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been pumped into a LDC in the past, the better would be its present and future position in regard to new aid, for it would be the case that creditor countries themselves would, in some way, have to finance repayments and interests due to them, and additionally a margin which would then count as net aid. It can easily be shown that such an arrangement would destroy every kind of control over whether imported funds are being invested sensibly or not, because no genuine repayment from earned profits would ever be made. If the authorities of the debtor country tried to add to debt servicing the flight of local capital, the result

would grow even more disastrous — for, as is well known, there are authorities who assert that this capital outflow, e.g. from South America, is at least as large as the imports of capital which enter debtor countries in the opposite direction.

In this context it is clear that such requests have not a chance to be met with, and they should not have one. Should any creditor agree to such a scheme, it would be an open invitation to use new and incoming funds without discrimination and to contract as many debts as humanly possible. Efficient capital aid would thus be made even more difficult than it actually is.

Dollar Overhang and Development Assistance

by Professor George J. Viksnins, Washington, D.C. *

Although according to the media, the theme for last fall's meeting of the International Monetary Fund and World Bank Group was all "sweetness and light", the February dollar crisis demonstrated the instability of the international monetary system. Now is the time for technicians to do the difficult task to work out the basic reform principles — giving dates, amounts, and other specifics.

Since President Nixon's August 1971 step to suspend the gold convertibility of the dollar, and its subsequent devaluation, we have seen the development of a love-hate situation. On the one hand, Europeans complain about having to hold dollars against their will. This so-called "dollar overhang" can be variously estimated, but as of the end of June, 1972, U.S. liabilities to foreign official institutions and short-term liabilities to "other foreigners" added up to \$ 74 bn.

These liabilities take the form of deposits in U.S. banks, Treasury bills, and other assets owned by foreign holders. Of this amount, \$ 54.6 bn was owed to official institutions, mainly central banks in Western Europe and Japan. These statistics represent an enormous increase over the end of 1970, for example, when the total short-term indebtedness of the U.S. stood at \$ 47 bn (and only \$ 23.8 bn was owed to official institutions). Even if one feels that the dollar balances held by central banks at the end of 1970 were roughly "normal", i.e., actual dollar holdings were equal to desired dollar holdings, the very large buildup of 1971–72 is surely excessive. Actually, foreign central banks

have been complaining about having to hold unwanted dollars for longer than most people care to remember. Thus, \$ 30–40 bn in central bank holdings is probably a reasonable estimate of the size of the dollar overhang. And besides the central bank dollar holdings, there may exist a fairly large private demand for dollar balances, currently low due to fears about their future, that may serve to reduce the official overhang.

The "Dollar Overhang Problem"

On the other hand, foreign governments resist suggestions that they get rid of these unwanted dollar balances by using the normal channels of trade and investment. Although this may be short-sighted from a long-run economic point of view, it is understandable that any foreign government would resist a sudden large increase in imports from the U.S. As a ridiculous example, Germany could close down Volkswagen and use their unwanted dollars to buy Vegas. The income and employment effects of such a move would quite possibly have serious political repercussions. Of course, it is expected that the effects of the dollar devaluation and the revaluation of the strong currencies will lead to an increase in U.S. exports in future. As is pointed out by the 1972 *Annual*

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Report of the IMF, "... not before 1973 can the equilibrating influence of the realignment make itself strongly evident, and its full impact will probably not be apparent until even later."

