, in fact, succeeded in distancing the Bank from U.S. pressure to a significant degree. He was greatly resented by the Nixon administration which found him 'unnudgeable' in such matters as cutting off aid to Allende's Chile in 1970 and reducing IDA loans to India during the cooling of Indian-U.S. bilateral relations.[5]

Unfortunately, McNamara's successor as president, A.W. Clausen, the Reagan administration and the U.S. Congress have been subjecting World Bank operations to greater scrutiny and reducing contributions to the soft loan affiliate in the face of serious budget constraints.[6] In particular, the Reagan administration has used U.S. leverage to promote reliance on the marketplace and to ensure more business for U.S. companies.[7]

In early 1981, for example, a $250 million loan for a fertilizer project in India was abruptly withdrawn when Prime Minister Gandhi reversed

[5] William Clark, "Robert McNamara at the World Bank", *Foreign Affairs* 60 (Fall 1981), p. 176.

[6] "Fate of World Bank's Soft-Loan Arm Remains in Doubt", *The Globe and Mail*, May 9, 1983.

[7] U.S. Department of the Treasury, *U.S. Participation in the Multilateral Development Banks in the 1980s*, Washington, D.C. (February 1982); see also, Robert L. Ayres, "Breaking the Bank", *Foreign Policy* 43 (Summer 1981), pp. 104-120.

her predeces. s decision to grant the contract to a U.S. company.[8] In September 1981, a loan of $700 million to modernize and electrify India's rail network was placed in jeopardy when India refused to accept some accompanying conditions. These included a stipulation that India import an IBM computer system from abroad rather than develop her own system,certain provisions relating to increases in suburban fares and rail tariffs in order to generate a 10 percent return on capital, and various changes in the railway's corporate structure and personnel policy.[9] In another instance, the U.S. expressed concern over 'subsidizing utopianism' when loans were considered for collective farming in Tanzania, and a confidential internal Bank study recommended a squeeze on funds to Nicaragua until more concessions were made to the private sector.[10]

Such blatant evidence of Northern control has prompted Southern demands for major reforms so that developing countries can have a greater role in Bank decision-making. Various proposals have been put forward. Some suggest adjusting the Bank's voting structure to population, for example, by increasing the number of basic votes by one per million inhabitants; others suggest a 50-50 division between lenders and recipients, at least for the soft-loan affiliate, the IDA.[11] But as with proposals to reform the IMF, the North firmly opposes such moves. Should they be implemented under extreme pressures, the North would most likely divert foreign aid and financial resources into bilateral channels, and the World Bank could be reduced to a mere skeleton, contributing little to resource transfers and greater international equity.

It can be expected, therefore, that the power structure and administration of the Bank will remain under the control of the industrialized countries. With this in mind, it is instructive to examine the Bank's lending operations during the 1970s to assess both how this dominance has been translated into practice, and to what extent the Bank's resources have promoted economic development in the South.

Bank or Development Agency?

As a preliminary, it is important to note that the constitution of the IBRD constrains it to provide capital flows only as a supplement to private investment. The nature of this restricted mandate can be understood by examining the purposes of Bank lending set out in Article I of the Bank's Articles as follows:

1. To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the res tion of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
2. To promote private foreign investment by means of guarantees or participation in loans and other investments made by private investors; and when private capital is not available on reasonable terms to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
3. To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labour in their territories.
4. To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.
5. To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate post-war years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.

These provisions clearly demonstrate that its founders intended the Bank to operate more as a bank than as a development agency. Its primary source of funds was and still is the international bond market wherein the Bank has built up a Triple A rating owing to prudent lending operations and its unblemished repayment record. Indeed, the IBRD is the largest single borrower in the international bond market. Investors rely on the government backing of the IBRD, despite the fact that most of the capital subscriptions are only callable rather than paid-up, and on the fact that no borrower has ever defaulted on an IBRD loan. Moreover, overall Bank lending is prudently constrained by the 1:1 'gearing ratio' stipulated in its Charter; that is, the Bank may not lend more than the equivalent of its subscribed capital and reserves.

By June 1983, the IBRD owed $35.9 billion to creditors in over 100 countries; of the $8.8 billion of medium- and long-term funds borrowed by the IBRD in the 1982-83 fiscal year, 68 percent was borrowed from private investors and the remainder from central banks and governments. The average cost on this outstanding debt was 8.72 percent per annum. Such favourable borrowing terms have enabled the Bank to onlend these funds on very reasonable terms and all

[8] "India Strays From the World Bank", *South* (February 1981), p. 73.

[9] "India and the World Bank", *The Economist* (September 19, 1981).

[10] "Shift Seen in Study by the World Bank", *International Herald Tribune*, September 3, 1981.

[11] Escott Reid, "McNamara's World Bank", *Foreign Affairs* 51 (July 1973), pp. 807-808; M. ul Haq, *The Poverty Curtain: Choices for the Third World*, pp. 213-216; and F. Mansour, "Restructuring of the World Bank?" in K. Haq (ed.), *Dialogue For A New Order* (Oxford: Pergamon Press, 1980), p. 35.

at a fixed in   st over the life of the loan, generally set at 0.5 percent over the average cost of the loan. In addition, IBRD loans usually have a maturity of 15-20 years, including a three- to five-year grace period.

As a consequence of escalating interest rates, however, the Bank has been forced to begin cautiously borrowing some short-term money, albeit only $1.5 billion out of the $10.3 billion borrowed in fiscal 1983, as well as to increase its access to the higher inflation, higher interest rate countries, notably the United States. Moreover, from July 1, 1982, the Bank began charging a variable interest rate on its new loans. The interest rate is calculated twice a year according to a weighting formula which reflects the overall cost of Bank borrowing. IBRD loans will nevertheless continue to be prized by eligible borrowers. The lending rate for the period July 1 to December 31, 1983 was 10.47 percent, significantly below commercial rates based on the London Interbank Offer Rate.[12]

Despite the relatively soft terms of regular IBRD loans, many developing countries simply cannot service such debt. For this reason, the International Development Association was created in 1960. Formally, the IDA is an autonomous institution with 131 members, but it shares the same staff and headquarters as the IBRD. It is funded primarily by triennial replenishments from 33 donor countries. This enables the IDA to provide interest-free loans extended over a 50-year period with a grace period of 10 years and subject only to a service charge of 0.75 percent on the disbursed portion and 0.5 percent on the undisbursed portion.

Since 1960, IDA has committed $29 billion to more than 1300 projects and programs in 78 countries.[13] The steady expansion of IDA funding and activities in the 1960s contributed greatly to the transformation of the World Bank into the dominant multilateral development agency. But the most important element in this transformation occurred after 1968 during Robert McNamara's tenure as president, until his resignation in 1981. A brief description of this period is now in order.

Changes under McNamara

As one insider noted, McNamara was driven by a sense of mission and was determined to reorient the World Bank more truly toward development objectives, particularly the alleviation of absolute poverty.[14] First, this required increased resources to expand the Bank's lending capacity. In his first term of office (1968-73), McNamara made great efforts to tap all major capital markets and to solicit greater credits for IDA. IBRD loans rose from $847 million to over $2 billion per annum, and IDA credits grew from $257 million to $1.36 billion per annum.

[12]LIBOR (London Inter Bank Offer Rate) has risen from approximately 5.5 percent in 1972 to 13.75 percent in 1980, 16.75 percent in mid-1982, and 10.5 percent in mid-1983.

[13]World Bank, *IDA In Retrospect* (Oxford: Oxford University Press, 1982).

[14]W. Clark, "McNamara at the World Bank", *Foreign Affairs* 60 (Fall 1981), pp. 167-184.

At the same time, McNamara undertook a major .   ientation of World Bank activities "to break the constraints of development".[15] Hitherto, most IBRD and IDA loans were used to finance major infrastructural projects, the economic return on which was easily quantifiable and the ability of the debtor government to repay easily monitored. This project approach to development finance was, in part, a requirement of the World Bank Articles of Agreement. Article III (4) (vii) provides, *inter alia*, that "loans made or guaranteed by the Bank, shall, except in special circumstances, be made for the purpose of specific projects of reconstruction and development".

Project financing has always aroused criticism by developing countries, but two distinct facets were of particular salience in the early 1970s. First, the Bank generally financed only the foreign exchange portion of a project, so that, for example, in 1968 less than 5 percent of lending by the IBRD and IDA was for local costs.[16] Second, because all contracts for World Bank projects were open to international competitive bidding, local suppliers were inevitably outbid by more sophisticated and efficient multinational corporations — which led to accusations that the Bank was insufficiently concerned with the transfer of skills and technology.

