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Monetary Policy

LDCs and World Monetary Reform

by Professor Karl-Heinz Sohn, Bonn *

A link between the creation of Special Drawing Rights and the financing of development aid is under discussion in order to meet the developing countries' demands for an adequate supply with international liquidity. This article expounds critically a number of objections raised against this concept.

The less developed countries (LDCs) have no less an interest in the stability of the international monetary order than the industrialised nations. They have suffered considerable losses as an outcome of the various measures which have been taken in recent time. Insofar as they have to settle accounts in DM or yen, they must surrender a proportionately larger amount of other currencies; insofar as their debts are expressed in US dollars, the repayments of most LDCs were not affected because their currencies were devalued in line with the dollar. Their dollar holdings, on the other hand, depreciated in terms of the currencies against which the US dollar was devalued. In monetary policy as in other spheres the LDCs are less "sovereign" than most of the industrialised countries.

Until UNCTAD III the developing countries were in the main excluded from discussions about the world monetary system. Only after the Committee of Twenty had been set up by the Board of Governors were the LDCs allowed a share in these discussions.

Although unquestionably any progress in the reform of the world monetary system depends essentially on a small number of stability-minded IMF member countries, the Federal Republic in particular should avoid giving the impression of keeping the LDCs wittingly away from the preparations in the Committee of Twenty. By giving this impression it would squander the high esteem which it enjoys in the Third World and invite a critical appraisal similar to that of the USA after the last war.

The Committee of Twenty will only have an advisory function; the decisions will be made by the Board of Governors. The LDCs are holding 28 p.c. of the voting power in the IMF. Considering the growing importance of the developing countries the other Fund members ought to concede a lar-

ger participation in the Fund and thus a correspondingly larger vote to the LDCs. In this way the developing countries would also be enabled to bring influence to bear on the two-thirds voting majority which the IMF Articles of Agreement require for decisions by the Board of Governors¹.

Additional SDR's for Developing Countries

If the LDCs are allowed a greater share in discussions on the reform of the monetary system and in the Fund itself, their participation ought not to be of a purely formal nature. The developing countries are known to be interested in making more use of the unevenly distributed international purchasing power for financing their foreign currency requirements. In line with a number of industrial countries they are demanding a link between the future (new) facility of Special Drawing Rights as the predominating reserve unit and an additional SDR allocation to finance their development.

It will be remembered that these plans are based on five models for the "real transfer" of SDR's to benefit the developing countries:

☐ Direct link: a portion of any SDR allocation to the industrialised countries to be transferred directly to the IDA;

☐ Indirect link: the industrialised countries to pay to the IDA contributions proportionate to their SDR allocations in their national currencies;

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¹ In this connection reference may be made to the suggestion by the then Federal Ministry of Economics and Finance that in the context of the reform of the monetary system more consideration should be given to the developing countries' need for liquidity by altering the quota distribution in the Fund in favour of the developing countries so as to give them not only a larger proportion of the Special Drawing Rights but at the same time larger contingent drawing rights and thereby greater voting power. Cf. Eckhard Pieske, "Gold, Devisen, Sonderziehungsrechte" (Gold, Foreign Currencies, Special Drawing Rights), Publications of the Federal Ministry of Finance, 3rd edition, September 1972, p. 45.

- ☐ Allocation of SDR's to the IDA in excess of the quotas;
- ☐ Larger quotas for developing countries;
- ☐ "Link in the Fund".

It must be recalled that because of the close connection between the Special Drawing Rights and the IMF quotas and the requirement to settle balances in a short time, the current SDR system has been operating mainly in favour of the industrialised countries (above all, the USA), even though in percentage terms the rise in currency reserves resulting from the allocations was larger in the developing countries.

A Greater Inflation Risk?

An argument put forward time and again against any kind of connecting link between Special Drawing Rights and additional development finance is that it creates an inflation hazard. It prompts the following comments:

- ☐ The importation of inflation over recent years must be unequivocally attributed to excessive creation of dollars. Of the growth of world reserves from \$ 75.4 bn at the end of 1969 to \$ 121.3 bn at the end of 1971, i.e. by \$ 45.9 bn (61 p.c.), \$ 43.4 bn, i.e. 94 p.c. of the increase of the reserves, was in the form of foreign currencies (especially US dollars). The creation of SDR's amounted to \$ 5.9 bn (13 p.c. of the increase). (The two items add up to more than 100 p.c. because other reserve assets, especially gold, diminished.) Put differently, the reserves in foreign currencies rose by seven times the increase in SDR's. (Cf. the annual report of the IMF for 1972.)
- ☐ All decisions on the creation of SDR's are made by the IMF; 85 p.c. of the total vote is needed for a decision. The EC of the Six had 17.5 p.c. of the total vote; the enlarged Community holds as much as 27.8 p.c., the USA 20.96 p.c., and Japan 3.82 p.c. The EC and the USA thus both possess blocking votes. There is virtually no risk of SDR's being created against their wishes. Even if a "link" is established, the IMF will still be able to act as responsibly in regard to the creation of SDR's as now. The so-called "confidence argument" of the opponents of the