During 1972, the impact of the realignment has probably been perverse — before the volume of U.S. exports and imports changes significantly, the effect of the exchange rate modification is to raise U.S. import prices. For example, at the end of 1970 DM 100 of imports from Germany would show up as a debit item of \$27.42 in the U.S. balance of payments; at the end of August 1972 the same amount would cost \$31.38. In the near future, however, some of the "overhang" may be absorbed by an expansion of U.S. exports, particularly if American inflation lags behind that of its major trading partners (as currently seems to be the case). Yet, this sort of a change is not likely to take up the bulk of the unwanted dollar balances very quickly. The other avenue for a "sopping up" of these dollar holdings through normal commercial channels would be an expansion in foreign long-term investment, which would undoubtedly be favored by Wall Street. Unfortunately (and in a few cases inexplicably), most foreign countries restrict the outflow of capital even more severely than the inflow. Most outward transfers require prior authorization and may be subject to value ceilings or differential exchange rates, or both. A strong expansion in the U.S. stock market, a cyclical rise in interest rates, and a relaxation of foreign regulations in this area would probably lead to a return flow of dollars. However, long-term investment by foreigners would probably not eradicate the overhang problem in the near future.

Short-term Solution Necessary

The time element is important here. Undoubtedly, there are long-run balancing forces at work, but as John Maynard Keynes said: "In the long run, we're all dead." The dollar overhang will continue to be a major destabilizing force — as that amount of money sloshes about from this central bank to that, it cannot be otherwise. Surplus countries wishing to minimize capital inflows will resort to various controls and restrictions, as will deficit countries wishing to hang on onto foreign exchange. In the end, what suffers is the guiding principle of the Bretton Woods System, free multi-lateral trade and payments.

In his September 26, 1972, speech before the Bank-Fund governors and participants, Treasury Secretary George Shultz suggested that "... careful study should be given to proposals for exchanging part of existing reserve currency holdings into a special issue of SDR, at the option of

the holder." Since Secretary Shultz's blueprint was presented, administration officials (notably Paul Volcker and Marina Whitman) have stressed that the set of proposals should be treated as an organic whole, not as a "smorgasboard of ideas".

The issue of providing international liquidity and avoiding speculative reserve shifts is sufficiently central to deserve special attention. World trade, both total exports and imports in value terms, has grown at an annual rate of 9.5 p.c. over the 1960 to 70 period. Total world reserves, as defined by the IMF, have grown by only a 4.1 p.c. yearly rate over this same period. In 1971, there was a total jump of more than 30 p.c. in the reserve total primarily due to the U.S. balance of payments deficit. The central problem with the world's reserves is that growth is quite uneven and may be inadequate. A closely related problem is the possibility of shifting preferences for gold, SDRs and other balances at the IMF, and the various convertible currencies. There is a general agreement that future additions to world liquidity should take the form of further creation of SDRs. (It is interesting to note in passing that for the first time the 1972 *Annual Report* of the IMF uses the SDRs instead of the dollar as the unit of account in its statistical tables.) At the present time, however, SDRs constitute only about 9 bn out of total world reserves of roughly 120 bn SDRs.

New Proposal for SDRs' Issue

As SDRs achieve general acceptance, as appears to be the case, it is possible to consider modifications in the method of their issue. At the present time, they are simply grants to IMF members. These grants are based on members' IMF quotas, which in turn were based on the country's GNPs — and the rich get richer. I propose that international monetary reform and development assistance be linked. The essence of this proposal is not new, being a descendant of the Stamp Plan, the Triffin Plan, and even the Keynes Plan, but some of the details may be worthy of further consideration. It is proposed that the IMF issue 20 bn SDRs in medium-term bonds of varying maturities from 5 to 10 years. They would offer an attractive rate of return, say 6–10 p.c. per year, payable in SDRs. This is not to say that central banks make their decisions solely on the basis of the profit motive, but a competitive interest rate would increase the attractiveness of SDRs relative to other forms of reserve holdings. Central banks subscribing to this bond issue would be permitted to make payment to the IMF only in gold or in dollars. The U.S. would be permitted to subscribe only in gold value at the official price of 35 SDRs or \$38 per ounce. Gold newly received by the IMF would be

sold on the open market whenever its price exceeded the 35 SDRs per ounce, which is its official parity (this would focus public attention on the superiority of SDRs holdings vis-à-vis gold or dollar balances). Since at the present time the open market gold price is rather substantially above its official price, there is the possibility of a modest profit being made by the IMF, at least for the short run. It is doubtful that the private gold market could absorb an IMF sale of a billion or two over the next couple of years without a sharp price break; any significant decline in the price of gold below the levels recently reached would probably lead to a cumulative sell-off.