Cognizant of these criticisms, McNamara established in 1972 a new Development Policy Staff under Hollis Chenery charged with devising and implementing a new strategy for development. The new strategy shifted emphasis away from *project loans* towards so-called *program loans*,[17] which provide foreign exchange mainly for importing goods and services that are important for the overall development program. In addition, more investment was to be directed to agriculture, education and population control efforts so as to remove long-term constraints on development. Growth targets would be established in terms of essential human needs — nutrition, housing, health, literacy and employment — rather than in terms of purely economic measures such as GNP. And greater emphasis would be placed on internal reforms designed to redistribute internal economic power, namely, land reform, tax reform and credit and banking reform.

This new orientation and a growing concern with the distributional dimension of growth became increasingly evident through the 1970s. By 1980, IBRD loans had increased to $7.6 billion per annum, IDA credit had risen to $3.8 billion per annum, and program lending amounted to approximately 10 percent of the total outstanding. This trend has continued into the 1980s, with IBRD and IDA loans amounting to $11.1 billion and $3.3 billion respectively in the year ending June 30, 1983 (see Table 4.2). In addition, more standard project financing was allocated to agriculture, rural development and local industry, and a greater proportion of funds was available for local costs.

[15]See generally, B.S. Hurni, *The Lending Policy of the World Bank in the 1970s: Analysis and Evaluation* (Boulder, Colorado: Westview Press Inc., 1980).

[16]Escott Reid, "McNamara's World Bank", p. 800.

[17]Mason and Asher, *The World Bank Since Bretton Woods*, pp. 26-40, pp. 260-294.

Table 4.2
World Bank Group: IBRD and IDA loans
($ millions)

Fiscal year (ending June 30)	IBRD	IDA	Total
1972	1,958	1,000	2,958
1973	2,051	1,357	3,408
1974	3,218	1,095	4,313
1975	4,320	1,576	5,896
1976	4,977	1,655	6,632
1977	5,759	1,308	7,067
1978	6,098	2,313	8,411
1979	6,989	3,022	10,011
1980	7,644	3,838	11,482
1981	8,809	3,482	12,291
1982	10,330	2,686	13,988
1983	11,136	3,341	14,477

Source: *World Bank Annual Report* (Various years).

In 1980, the year before McNamara's departure, yet another major innovation in World Bank operations was initiated. This was the *structural adjustment lending program*, the objectives of which are stated as follows:

> . . . to support a program of specific policy changes and institutional reforms designed to achieve a more efficient use of resources and thereby contribute to a more sustainable balance of payments in the medium and long term and to the maintenance of growth in the face of severe constraints, and to lay the basis for regaining future growth momentum; and to act as a catalyst for the inflow of other external capital to help ease the balance of payments situation.[18]

Structural adjustment loans are thus designed to help a country to adjust to higher energy prices, restricted export markets and other unexpected and adverse changes in the international environment without setting aside long-term growth objectives.

The loan is usually disbursed in instalments and is subject to conditions such as ceilings on credit expansion and government borrowing, the reduction of trade deficits to sustainable levels relative to anticipated capital inflows, and the removal of obstacles to growth, greater productivity and efficiency. In terms of repayment, there is normally a grace period and a final maturity in the range of 17 to 20 years. As of June 1982, 15 structural adjustment loans had been approved for $2.1 billion, representing 8.2 percent of the Bank's total commitments in the 1982 fiscal year.

Perhaps the most interesting aspect of structural adjustment lending is its resemblance to the IMF's conditional lending to finance balance of payments deficits. The World Bank-IMF Joint Development Committee acknowledges this complementarity. The World Bank has an

[18] *World Bank Annual Report* 1982, p. 39; see generally, E.P. Wright, "World Banking Lending For Structural Adjustment", *Finance and Development*, Vol. 17, No. 3 (September 1980).

interest in reducing current account deficits so that investment programs and activities are not jeopardized; and the IMF recognizes the need for its macroeconomic policy prescriptions to mesh with long-term development strategies.

It has already been noted how the IMF has begun providing longer-term finance for balance of payments problems and, for example, the creation of the extended fund facility reflects the need to consider a country's development prospects. In addition, with respect to IMF conditionality, there has been a shift from exclusive emphasis on demand management to an awareness of supply-side problems and the need to raise the long-term productive potential of the debtor country through appropriate savings and investment incentives.

The degree of cooperation between the IMF and World Bank has been described succinctly by the IMF managing director, M. Jacques de Larosiere:

> While the Fund and Bank retain their separate responsibilities and functions, we call upon each other for advice within each institution's area of expertise and consult and collaborate so as to ensure that the efforts of each institution reinforce the effectiveness of programs supported by the other. The Fund, for example, looks to the Bank for views on the size and composition of a country's investment program and for analysis of the microeconomic impact of pricing decisions, while the Fund provides the Bank with guidance on macroeconomic policies.[19]

In addition, staff members of both institutions are more and more frequently participating in the missions of the other. Certainly, cooperation and interdependence between the Bank and the Fund will expand in future, particularly as member countries attempt to combine World Bank and IMF lending in a single program and to link short-term stabilization policy with long-run goals for economic development.[20]

Replenishing the IDA

Perhaps the major problem facing the World Bank Group is how to increase the volume of IBRD and IDA lending both in absolute terms and in such a way as to accelerate the flow of private and official finance to developing countries. One way is to increase IBRD borrowings and IDA replenishments. Floating additional IBRD bonds does not present a real obstacle, particularly in light of the 1980 increase in the Bank's authorized capital from $37 billion to $75 billion and the decision of the Bank to engage in short-term borrowing in the capital markets.

Increasing IDA replenishments, however, is extremely uncertain. Indeed, in 1981, the Reagan administration effectively reduced the U.S. contribution of $3.2 billion to the Sixth Replenishment (IDA-6) by

[19] "Conversation with Mr. de Larosiere", *Finance and Development*, Vol. 19, No. 2 (June 1982), p. 1.

[20] Dell and Lawrence, *The Balance of Payments Adjustment Process*, p. 72. With the exception of Bolivia, all countries which had received structural adjustment loans from the World Bank up to June 1982 had first entered into an arrangement with the IMF.

deciding . stretch payment over four years instead of three. This precipitated a crisis since, pursuant to a 1980 agreement, other IDA donors only contribute in proportion to the United States. Although ultimately the other donors finally paid their full shares (Britain paid up only after Indira Gandhi promised Mrs. Thatcher some lucrative contracts for power stations), lending had to be slashed by 35 percent or $1.5 billion in the 1982 fiscal year.[21] At the 1982 annual meeting of the IMF and World Bank, the non-American IDA deputies agreed to bridge the shortfall until IDA-7 commences in 1985. An additional $2 billion in contributions were made which had the effect of restoring annual transfers by IDA to pre-1982 levels — approximately $3.5 billion per annum. It should be noted that about $500 million of this $2 billion, representing the contributions from Canada, France, Norway, Sweden, Italy and Denmark, was placed in a Special Fund in which procurement will be restricted to the contributors and other developing countries. This decision was intended as a symbolic gesture to signal disapproval of the breach of the principle of burden sharing by the U.S.

Negotiations for the Seventh Replenishment, which opened in November 1982, proved particularly difficult largely due to weakening U.S. support for multilateral development institutions. In response to the World Bank management's position, that a $16 billion replenishment was the minimum necessary to continue IDA lending at an acceptable level, the United States proposed a replenishment of no more than $9 billion. A $9 billion replenishment was agreed upon only after lengthy and acrimonious negotiations, although Canada and most other donors sought a compromise $12 billion replenishment.

While downward pressure has been exerted on IDA funding levels, the resource needs of eligible countries — those with per capita incomes of less than $730 (at 1980 prices) — continue unabated. These countries are mainly found in Sub-Saharan Africa where the average income (excluding Nigeria) was only $330 in 1979 and has since fallen 0.5 percent each year in real terms. In addition, the entry of China has posed a problem. It is anticipated that China will receive approximately 15 percent of IDA-7 funds, while the other large recipient, India, will have its share only slightly reduced to 27 percent. Of course, there is always the possibility that some recipients will 'graduate' to the IBRD, as have 29 IDA members in the past. Moreover, a great deal of attention has recently been focused on 'blended credit' — the mixing of both IDA credit and IBRD loans, particularly for countries such as China and India. Finally, it is also likely that a modest interest charge will be imposed on IDA lending and that maturities will be reduced as a means of supplementing IDA resources.

[21] "A Bank For All Seasons: A Survey of the World Bank", *The Economist* (September 6, 1982), p. 18.

Prospects for Expansion

In view of the limit on IBRD lending and the political uncertainties regarding IDA resources, the most important source for potential expansion of World Bank operations is the increasing collaboration with the private sector and, particularly, the multinational commercial banks. World Bank president A.W. Clausen has proposed three possible avenues: increased activity by the International Finance Corporation; a multilateral investment insurance scheme to stimulate private investment; and more cofinancing with the commercial banks to supplement cofinancing with official aid agencies in industrialized countries and OPEC countries.