"link" ignores that for the mentioned reason the IMF is in a position to control the volume of liquidity. In view of the distribution of voting strength in the IMF there is therefore no great danger of decisions on allocations no longer being made in accordance with the criterion of global reserve requirements but solely from the point of view of development aid, and this will still be so when the developing countries have been given increased voting rights. The establishment of the "link", it may be assumed, would be one more reason for circumspection in the creation of SDR's when these have become the principal reserve asset. On the industrialised countries this would have the indirect effect of inclining them towards rather more painful methods of restoring the balance of payments in preference to recourse to additional SDR's.

- ☐ For the 1973-74 period the creation of SDR 3 bn (1 bn in 1973, 2 bn in 1974) is envisaged. Of these about 2 bn will go to industrialised countries. If, as discussed, between 25 and 75 p.c. were used by way of the "link", about SDR 0.25 bn or 0.75 bn a year would be available for developing countries. The total exports of the industrialised countries in 1971 amounted to \$ 232 bn and those of the Federal Republic of Germany alone to \$ 38.9 bn. If the SDR's, as is to be assumed, were used to finance imports of goods from industrial countries, the exports of the latter could not increase by more than about 0.1 or 0.3 p.c. a year on average. (Demand impulses of less than about 2 p.c. are of no relevance for the economic trend.) On the theoretical assumption that the whole of the import pull by all the LDCs resulting from the "link" were concentrated on the Federal Republic, the annual increase in exports entailed would still be no more than 0.65 or 1.9 p.c., respectively. From this follows that the inflation argument (world money through money creation without a savings or sterilisation effect in industrial countries) is quantitatively irrelevant. Besides, when this argument is advanced it is always implied that the demand will be concentrated entirely on the surplus countries which are threatened by inflation. It is mostly forgotten that the currents of demand may well flow to countries in deficit (traditional trading contacts, quality,

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etc.), and these countries would actually be helped to equilibrate their balances of payments.

The following considerations also apply: In recent years the Federal Republic has as a rule achieved a large surplus in its trade with industrialised countries. In 1972 alone it amounted to about DM 17 bn (leaving the eastern trade out of account). The balance of trade with developing countries (as defined for UN statistics), on the other hand, was always slightly in deficit. In 1971 the exports of the Federal Republic to Africa, Asia and Latin America amounted to about DM 16.9 bn while imports from these continents totalled about DM 19.4 bn. Even if the imports of mineral oils are excluded, the trade between the Federal Republic and the LDCs is still roughly in balance.

Deficit in Trade with Developing Countries

As long as there were fixed exchange rates, the German Bundesbank was of course under an obligation to exchange into DM the foreign currencies which were received in payment for exports. The currency holdings of the Bundesbank, especially its US dollars, originated in the main from foreign trade surpluses and capital inflows. The Federal Republic is unlikely ever to succeed in presenting the foreign currencies accruing from trade surpluses, which are essentially claims on the social products of other countries, in the markets of the latter and importing goods for them.

Foreign Trade of the FRG with Developing Countries *

(Producer and Consumer Countries)
(in billion DM)

Year	incl. oil producers ¹			excl. oil producers ¹		
	Ex-ports	Im-ports	Bal-ance ²	Ex-ports	Im-ports	Bal-ance ²
1960	9.0	9.5	— 0.5	7.2	6.8	+ 0.4
1961	9.1	9.4	— 0.3	7.3	6.6	+ 0.7
1962	8.2	10.2	— 2.0	6.7	7.0	— 0.3
1963	8.4	10.6	— 2.2	6.8	7.3	— 0.5
1964	9.2	12.0	— 2.8	7.4	7.9	— 0.5
1965	10.3	13.5	— 3.2	8.1	9.1	— 1.0
1966	11.2	14.1	— 2.9	8.6	9.4	— 0.8
1967	11.7	13.7	— 2.0	9.0	8.8	+ 0.2
1968	12.9	15.6	— 2.7	9.8	9.7	+ 0.1
1969	14.0	17.0	— 3.0	10.7	10.9	— 0.2
1970	14.9	17.7	— 2.8	11.5	11.4	+ 0.1
1971	16.3	19.1	— 2.8	12.4	11.1	+ 1.3
1972	17.0	19.6	— 2.6	12.5	11.9	+ 0.6

* as defined by the UN.

¹ OPEC countries (Iraq, Iran, Kuwait, Saudi Arabia, Venezuela, Qatar, Libya, Indonesia, Abu Dhabi, Algeria, Nigeria).