Utilization of Funds

The amount raised by the SDRs-bond issue would mostly be in dollars, though small amounts of other convertible currencies could be gained through gold sales on the open market. The IMF could utilize these funds in a number of ways. The first possibility is a direct purchase of World Bank bonds and participation certificates in the International Development Association. At the present time, however, their joint size is only about \$ 15 bn. There would undoubtedly be some "absorptive capacity" problems for both institutions, if a large sum of money were to become available in a short period of time. If they were to utilize about \$ 2 bn per year over the next five years or so, their net lending would roughly be doubled.

IBRD bonds have recently yielded about 6.5–8.5 p.c., which would mean that the IMF might need to subsidize the interest yield on its SDRs-bonds to some extent. This subsidy could be financed in a number of ways — profits from gold sales (if any), interest income on member SDR drawings from the Fund, a proportional charge to all members, compensatory payments levied on surplus countries, or some combination of these. It is important to note here that an expansion of World Bank–IDA dollar loans would greatly increase the scope of *multilateral* development assistance, which has been generally favored, but in principle only. It would also make it more possible to meet during the 1970s the generally accepted target of a 1 p.c. GNP resource transfer from the developed to the underdeveloped world, which now appears to be out of the question.

Another possible use for the dollar balances gained by the IMF would be investment in the regional developed banks, such as the Inter-American Development Bank, the Asian Development Bank and the like. One would expect that these two investment avenues would not absorb all of the dollars generated. Therefore I propose that the remainder be invested in a special issue of U.S. Treasury

obligations which would be denominated in SDRs and carry an identical interest rate to the IMF bond. To the extent that the U.S. had acquired these IMF bonds by using its gold holdings, there would be a direct offset. At the limit, the U.S. could turn over its \$ 10 bn in gold to the IMF — and let the Fund worry about its ultimate meaning and significance in the international system.

Advantages of Proposal

The advantages of this proposal should be obvious. The use of the proceeds of a "one-shot" SDR-bond issue mainly for development assistance would reverse the downtrend in official resource transfer and emphasize multilateral decision-making. This gets around the customary objection to distributing newly-created "money-SDRs" chiefly to the developing countries, as was proposed years ago. The objection has been that this procedure would somehow affect the acceptability of this form of international money. Second, the distribution of dollars to less developed countries through official assistance institutions would probably lead to an improvement in the U.S. balance of payments, but not through a sharp reduction in the trade balance of any single trading partner. Specifically, neither Germany nor Japan would have to make a conscious effort to "buy American".

Third, the varying maturities of the SDRs-bonds would ensure the creation of additional international liquidity in the near future as the bonds would be repaid five to ten years from now. Fourth, the IMF sales of newly acquired gold, whenever it is "profitable" to do so, would eventually convince potential official speculators (say the Bank of France) of the superiority of holding SDRs (and in particular interest-yielding SDRs-bonds) to the barbaric practice of hoarding gold. As mentioned earlier, a sharp decline in the price of gold might well result. This would have the additional advantage of educating private speculators, not only French peasants and the good "burghers" of Switzerland, but also the oilmen of the Middle East, Indian princes and Meo tribesmen. This unproductive use of savings in the less developed world would be discouraged, if gold really became just another commodity, and this would give an opportunity to the government of the country in question to mobilize these savings. Whether such an opportunity would be wisely handled is another matter, of course. Finally, this proposal would rid the system of the dollar overhang problem and establish the SDRs as the unit of account and the basic reserve unit. The dollar would become one of many convertible currencies, whose values can fluctuate in the market vis-à-vis the SDRs and in terms of other currencies.