The IFC has considerable potential for stimulating private sector investment in developing countries.[22] Its Articles of Agreement stipulate that the affiliate should only make investments "in cases where private capital is not available on reasonable terms". The IFC typically provides up to 25 percent of the total investment required by eligible local, indigenous private enterprises. Other investors are then attracted on the strength of the IFC's expert assessment of the project and its stamp of approval. Once the viability of the local venture is proved, the IFC sells off its holdings, thereby strengthening the local capital market. The IFC also further upgrades the financial expertise of developing countries by underwriting public offerings or private placements of various forms of corporate securities.

In the 1983 fiscal year, the IFC Board of Directors approved 58 projects with project costs of $2.9 billion, involving an IFC investment of $612 million. More importantly, the IFC has been diversifying into non-manufacturing activities, and expanding steadily into sub-Saharan Africa where, for example, it has backed food processing plants in Somalia and Swaziland, cement factories in Lesotho and Sierra Leone, and a development finance corporation in Botswana.

Another means of encouraging direct foreign investment in developed countries is through a proposed Multilateral Investment Insurance Agency (MIIA). This agency is intended to complement national insurance schemes in many OECD countries which insure investors against 'political risks' — mainly expropriation, inconvertibility and war. In this way, the World Bank may help to reduce real or perceived non-commercial risks, stimulate investor confidence and reverse the decline in investment flows to needy areas such as Africa.

The third and perhaps most important avenue to be pursued by the World Bank in future is greater cofinancing with commercial banks.[23] It is the multinational banks that are presently the main source of finance for many of the more advanced developing countries. Yet they are

[22] "International Finance Corporation: Merchant Banker to the Third World", *Institutional Investor* (September 1982).

[23] World Bank, "*Co-Financing — A Review of World Bank Co-Financing With Private Financial Institutions*", Washington, D.C., 1980.

increasi cutting back their lending operations for fear of the consequences to the banking system of any massive default. The World Bank hopes to reverse this tendency as well as to broaden the country coverage of private lending by effectively providing the banks with the World Bank's stamp of approval and ongoing supervision with respect to various projects, all of which are required to show an estimated economic rate of return of at least 10 percent in real terms. In other words, cofinancing enables the World Bank to leverage its capital and professional expertise and attract needed additional funds to borrowing countries, in much the same way as the IMF uses its stand-by arrangements as a catalyst for increased private lending to help finance current account deficits.

At present, cofinancing is proving to be a popular theme with the multinational banks which are all anxious to reduce the risk of lending to developing countries. The number of cofinanced operations has jumped from 37 in 1973 to 99 in 1982 and the total volume of funds provided by co-lenders has risen from $946 million to $7.4 billion, with private financial institutions contributing approximately $3.3 billion. Moreover, multinational banks are now placing loans cofinanced with the World Bank in a special category when setting up country lending limits, and the U.S. Treasury is prepared to exempt such cofinanced loans from any restrictions placed on total loans by U.S. banks to a single borrower.[24]

Various cofinancing techniques are being used or considered. Usually the World Bank and the commercial banks enter into separate loan agreements with the borrower. The commercial loans are on market terms and are frequently linked to the World Bank loan through a cross default clause and a Memorandum of Agreement signed by both the World Bank and an agent for the commercial lenders. The Memorandum provides for the exchange of information regarding the progress of a project, and any administrative services to be carried out by the World Bank on behalf of the commercial banks.

In conclusion, the World Bank Group has undoubtedly played a significant role in providing development finance and in promoting a more equitable distribution of resources. And notwithstanding Mr. Clausen's protestations that "the World Bank is not in the business of redistributing wealth from one set of countries to another set of countries [and that] it is not the Robin Hood of the international financial set",[25] the Bank is nevertheless an important actor in the North-South arena.

Nevertheless, it remains firmly under the control of the industrialized countries, particularly with respect to any operational changes aimed

[24]See "Third World Debt-Housekeepers Charter", *The Economist* (April 16, 1983), for a detailed discussion of the regulatory package recommended by the U.S. Federal Reserve, the comptroller of currency, and the Federal Deposit Insurance Corporation.

[25]"No More North-South", *International Herald Tribune*, February 6, 1982.

at augmenting the quantity and quality of financi nsfers to developing countries, as well as improving the distribu on. Subject to the cooperation of these members, future bank activities should include increased program lending and structural adjustment loans, greater coordination with the IMF even if only on an *ad hoc* basis in the Development Committee, and more cofinancing with private financial institutions. It would therefore seem that a more integrated approach towards the transfer of financial resources for development purposes is beginning to crystallize, but it remains to be seen whether this evolution will be sufficient to satisfy the demands of the South.

5 The Private Multinational Banks

During the 1970s the global economy was deeply affected by the emergence of a major new source of finance for the developing countries — the multinational commercial banks. With the quadrupling of oil prices in October 1973, huge sums of petrodollars — the dollar reserves of the oil-exporting states — flooded the Eurocurrency markets,[1] and with this influx the private, multinational banks emerged as major suppliers of finance to deficit-ridden developing countries. Not only were private banks eager for new profit opportunities, but they possessed certain technical advantages (such as the risk-spreading syndicated bank loan and the six-month rollover loan) which allowed them to shift the risks arising from fluctuating international interest rates onto borrowers.[2]

As shown in Table 1.1, multinational bank lending is second only to bilateral aid flows as the single most important source of external finance for developing countries as a whole. Clearly, this has had important implications for the structure of international financial relations, expecially since many formerly creditworthy debtors can no longer service their monumental debts. Medium- and long-term debt service payments of the non-OPEC developing countries, expressed as a percentage of their exports (and net private transfers), rose dramatically from 12 percent in 1973 to an estimated 21 percent in 1982.[3]

Petrodollars and Developing Countries

The emergence of the multinational banks as major suppliers of financial resources to developing countries is probably the single most important dimension of the political economy of North-South relations in the 1970s. By way of brief historical background, in the postwar period at the inception of the Bretton Woods System, it was widely believed that the intermediation function of the international capital markets had been irrevocably extinguished after the financial chaos and multiple defaults of the 1930s; hence, the necessity in the postwar years to substitute international financial institutions such as the IMF and the World Bank. It became clear, however, in the course of the 1950s and 1960s that not only did these institutions lack sufficient resources to perform an adequate intermediation function themselves, but also that private investment, bilateral loans and foreign aid were likewise unable to satisfy the need for development finance. Nevertheless, as recently as 1970, few developing countries had even modest access to international capital markets either as a supplementary source of finance or as a substitute for direct foreign investment by the much-criticized multinational corporations.[4]

The oil price shock of 1973 and the consequential massive increase in the deficits of all oil-importing developing countries radically altered the situation. The multinational banks, as major recipients of the petrodollars deposited in the Eurocurrency market and in anticipation of good profit opportunities, began to play a key role in providing balance of payments finance to developing countries.

A few statistics indicate the magnitude of this recycling process. In 1971, borrowing in the Eurocurrency markets on the part of developing countries amounted to a mere \$1.4 billion. But as current account deficits jumped from \$11.3 billion in 1973 to \$37 billion in 1974 after the first oil price shock, and to \$89 billion in 1980 after the second oil shock, private borrowing increased commensurately from approximately \$6.5 billion in 1973 to \$28.4 billion in 1980. By 1983, \$39.1 billion out of a total \$67.8 billion in current account deficits of non-oil developing countries was privately financed (see Table 5.1).

Table 5.1
Non-oil Developing Countries: Current Account Deficits and Private Borrowing, 1973-83
(\$ billions)

Year	Current Account Deficit	Long-Term Private Borrowing[a]
1973	11.3	6.5
1974	37.0	10.3
1975	46.3	14.2
1976	32.6	15.3
1977	28.9	9.4
1978	41.3	19.5
1979	61.0	21.7
1980	89.0	28.4
1981	107.7	35.7
1982	86.8	18.5
1983	67.8[b]	39.1[b]

[a] Estimated by the IMF.
[b] Preliminary.
Source: IMF, *World Economic Outlook*, Washington, D.C., 1983, Table 25, p. 194.

[1] The Eurocurrency market encompasses all banking institutions that accept deposits and make loans in currencies other than the bank's own country of residence. It is thus the major channel for international banking operations. See R.I. McKinnon, *The Eurocurrency Market*, Essays in International Finance No. 125, Princeton University, December 1977; J.D. Aronson, *Money and Power: Banks and the World Monetary System* (Beverly Hills, Calif.: Sage Publications, 1977), pp. 69-95; E. Versluyen, *The Political Economy of International Finance* (London: Gower Publishing Co., 1981).