² Import (—) or export (+) surplus of the FRG.

While it is true that the Federal Republic needs surpluses in trade and industry to offset other items of the basic balance, it is questionable whether these must be derived from a consistent surplus on the balance of trade with highly developed countries, i.e. by exchanging real goods

for claims of relatively little value on these countries.

It is certainly a fact that by concentrating the real transfer of parts of its social product exclusively on the industrialised countries the Federal Republic has made a contribution to their growth and standard of living while the reverse has happened in regard to the developing countries: more goods have been imported from the latter, with the result that there was no real transfer from the Federal Republic to the benefit of the LDCs. One could certainly conceive a situation in which the Federal Republic was consistently showing a large surplus in trade with the developing countries which would be credited to them and thereby plainly show that more goods have been exported to the LDCs than were imported from them. In the final analysis it makes no difference whether US dollars depreciating in value or claims on developing countries and/or SDR's appear in the German balance of payments as the set-off for exports of real capital. The public development aid rendered is, incidentally, here already taken into account. Not even the exports to developing countries which were financed out of German capital aid were capable of eliminating the deficit in trade with the Third World.

Earnest consideration should be given to the question whether the LDCs should not be given the chance, which has thus far been reserved for the rich countries, of importing more from the Federal Republic than they export to it. This could be done by giving them far more generous credits than hitherto. If the demand were to grow excessively, the Central Bank or Government could take counter-action by using the instruments of economic policy at their disposal. In this respect the "link" does not pose any problems materially different from those usually encountered in economic policy.

Liquidity Function

The objection that linking SDR's with development aid would raise doubts about the liquidity function of this reserve asset is also invalid. With such a link the SDR's, wherever they accumulate, can still be employed as currency reserves (for settling payments balances). Besides, it is the currency reserves in their entirety which perform the liquidity function.

If SDR's are taken over by the IDA and passed on to the group of least developed countries, they could exercise their real transfer function without detriment to their liquidity function because, apart from any other factor, this transfer could be controlled by an institution which forms part of the World Bank system. It would therefore take place within the perimeter of the liquidity position

at the time although allowance would be made for priorities of development policy.

Just a word about the "Link in the Fund": the basic idea here is to transfer a portion of the quotas of the industrialised countries in the IMF General Account and use it to finance certain stabilisation programmes of the developing countries. The intention is evidently to give balance of payments assistance so as to help the developing countries to cope with acute difficulties. The problems inherent in a "link in the Fund" are first, that other than development priorities would determine the recourse to and use of SDR's by way of the General Account, and secondly, that a new institution for quasi-development tasks would be created beside the World Bank and IDA.

The Problems of a "Link in the Fund"

The approach of the German delegation at the Third World Trade Conference was much more flexible than the very restrictive attitude adopted of late by the Federal Ministry of Finance. The head of the German delegation at the time said that SDR's must not be used for the creation of excessive liquidity, but he added that the Federal Republic was willing to meet the interests of the developing countries by granting them larger quotas at the expense of its own quota. His words were: "My Government is willing to take this consequence upon itself."

The inflation argument in particular carries no conviction since the acute world-wide inflation problems bear no relation to negative experiences with the current and still less with the future SDR facility. This is true even if due allowance is made for the majority conditions in the Fund as they are now and as they will be after the LDCs have been given a greater share in the decisions of the Fund.

It is worth noting incidentally that Triffin, who in his book on "Gold and the Dollar Crisis" (published in 1960) urged that the Fund be authorised to buy and sell international currencies (including long-term paper and gold) in the financial markets by means of SDR's, was one of the first writers to call for a link between Special Drawing Rights of the future type and long-term transactions. Triffin at that time was equally unequivocal in his opposition to the "link in the Fund" — i.e. direct granting of long-term credits to ultimate borrowers. This task he assigned to the competent institutions (the World Bank).

Prospects for the Future

To sum up, the case for special consideration for the interests of the LDCs in the creation of

Special Drawing Rights by means of the "link" need not be turned down on grounds of stabilisation policy. It would be a successful move from the point of view of foreign and development policy. Of the alternatives mentioned the first three are to be preferred. If quantitative limits are set and the decisions on the use of the moneys are left entirely to the IDA, there would be every conceivable safeguard against abuse of this combination of Special Drawing Rights and development aid finance.

It seems that the increasing public aid and the — admittedly fast rising — World Bank credits alone will not suffice to cover the foreign currency requirements of the developing countries over the next few years. Even private investment will not be quite sufficient to plug the gap. The fast growth of the indebtedness of the developing countries must be expected to give rise to more and more crises against which such debt rescheduling as has thus far been carried out will not avail. This is another reason why, as long as public budgets are not drawn upon to a much greater extent, the creation of SDR's will inevitably have at least in part to be coupled with development finance.

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