[2] See generally, an excellent study in B.J. Cohen (ed.), *Banks and the Balance of Payments: Private Lending in the International Adjustment Process* (London: Croom Helm, 1981); also, S. Robinson, *Multinational Banking* (London: A.W. Sijthoff, 1974).

[3] OECD, *External Debt of Developing Countries, 1982 Survey*, Table 13, p. 38.

[4] Susan Strange, "Debt and Default in the International Political Economy", in J.D. Aronson (ed.), *Debt and the Less Developed Countries* (New York: Praeger Publishers, 1979).

Althoug[illegible] [illegible]e multinational banks have played the major role in recycling petrodollars to certain creditworthy oil-importing countries and are currently the largest single source of capital for these countries, it is equally clear that the activities of the banks in the Eurocurrency market have introduced a serious element of instability into the international financial system as a whole.

Perhaps the most disturbing aspect of the activities of the banks in the Eurocurrency market has been and remains their largely unregulated nature. Throughout most of the 1970s, the multinational banks had yet to develop a sophisticated means of analyzing what is termed 'sovereign-risk'. Their loans to developing country debtors were primarily a function of the available funds and the perceived profit opportunities. Little thought, at least initially, was given to the possibility of a default by a sovereign debtor and the repercussions on the financial system.

The situation was rendered particularly precarious by the existence of the interbank market. Over 50 percent of Eurocurrency transactions actually consist of interbank transactions whereby banks regularly redeposit funds with other banks.[5] This system originally evolved as a means of stabilizing the international capital markets by allowing banks to adjust their liquidity positions by lending and borrowing funds among themselves. In addition, it permitted banks to reduce their tax burden by 'booking' transactions through banks located in various tax havens.

For example, in 1977, banks in the Bahamas were responsible for 32 percent of all loans by branches of United States banks. Ironically, this complex interbank market now enhances the likelihood of financial instability insofar as the collapse of one bank, perhaps as a result of the default of a developing country debtor, may easily precipitate the collapse of a succession of banks.

Hitherto there has been no effective international regulation of such bank lending. In 1974, in the crisis which followed the collapse of the Herstatt Bank in West Germany and the Franklin National in the United States, all the central banks of the member countries of the Bank for International Settlements (BIS), which informally tries to monitor the Eurocurrency market, agreed in the Basle 'concordat' to rescue any ailing bank heading for a major bankruptcy.[6] However, BIS statistics are incomplete and inadequate, and the 'concordat' is vaguely worded and does not formally apply to non-Group of 10 countries — for example, such important financial centres as Hong Kong. Thus, it is difficult if not impossible to identify potential crisis areas before problems erupt, as demonstrated by the recent cases involving Mexico and

[5]J.D. Aronson, *Money And Power*, Chapter 3. This situation is highlighted in Anthony Sampson, *The Money Lenders* (London: Hodder and Stoughton, 1981); and H.M. Wachtel, *The New Gnomes: Multinational Banks in the Third World* (Washington D.C.: Transnational Institute, 1977).

[6]Richard Dale, "Safeguarding the International Banking System", *The Banker* (August 1982), pp. 49-56.

Brazil. Moreover, the Basle agreement is deliberat[illegible] [illegible]bscure and states simply that "it would not be practical to lay down in advance detailed rules and procedures for the provision of temporary liquidity" but that "means are available for that purpose and will be used if and when necessary".[7]

The possibility of default by a developing country debtor is now an important preoccupation on the part of the multinational banks and both national and international regulatory authorities. This concern is focused primarily on the largest debtors; for example, over 60 percent of 1983 Eurocurrency market borrowing by non-OPEC developing countries was accounted for by four of the largest developing countries: Mexico, Brazil, Argentina and South Korea.[8]

After the 1979 oil shock and the onset of world recession, it became evident that these four major debtors in particular faced increasingly burdensome debt service payments. Indeed, a large proportion of new borrowing was (and still is) related to *financing existing debt*, and concern intensified over the ability of debtors to continue to service the debt. Accordingly, the banks began to develop a much more sophisticated concept of sovereign-risk and to adhere to country limits governing the maturity and the amount of loans to individual developing countries. By 1982, the growth rate of new bank lending had dropped to 8-10 percent, compared to 20 percent in 1980-81. In addition, the banks insisted on loans with shorter maturities, shorter grace periods and higher interest rate spreads.[9]

The implementation of these supposedly preventive measures coincided with a steep rise in international interest rates from approximately 9.1 percent on average in 1978 to 16.5 in 1981,[10] and a reduction of export earnings of developing countries as a result of the world recession. Not only did debt servicing costs escalate, but there was less foreign exchange available to service the debt.

Undoubtedly, the Mexican crisis was the catalyst for a more generalized developing country debtor crisis which has engendered a further retrenchment on the part of the banks and drawn the banks and the IMF closer together. Not only Brazil, but all of the major Latin American debtors (except Colombia) have either IMF agreements in place or

[7]W. Brandt *et al.*, *Common Crisis, North South*, p. 88. A purported revision of the concordat has not changed the situation: "Banking Supervision: Full of Holes as a Swiss Cheese", *The Economist* (June 11, 1983).

[8]OECD, Financial Statistics Statistiques Financieres de l'OCDE, Part I, Monthly Financial Statistics, February 1983.

[9]Federal Reserve Bank of New York, *Quarterly Review*, December 1982; "Third World Debt — Housekeepers' Charter", *The Economist* (April 16, 1983).

[10]This refers to LIBOR: The London Inter Bank Offer Rate. Note that in the period 1972-79, rapid inflation resulted in negative real interest rates and, hence, an effective transfer of real resources to the debtor countries. See G. Russell Kincaid, "Inflation and the External Debt of Developing Countries", *Finance and Development* 18 (December 1981), pp. 45-48.

are curre negotiating them. This trend is also occuring in an increasing n...nber of countries in Asia, Africa and Eastern Europe. For example, the Philippines, South Korea and Thailand are all experiencing difficulties in servicing their present debt structure.

Coordination with the Fund

The current situation closely resembles one of mutual hostages between debtors and creditors, and international lending has become a dangerous game of brinkmanship.[11] Although the banks can discipline a recalcitrant debtor by threatening to withhold further credit, a debtor country can, with equal and opposite effect, threaten to default and rupture the delicate banking structure. The exposure of some major banks is shown in Table 5.2.

In order to avert the now very real risk of default, the banks have had to resort to repeated rescheduling of debt as a means of adjusting the financial obligations of debtor countries to their capacity to service the debt. The institutionalization of this process of rescheduling is, however, recognized as a temporary expedient. A reappraisal of private multinational banks in their role as providers of finance to developing countries is under way, and proposals aimed at increasing the involvement of international financial institutions, notably the IMF and the World Bank, are gaining support.

The emerging pattern of coordination between the banks and the IMF is highly ironic. During the 1970s, private bank credit to the middle-income developing countries was regarded as a valuable source of unconditional finance and an ideal substitute for cumbersome, conditional IMF credit and other official transfers. For example, Brazil's access to the Eurocurrency market enabled her to avoid recourse to the IMF altogether. Similarly, Algeria and Peru obtained Eurocurrency loans at a time when they were denied official resources. Even Gabon was able to finance a railway on Eurocredits after the IBRD rejected a loan on the basis of an elaborate cost-benefit analysis.

It should be noted, though, that the banks were not totally oblivious to the need to ensure a certain degree of good economic management and fiscal discipline on the part of their sovereign clients such as to increase their ability to repay and ultimately reduce their need for further borrowings. But particularly in situations where, literally, hundreds of banks were involved in syndicated loans or consortia, the banks simply lacked the means for ongoing supervision and for ensuring that the appropriate adjustments of domestic economic policy were made.

For example, in 1976 a consortium of six banks led by the Bank of America attached stringent conditions to a $400 million refinancing

[11] J.D. Aronson, "The Politics of Private Bank Lending and Debt Renegotiations", in J.D. Aronson *et al.*, *Debt and the Less Developed Countries* (Boulder, Colorado: Westview Press, 1979), p. 306.

loan to Peru,[12] as part of which a steering committe s formed to monitor Peru's economic performance and the gove...ment's compliance with the loan conditions. These conditions included deflationary measures and a currency depreciation. But the banks lacked both the expertise and the legitimacy to successfully carry out this experiment in direct conditionality. Ultimately, in 1977, President Morales was prevailed upon to accept an IMF-imposed stabilization program of domestic deflation and a 30 percent devaluation. When the IMF suspended a further credit as a result of Peru's failure to meet a budget-cutting target, the private creditors did likewise. Only after a new, even more severe IMF agreement was concluded in September 1978 was the rescheduling of Peru's private and public debt completed.

This link between the multinational banks and the Fund has become increasingly formalized as multilateral debt reschedulings have become a regular feature of international financial relations. As of early 1983, one banker estimated that there were 25 countries in arrears, in the process of rescheduling or which had already rescheduled portions of bank debt, compared with 27 reschedulings for the entire decade of the 1970s.[13]

The rescheduling of commercial debt usually, though not always, occurs in conjunction with a rescheduling of official public debt within the so-called Paris Club forum. The private creditors hold a parallel conference while the Paris Club of official (government) creditors meets. Any renegotiation concluded by the Paris Club will contain a provision obliging the debtor country to negotiate rescheduling of private debt on the same terms.

As a condition of any rescheduling, the country is now almost always required to enter into a stand-by arrangement with the IMF, thus bringing the full panoply of Fund conditions to bear on the debtor-creditor relationship.[14] In addition, many private bank loan agreements may allow for advances to be withheld if the member's right to draw under a stand-by arrangement is suspended, or stipulate that borrowers must 'be in good standing' or be 'fully eligible' to purchase Fund resources. Clearly, the IMF 'good housekeeping seal of approval' is now the linchpin of the privatized system. The IMF has emerged in a new supervisory capacity as the institution responsible for disciplining debtors, scrutinizing finances and thereby enhancing the security of private loans.

[12] Barbara Stallings, "Peru and the U.S. Banks: Privatiz .tion of Financial Relations", in J.D. Aronson (ed.), *Debt and the Less Developed Countries*; H. Shapiro, "Monitoring: Are The Banks Biting Off More Than They Can Chew?", *Institutional Investor* (October 1976). A similar experiment in Zaire in 1976 also failed: D.O. Beim, "Rescuing the LDCs", *Foreign Affairs* 55 (July 1977), pp. 717-731.

[13] Morgan Guaranty Trust Co., *World Financial Markets*, February 1983.

[14] J. Gold, *Order in International Finance, the Promotion of IMF Stand-By Arrangements and the Drafting of Private Loan Agreements*, IMF Pamphlet Series No. 39 (August 1982); see also, Charles Lipson, "The IMF, Commercial Banks and Third World Debts", in J.D. Aronson (ed.), *Debt and the Less Developed Countries*; and C.R. Neu, "The International Monetary Fund and Less Developed Country Debt", in L.G. Franko and M.J. Sieber (eds.), *Developing Country Debt* (New York: Praeger Publishers, 1979)

Table 5.2
Exposure of Major Banks in Latin American Debtor Countries

	Brazil	Mexico	Venezuela/ Argentina (whichever larger)	Total	Total/ Equity
Canadian Banks					
October 31, 1983 (C$ millions)					
Bank of British Columbia	32	60	—	92	0.68
Canadian Commercial Bank	—	—	—	17	0.16
Canadian Imperial Bank of Commerce	934	940	350[a]	2,224	0.91
Continental Bank of Canada	44	81	19	144	0.66
Mercantile Bank of Canada	83	50	—	133	0.74
Bank of Montreal	1,211	1,493	551	3,255	1.36
National Bank of Canada	545[a]	543[a]	145[a]	1,233[a]	1.88
Bank of Nova Scotia	726	941	506	2,173	1.18
Royal Bank of Canada	1,075	1,328	500[a]	2,903	0.88
Toronto-Dominion Bank	712	822	288	1,822	0.96
Total, Canadian Banks	**5,362[b]**	**6,258[b]**	**2,359[b]**	**13,996**	**0.94**
U.S. Bank Holding Companies					
September 30, 1983 (US$ millions)					
Bank of America	2,487	2,750	1,635	6,872	1.33
Bank of Boston	290	225	255	770	0.80
Bankers Trust N.Y. Corp.	775	1,175	425	2,375	1.37
Chase Manhattan Bank	2,450	1,500	1,200	5,150	1.47
Chemical Bank	1,300	1,400	350[a]	3,050	1.36
Citicorp[c]	4,360	3,270	1,090	8,720	1.64
Others	5,820	5,151	3,659	17,136	0.96
Total, U.S. Companies	**18,482**	**17,201**	**8,614**	**44,297**	**1.10**

[a] Estimated. [b] Not including Canadian Commerical Bank. [c] At June 30, 1983.
Source: *Dominion Bond Rating Service*, reproduced in *The Globe and Mail*, March 19, 1984, p. B4.

The Fund also plays an important, although still small, ..dvisory role during the creditor club and private bank negotiations. Guidelines issued in January 1981 indicate that the IMF intends to assume a higher profile in such forums and to liaise more closely with official and private creditors, as well as with other institutions such as the World Bank and UNCTAD, in gathering and analyzing factual information.[15] But although contacts between the banks and the IMF have undoubtedly increased, the Fund must remain discreet, since the information received from its members is confidential. Member countries object to the Fund giving the appearance of aligning itself with their creditors, particularly when the IMF assists and advises the member during negotiations of private loans.

The recent debt crises in Mexico, Brazil and Argentina, all in quick succession in late 1982, highlighted the need for a better early warning system and for increased coordination between the IMF and the multinational banks. The resultant change in the pattern of Fund operations reveals the IMF's underlying concern with the preservation of the overall financial system. No longer is the Fund mainly a provider of temporary balance of payments financing; it is also actively assisting multinational commercial banks that have, in retrospect, clearly engaged in improvident lending. This new role was clearly illustrated by the sequence of events surrounding the Mexican and Brazilian crises.

The Mexican Case

In the Mexican case, by August 1982 over $80 billion of medium- and long-term external debt had accumulated and Mexico was heavily committed to well over 300 foreign banks. (Indeed, as many as 1400 banks have been involved to some degree in the rescheduling of Mexico's debt). By this date, debt service payments were consuming 58.1 percent of Mexico's export earnings, compared to 23.2 percent in 1978; $10 billion of principal repayments were due in the last four months of 1982. Falling oil export revenues, continuing high interest rates and short-term capital outflows precipitated the breakdown of its debt servicing efforts.

In August 1982, the Mexican government declared a three-month moratorium on the payment of principal to public and private creditors and suspended interest payments on private debt. It also imposed exchange controls, froze all dollar deposits and devalued the peso. The action stunned the international banking community[16] and electrified the atmosphere at the annual meeting of the Board of Governors of the IMF and World Bank held in Toronto two weeks later. The central banks of the Group of 10, operating through the Bank for International Settlements, put together a crash rescue program involving $1.85 bil-

[15] B. Nowzad and R.C. Williams, *External Indebtedness of Developing Countries*, IMF Occasional Paper No. 3 (May 1981).

[16] It must be noted that Mexican banks themselves had borrowed heavily in the interbank market, and when, in its negotiations with its creditors, Mexico threatened to suspend payments of principal and interest on interbank loans as well, the spectre of a chain collapse of the international banking structure became a real possibility.

lion of sl term credit available until the end of the year. Two U.S. government agencies provided an additional $2 billion and the Federal Reserve reactivated a pre-existing 'swap' facility.

All major governments clearly viewed the situation as an emergency and as posing a severe threat to the international financial system. The United States came to the IMF-World Bank meeting with an unexpected proposal for a special emergency fund within the IMF, with resources of up to $20 billion, to carry out bridging operations. Clearly, the U.S. did not want to face so large a responsibility alone.

Ultimately, Mexico reached an agreement with the IMF for a $3.84 billion purchase over three years from the extended fund facility (Mexico's quota was then SDR 802.5 million), and successfully negotiated the rescheduling of its public and private sector debt. Approximately $20 billion of such debt was to mature between August 1982 and December 1984, 50 percent of which is short term.

The interesting new feature of the IMF arrangement was the unprecedented degree of cooperation between the IMF and the private financial institutions. More specifically, in an unusually explicit statement, the IMF managing director personally asked the banks to lend an additional $5 billion to Mexico and made it clear that Mexico could not meet the conditions in the extended arrangement without the bank credit. Moreover, Mr. de Larosière indicated that he would not recommend approval of the agreement by the Executive Board without assurances from both official sources and commercial banks that adequate external financing was in place and a realistic restructuring scheme formulated. Since any new bank loans (or official credit) are in turn dependent on the adherence by Mexico to IMF conditions, it is clear that, in the words of the executive vice-president of Citibank, "the IMF and bank loans are absolutely interdependent".[17]

The Brazilian Case

The Brazilian debt crisis followed closely that of Mexico. It was thought at first that a softening of world oil prices and a more diversified debt maturity structure would make Brazil's $90 billion debt, the largest in the Third World, easier to handle. Ironically, events have shown the opposite to be true. In part, this was because oil prices did eventually stabilize and because Brazil, unlike Mexico, did not have a large chunk of short-term debt that would bring immediate relief through a single large rescheduling. More importantly, however, Brazilian authorities, again unlike their Mexican counterparts, were much less decisive and comprehensive in their approach to the crisis, hesitating to acknowledge its seriousness or intervene in the deteriorating market process until the end of 1982. As a result, a large portion of Brazil's interbank credit lines were withdrawn. These lines have not been restored despite pressure from the IMF, the Western Central banks, and from the major multinational banks themselves.

[17] "Latin American Debt Crisis Fosters Unusual Cooperation", *The Globe and Mail*, December 2, 1982

A $5.9 billion stabilization agreement with the IMF early in 1983 did not attract the level of multinational bank finance that had been expected. Many bankers expressed concerns about the ability of an uncertain political structure to absorb the social costs of the tough austerity measures needed to meet the IMF's conditions. As it turned out, Brazilian austerity measures were indeed not strong enough. In May 1983, the Fund suspended its allocations, automatically bringing to a halt further bank disbursements. It took several months of accumulating service payments arrears and growing fears of a breakdown in negotiations before a new agreement with the IMF was reached (November 1983). This new agreement, which includes revised performance criteria, unlocks a financing package of new bank loans, trade credits and debt rescheduling, over and above the previously agreed IMF financing. However, the added adjustment burdens on the Brazilian population and uncertainty regarding the adequacy of future private financial flows continue to jeopardize a satisfactory completion of the Brazilian rescheduling.

Proposals for Debt Relief

As the foregoing has indicated, debt crises have been hitherto dealt with through *ad hoc* coordination among official creditors, private creditors and the IMF in the context of Paris Club negotiations and the informal rescheduling committees of the private banks. In light of the recent crises, however, more permanent changes in the operations of the international financial institutions can be expected. The resources of the IMF have been increased and an emergency line of credit made available to the IMF through the General Arrangements to Borrow.[18] In addition, the IMF is seriously considering the private market option, at least as an interim measure, whereby the Fund will borrow from the international capital markets and on-lend to developing countries. This initiative is endorsed by the multinational banks since it would permit them to share the risk of lending with the IMF. At the very least, the IMF will formalize and routinize its contacts with both official and private creditors.

More radical suggestions range from the designation of the IMF or the Bank for International Settlements as an international lender of last resort, to the creation of a special forum for debt rescheduling covering all creditors — international agencies, governments, commercial banks and export suppliers. This latter proposal is modeled on the World Bank aid consortia which have been set up for India and Pakistan and the OECD-led consortium for Turkey. These consortia have relatively permanent structures and are activated at periodic intervals or as crises arise.[19] The chairman, usually a World Bank representative, brings all

[18] See discussion in Chapter 2.

[19] A good description is found in C. Michalopoulos, "Institutional Aspects of Developing Countries' Debt Problems", in D.B.H. Denoon, *International Economic Order: A U.S. Response* (London: The Macmillan Press, 1979). Note that the World Bank has also set up aid consultative groups for some countries.

creditors ther to coordinate their assistance efforts so as to maintain a debt structure appropriate to the country's debt servicing capacity and long-term development policies and objectives. For example, one of the objectives of the India Aid Consortium is to keep debt service payments at less than 20 percent of export earnings.

From the perspective of the South, such comprehensive schemes for debt relief are preferable to the *ad hoc* convocations of the Paris Club and commercial bankers only when a debtor faces "imminent default".[20] At UNCTAD V in 1979, proposals were advanced for a new institution — an international debt commission — that would assume the debt of less developed countries and refinance it on easier terms. Similar suggestions for institutional reform can be found in the Brandt Report in connection with a World Development Fund. Other proposals relate to generalized automatic debt relief, perhaps triggered whenever certain objective indicators fall short of specified targets.

Northern countries, on the other hand, are adamantly opposed to dealing with debt crises in a multilateral, generalized manner, regarding this as tantamount to using debt relief as a source of development assistance. In their view, debt crises must be dealt with on a case by case basis through coordinating the efforts of the international financial institutions and private and official creditors. The only exception to this is in respect of official loans to the least developed countries where commercial bank involvement is minimal. In March 1978, an Agreement on Retroactive Terms Adjustment was reached within UNCTAD which provided for the conversion of approximately $6.2 billion of past official loans to these countries into grants.[21]

Conclusion

In conclusion, it is likely that debt crises and reschedulings will continue to be a regular feature of the international financial system and an important issue on the North-South agenda. The magnitude and persistence of such crises will be closely affected by future trends with respect to the level of economic activity in industrialized countries, in general, and to interest rates and oil prices, in particular. But regardless of the trends, there will continue to be concern over the degree to which uncontrolled lending by multinational commercial banks to developing countries has brought the world banking and financial system to the verge of collapse.

Undoubtedly, much closer cooperation between the private multinational banks and international financial institutions can be expected

[20]See generally, M J. Seiber, "Alternative Proposals for Debt Relief", in L.G. Franko and M J. Seiber (eds), *Developing Country Debt*, Chapter 9; P.B. Kenen, "Debt Relief As Development Assistance" in J Bhagwati (ed) *The New International Economic Order* (Cambridge, Mass.: MIT Press, 1977).

[21]Stephen Cohen, "Forgiving Poverty: The Political Economy of the International Debt Relief Negotiations", *International Affairs* 58 (1982), pp. 59-77

in future in order to improve the monitoring of p tial danger areas.[22] Stand-by and extended arrangements with the IMF will submit the debtor country to tough fiscal discipline and enhance the security of the multinational banks. Cofinancing with the World Bank is steadily increasing, permitting the multinational banks to benefit from the Bank's expertise in project analysis. Certainly, the private banks will continue to contribute significantly to the flow of financial resources from North to South. But it is now evident that more far reaching changes to the structure and operation of the financial and monetary order are required in order to ensure that such finance both is consistent with international financial stability and better serves the long-term interests of all developing countries.

[22]See discussion of the need for more effective international regulation of bank lending in Karin Lissakers, "Dateline Wall Street: Faustian Finance", *Foreign Policy* 51 (Summer 1983)

6 Summary and Conclusions

The focus of this essay is the North-South debate on international monetary and financial reform. Implicit is the assumption that the financial constraints faced by developing countries are, and will continue to be, a major obstacle to sustained economic development. Moreover, financial instability has been a significant source of political and social instability within developing countries and in the South as a whole. Yet there is still no integrated system of international financial cooperation for development in the sense of common objectives regarding the volume, distribution and composition of financial flows to developing countries on terms and conditions appropriate to their needs and capabilities.

The sources of external finance for developing countries remain diverse, consisting primarily of commercial loans by multinational banks, direct investment by multinational corporations, export credits, and official development assistance (bilateral foreign aid and official transfers through multilateral financial institutions). Resources supplied by the IMF and World Bank, though quantitatively small, are often critical in an absolute or catalytic sense for individual countries.

Developments in the world economy have revealed the shortcomings of the existing 'system' of financial transfers and highlighted the need to ensure sufficient finance for both balance of payments adjustment and economic development.

The prolonged recession and concomitant stagnation of world trade, plummeting commodity prices, high and volatile interest rates and high oil prices have all combined to increase the current account deficits of developing countries to staggering levels while simultaneously reducing the financial flows from traditional sources available to finance such deficits. One must note, of course, the remarkable rise in private lending by commercial banks to certain more advanced developing countries after the two oil price shocks of 1973 and 1979. However, these debtors have now accumulated unsustainable debt burdens which present a serious challenge to the stability of the financial order.

The trend toward more and more private finance has had a major impact on the shape of the existing system. But most importantly, it has highlighted the need for some form of international control and management, not only to improve the prospects for economic development in the South, but also in the interests of global financial stability.

In pressi or reforms, the South has concentrated on increasing the volume and quality of financial flows through the major multilateral institutions. With reference to the IMF, it was seen in Chapter 2 that problems arise not only from resource shortages but also from the element of conditionality attaching to the various drawings from the General Resources Account or special facilities. For the South, this conditionality represents an unjustifiable intervention in internal sovereignty, whereas for the North, which controls the IMF, conditionality is essential to ensure good economic management and careful use of the funds. Another problem with IMF finance, according to the South, is its predominantly short-term nature, whereas most developing countries are in need of longer-term balance of payments finance to permit the gradual elimination of structural deficits.

The IMF has gone some way towards meeting these criticisms of the South, particularly those raised by the Group of 24 in the Interim Committee. Access to Fund resources has been substantially expanded; longer-term finance is now available together with interest subsidies for the least developed countries; and a new set of guidelines on conditionality may presage a more sensitive approach to developing country circumstances. In addition, the Fund is making greater efforts to coordinate its activities with those of the World Bank through the medium of the joint IMF-World Bank Development Committee. It is similarly regularizing its contacts with multinational banks and providing its services as a 'financial policeman' while pressuring the banks to continue their lending to major debtor countries.

Certainly, the Fund is, directly or indirectly, involved in matters of economic development and the issue of distributional equity as between North and South. The developing countries, however, remain skeptical of the Fund's commitment in light of the industrial countries' control of the IMF. In the South's view, further restructuring is required so as to permit the implementation of such automatic redistributive mechanisms as an SDR-aid link.

The developing countries are likewise critical of the structure and operation of the World Bank. Again, a major obstacle to increased lending is the limited resources available to both the IBRD and IDA. Like the IMF, the World Bank has recently taken steps to stimulate greater resource transfers, for example, through cofinancing operations with the private banks. Also, increasing emphasis has been placed on program and structural adjustment lending, as opposed to much more limited project loans, a step which has necessitated greater coordination with the IMF. Nevertheless, the South remains convinced of the need to reduce the North's domination of the World Bank as a first step toward gearing lending operations more closely to development needs.

While inadequate external finance and the conditionality associated with existing flows have impeded economic growth and social stability in the South, and aggravated inequities between North and South,

there is little prospect of major changes in the pov structure of international multilateral financial institutions as a m s of solving these problems. The most powerful member states can be expected to protect their interests and ensure that financial flows are in accordance with their own economic and political priorities. Changing the voting structure and operational control of existing institutions, in the absence of commensurate changes in economic and financial power, or indeed creating new institutions, will not change the underlying realities of international politics. Conversely, resistance to needed changes to take account of changing political realities can only exacerbate tensions within the institutions.

The prospects for resolving the North-South controversy rest on the ability of both parties to mitigate this fundamental contradiction; to realize their common interest through the establishment of an integrated and comprehensive monetary and financial framework for orderly and equitable economic relations in an interdependent world.

Appendices

Classification of Countries

I UN and UNCTAD

Least-Developed Countries: Three basic criteria for this category were adopted by the UN in the mid-1960s: per capita GDP of $100 or less, a share of manufacturing of 10 percent or less of GDP, and a population with 20 percent or less of literate persons aged 15 years or more. The following 36 countries are at present recognized as such: Afghanistan, Bangladesh, Benin, Bhutan, Botswana, Burundi, Cape Verde, Central African Republic, Chad, Comoros, Djibouti, Equatorial Guinea, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Haiti, Laos, Lesotho, Malawi, Maldives, Mali, Nepal, Niger, Rwanda, Sao Tome and Principe, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Upper Volta, Yemen Arab Republic, Yemen Democratic Republic and Western Samoa.

The Socialist Countries of Eastern Europe comprise Albania, Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, Poland, Romania and the Soviet Union. A wider category of centrally planned economy countries would also include China, Kampuchea, Laos, Mongolia, North Korea and Vietnam.

Non-Oil Exporting Developing Countries: all countries except OECD members, OPEC members, the Socialist countries of Eastern Europe (as defined above), China, Israel and South Africa.

Oil-Importing Developing Countries: non-oil exporting developing countries as defined above, except Bolivia, Egypt, Malaysia, Mexico, Peru, Syria, Tunisia and Zaire.

II IMF and World Bank

Low-Income Developing Countries: all countries whose 1981 per capita income was less than $410.

Middle-Income Developing Countries: those developing countries with 1981 per capita income of $410 and above.

Oil-Exporting Countries: those countries whose oil exports (net of any crude oil imports) both accounted for at least two-thirds of the country's total exports and were at least 100 million barrels a year during 1978-80 — a similar, but not identical group to OPEC: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.

Non-Oil Developing Countries: all developing countries except those listed above.

Net Oil Exporters (IMF): a sub-group of non-oil deve[illegible]g countries whose members have significant production and/or exports of petroleum but are not part of the oil-exporting countries category. They are: Bahrain, Bolivia, People's Republic of the Congo, Ecuador, Egypt, Gabon, Malaysia, Mexico, Peru, Syrian Arab Republic, Trinidad and Tobago, and Tunisia.

High-Income Oil Exporters (World Bank): a group of Middle East countries which are not included in the World Bank's category of developing countries. They are: Kuwait, Libya, Saudi Arabia, Qatar, United Arab Emirates.

Oil Exporters (World Bank): comprises the IMF category of oil-exporting countries (except the high-income oil exporters) as well as the IMF's net oil exporters (except Bolivia). It also includes two countries not part of these IMF groupings, Angola and Brunei.

Industrial Countries: all OECD members (see below) except Greece, Portugal and Turkey which are regarded as 'middle-income' developing countries.

Major Exporters of Manufactures: This group is similar to, though not identical with, the OECD newly industrializing countries category (below). It comprises: Argentina, Brazil, Greece, Hong Kong, Israel, Korea, Portugal, Singapore, South Africa and Yugoslavia.

III OECD

Newly Industrializing Countries: This category is variously defined but includes countries at a relatively advanced level of economic development with a substantial and dynamic industrial sector and with close links to the international trade, finance and investment system. The OECD category of newly industrialized countries comprises Argentina, Brazil, Greece, Hong Kong, Republic of Korea, Mexico, Portugal, Singapore, Spain, Taiwan and Yugoslavia.

Non-OPEC Developing Countries: all countries except OECD members (other than Greece, Portugal, Spain and Turkey), OPEC members (other than Indonesia and Nigeria), the Socialist countries of Eastern Europe, Mongolia, North Korea and South Africa.

IV Other Groups with Defined Membership

OPEC: The Organization of Petroleum Exporting Countries comprises Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela. The Development Assistance Committee (DAC) of the OECD defines 'OPEC countries' as excluding Indonesia and Nigeria which it regards as 'low-income' and 'middle-income' respectively.

OECD: The Organisation for Economic Co-operation and Development comprises Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

Group of Ten (G-10): Belgium, Canada, France, Federal Republic of Germany, Italy, Japan, Netherlands, Sweden, United Kingdom and United States.

Group of Five (G-5): France, Federal Republic of Germany, Japan, United Kingdom and United States.

Intergovernmental Group of Twenty-four on International Monetary Affairs (G-24) comprises eight developing countries from each of Africa, Asia, and Central and South America. The countries are: Algeria, Egypt, Ethiopia, Gabon, Ghana, Ivory Coast, Nigeria, Zaire; India, Iran, Lebanon, Pakistan, Philippines, Sri Lanka, Syria, Yugoslavia; Argentina, Brazil, Colombia, Guatemala, Mexico, Peru, Trinidad and Tobago, Venezuela.

Source: Based on Commonwealth Study Group, *Towards a New Bretton Woods: Challenges for a World Financial and Trading System* (London: Commonwealth Secretariat, 1983).

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Book Reviews

MONETARY AND FINANCIAL REFORM

J. Muns (ed), *Adjustment, Conditionality and International Financing* International Monetary Fund, Washington, 1984. pp. xi + 214. No price stated.

D. M. R. Coyne, *Monetary and Financial Reform: The North–South Controversy.* North-South Institute, 1984. Ottawa. pp. v + 87. Price Can $6.

P. Mentré, *The Fund, Commercial Banks, and Member Countries.* IMF, Washington, 1984. Occasional Paper no. 26. pp. vii + 39. Price U.S.$5.

H. A. Lund, R. P. Sibert and P. K. Chamberlain, (eds.) *Private Placements National and International Markets,* Euromoney Publications, London, 1984, pp. xi + 140. No price stated.

L. de V. Wragg (ed.), *Composite Currencies,* Euromoney Publications, London, 1984. pp. vi + 162. Price U.S.$85.

The first volume is based on papers and commentaries presented at a seminar sponsored by the IMF, the Universidad Federico Santa Maria and the Central Bank of Chile. There were participants from six Latin American countries. The main papers and subsequent discussion of each were on the process of balance of payments adjustment; the IMF's conditionality in practice; the role of economy-wide prices in the adjustment process; fiscal deficits and balance of payments disequilibrium in adjustment; foreign debt; and the role of commercial banks in the adjustment process. The paper on balance of payments adjustment argued that with proper management of the asset portfolios of central banks there could be both greater exchange rate stability and a lower cost of indebtedness. In the discussion on conditionality the majority agreed that the performance of the Fund could be strengthened by widening its capital base. In the discussion of the paper on economy-wide prices, while there was general agreement on the significant negative effects which price distortions, especially in exchange and interest rates, have had on the economies of Latin America, several participants felt that the author had been too macro-economic in his approach, and that it was important to know how prices affected the different sectors of the economy and were transmitted throughout it. The paper on the role of commercial banks concluded that current circumstances require that debt should rise over the next five years by about three points below the rate of exports estimated at 10 per cent, —an annual increase over the next five years of 7 per cent in net international bank commitments to developing countries. The author considered that private banking had not been overexposed. It was agreed by all that it was essential that banks should not withdraw their confidence from Latin American and that the paper had made a positive contribution to the reasoned attainment of this objective.

Ms Coyne's book is in three parts. In the first the political framework is set out in historical perspective, from Bretton Woods through UNCTAD and OPEC to the stalemate in the north–south dialogue. The second part is concerned with the IMF and the World Bank Group and the third the private multinational banks. The thesis is familiar enough. The IMF is short of funds, it has to operate on a short term basis and despite some improvements its conditionality is too severe; it should have finance for a longer term approach, with interest subsidies

for LDCs and more sensitive conditionality guidelines; there should also be closer contacts with the World Bank and with private banks. The south resents northern control and also wants more automatic redistribution eg the SDR-aid link. The World Bank has also improved with its programme and structural adjustment lending. But its resources are limited and again subject to northern control. The resultant inevitable trend towards more private financing highlights the need for proper control, both for the sake of the south and stability. There is a need for a change of heart in the interests of both north and south.

The IMF Occasional Paper also starts from a familiar situation: the simultaneous occurrence in 1982 of high interest rates, political tensions exceptional even by current standards and debt crises in several major borrowing countries, leading to a sharp decrease in new bank lending. An increase in World Bank resources would lead to a spreading out of the graduation process; imaginative co-financing techniques between the commercial banks and the World Bank and adequate Fund resources are necessary complementary elements. Specific proposals are made. First, better assessment of market trends and the attitudes of commercial banks to borrowing countries, including a deeper analysis of capital flows, better statistics and the release of more information by governments and further examination of the Fund setting up an internal country risk assessment statistical model. Secondly a contribution to better external debt management in individual countries, involving greater attention to liquidity and technical assistance in diversifying and monitoring external debt. Constructive collaboration with commercial banks to allow better integration of private financial flows in Fund programmes, thus avoiding undue recourse to short term borrowing and complementary financing for countries re-entering the market after a phase of adjustment. And finally better handling of actual or potential debt crises, *inter alia* requiring adequate Fund involvement in rescheduling negotiations.

The two Euromoney Publications are technical, specialized and of interest to all those who are professionally engaged in the management of financial matters, not least in developing countries. They may regarded as high level handbooks. One has fifteen country chapters, and another on euromarkets, as well as a succint overview on the nature of private placements. The other has a substantial introduction on the international deposit markets and floating rates, followed by sixteen chapters on various aspects of the subject, including baskets and similar methods of currency valuation, several chapters on the actual role of SDRs and of ECUs and one on the currency as a hedging instrument. All the chapters in these volumes are contributions by experts; it is obviously impossible to do more than draw attention to them in a review of this kind. Suffice to say that if for those who are accustomed to denounce "international finance" there is nothing of interest, there is much nourishment for those who would like to understand it better and harness it as an instrument of economic development.

On the face of it three of the five books considered in this review may give the impression of "we've been here before" and this is even more true of other recent publications on the subject, not least in the media and particularly the continuing outcry about greedy American bankers who continue to make huge profits whatever happens and who are also the witting, or unwitting creatures of their government's aggressive imperialism. It is salutary to contemplate what happens to the customers of banks which do not make profits; and to recognize that despite

the exceptional strains of the last three or four years the international banking system has been flexible and professional enough to survive—without significant default or an intergovernmental "rescue operation," as gleefully predicted—or hoped for—by financial journalists and political commentators.

The North–South Institute study is a good example of the sober, well intentioned approach which characterized the Brandt reports. But most of the policies advocated which are both politically realistic and economically viable, particularly a longer-term view of adjustment involving the Fund, the World Bank and the commercial banks, making possible more flexible conditionality, are in the course of being implemented. In this context a recent exchange between Tony Killick, Director of ODI and the master-mind behind the most perceptive, empirically based and constructive criticisms of the Fund's policies, and the Editor of *Finance and Development*, is instructive. It can be seen that the Fund is in the course of doing almost everything which critics of this kind are advocating.[1]

It is also salutary to recall that the ratios of debt service charges to exports in developing countries are by no means excessive by historical standards. The ratio of long term debt to exports of non-oil developing countries in 1982 was well below the lowest ratios in 1913 (China 2.2, Japan 2.3) and a fraction of those for Australia, Latin America, South Africa and Canada, most of whom knew how to make good use of foreign borrowing, since they understood the nature of a positive rate of return and how to convert the equivalent domestic resources into foreign exchange.[2] All the pious exhortation and invective is useless unless this simple truth is understood.

There is not going to be a major recasting of the world's financial institutions, intergovernmental and private multinational, not just because those who have the substantial control thereof—a widening circle—will not agree; but also because it is in no one's interest to do so. There will continue to be gradual reforms and four of the books considered here are a valuable contribution to this process. But one problem is not specifically addressed—the special plight of the very poor countries, who require special measures and techniques, as well as a more generous and realistic attitude by the United States administration.

A. F. Ewing

Canadian Book Review Annual

Framework. Toronto: James Lorimer, 1984. Published in association with the Canadian Institute for Economic Policy. 114p. illus. (chart). $16.95; $7.95pa. ISBN 0-88862-708-4; 0-88862-707-6pa.

To tame the lion of inflation was considered, during the past four years, the primary emphasis of government economic policy. Now that inflation has been brought down in Canada to around four per cent, the expected benefits of lower unemployment and interest rates have not come to pass. This treatise by John Cornwall, a professor of economics at Dalhousie University, and Wendy Maclean, an assistant professor of economics at Mount Saint Vincent University in Halifax, is concerned with why the lower inflation rate did not bring the hoped-for results and with the framework for recovery.

The proposed plan for recovery is four-fold: a tax-based incomes policy to control inflation; a stimulation of the economy to achieve full employment; an industrial strategy that concentrates on innovative rather than cost-cutting investment; and measures to accelerate productivity growth, drawing on the Japanese style of management. These general statements are supported with numerous statistics, graphs, and bibliographic notes for further reading.

Some of the statements will surprise the readers, such as "the State must more actively intervene in the economic affairs of the country" (p.3). This plea will go unheeded in Canada, where the popular slogan is for less government intervention (followed by the weasel words "free enterprise") as the answer to all our problems. Huge budget deficits are not considered alarming because "any attempt to reduce the size of the deficit (in order to bring interest rates down) will depress economic conditions even further, causing more unemployment." The former Liberal Government will be pleased to know that "the large deficits today are the result of depressed economic conditions, to a large extent induced by the Bank of Canada's ...high interest rate policies of the recent past" (p.69). And the new Conservative government (Sept. 1984) either has not heard of this book or certainly has not heeded it. Certainly the Canadian Institute for Economic Policy, although it is located a stone's throw from the Parliament Buildings, doesn't have an influence commensurate with its proximity.

Kenneth M. Glazier

4138 Coyne, Deborah M.R. **Monetary and Financial Reform: The North-South Controversy.** Ottawa: North-South Institute, 1984. 87p. bibliog. $6.00pa. ISBN 0-920494-40-4pa.

Pierre Trudeau brought the words "North-South dialogue" into our vocabulary and concerns by his travels and speeches on the relations between industrialized and developing countries. This work by Deborah M.R. Coyne, based on the author's thesis for a M. Phil. degree at Oxford, is published by the North-South Institute in Ottawa because of their interest in the research material in this area.

The primary emphasis is on the financial problems of the poorer countries of the world and their need for substantial sums of money from the international banks, the International Monetary Fund and the World Bank Group. Because of the default in repayments on the enormous sums loaned to the Third World countries, the multinational banks have suffered staggering losses, which in turn has influenced their performance in Canada, in Britain, and on the Continent. There is also the realization that very few, if any, of these debts will ever be repaid. This critical situation has prompted the developing countries to demand major reforms in the world's monetary and financial system.

This study, intended mainly for the non-specialist, is a scholarly work setting forth, with the use of statistics and extensive bibliography, the background to the present situation and offering some proposals for debt relief. The work is primarily an academic paper on how the banks and the developing countries got into the present position. No panaceas are offered for this world-wide and threatening problem.

Kenneth M. Glazier

4139 **The Current Industrial Relations Scene in Canada 1984.** W.D. Wood and Pradeep Kumar, eds. Kingston, Ont.: Industrial Relations Centre, Queen's University, 1984. 591p. illus. (charts). bibliog. index. $50.00pa. ISBN 0-88886-122-2pa. ISSN 0318-952X.

The 1981 edition of this annual was reviewed in CBRA 1981 (entry 4181). This annual survey identifies the key emerging industrial relations patterns and issues, along with the complex environment shaping them. The seven major sections, each completed by charts and tables of statistics, plus a summary, include: the economy (with special data on the recent economic recession and recovery); human resources (with special data on labour markets); labour legislation and policy; labour movements; collective bargaining (including the American scene); wages and productivity; and a reference section, which contains technical notes and data sources (government documents of