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## Why a new International Development Organisation is needed

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China will hardly be able to develop the transport and communications sector through use of her own resources sufficiently to sustain the modernization of the economy which is after all characterized by a marked regional and operational specialization and correspondingly high transport and communications requirements. Even now the current production and many investment projects are far too often impaired by a shortage of transport capacities. How underdeveloped the transport system is as a whole can be judged from the fact that the railway network which has to provide substantially more than half of all transport services is little more than 50 000 kilometres long.

For comparison, the Federal Republic of Germany has about 30 000 km of railway lines and Japan about 40 000 km. China will want railway engines, signal systems, trucks, ships and quay installations to modernize and extend her transport and communications system.

To take over technical solutions from the outside world or use Western examples for guidance was denounced in China for a long time as "adulation" of foreign countries or as "lumbering behind". The West could never be overtaken by emulating its concepts, it was thought. While laborious attempts were made to copy Western solutions, the Western countries were getting farther ahead. But now it is pointed out that Japan has achieved a leading role in the world economy by adopting Western technologies in the initial phase of her industrialization. For a long time certain groups in the Chinese leadership were, besides, convinced that Western concepts could not be made to serve Chinese needs and the objectives of the building of socialism in particular. They denied the existence of "compelling technical factors" and sought alternatives based on China's own resources. This made China for many a development model. It remains to be seen whether China can still preserve free scope for alternative solutions as her development advances.

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#### DEVELOPMENT FINANCING

## Why a New International Development Organisation is Needed

by Graham Bird, Guildford\*

**The present arrangements for providing developing countries, and in particular the least developed countries, with international finance are inadequate in both quantitative and qualitative terms. Fundamental changes seem necessary. These changes might incorporate the establishment of a new International Development Organisation (IDO). Such an organisation could be financed in a way which does not conflict with the current consensus on international monetary reform.**

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Developing countries may gain access to international finance through a number of channels. These include: long term capital direct from other countries; short term finance from the Eurocurrency market; loans from the World Bank or International Development Association or various regional development banks; or short to medium term finance from the International Monetary Fund.

However existing arrangements have, over recent years, exhibited a number of shortcomings. Crucial amongst these are: first the specific project orientation of the clear majority of long term finance and the degree of conditionality attached to short term finance from the IMF; second the inability to deal with the particular problems faced by the least developed countries which find it difficult if not impossible to attract private finance and therefore have to rely more heavily on institutional assistance which, as the first

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point suggests, may itself involve associated problems; third, the problem of debt financing where a growing proportion of export receipts and new loans have to be directed towards financing and re-financing existing loans; fourth, the deficiencies associated with private finance in terms of its geographical concentration, its uncertain availability, and its shortening maturity structure; and fifth, the inadequacies of current schemes to compensate for shortfalls in export receipts in terms of the low proportion of actual shortfalls for which compensation is available, the relatively short repayment period, and the specific concentration on exports rather than the availability of foreign exchange in general which may equally well be influenced by cyclical upturns in import payments caused by external price increases.

There is little doubt that within the existing institutional structure a number of these problems may be alleviated. For example the Compensatory Financing Facility in the IMF could be liberalised to make good some of its shortcomings. But it would seem unlikely that all of the problems mentioned above could be so conveniently remedied given the terms of reference and historical experience of existing international agencies.

### **Priority for Least Developed Countries**

A new International Development Organisation (IDO) would have as its major responsibilities first the provision of largely general purpose aid to the least developed countries which find it most difficult to attract financial assistance through other agencies or private capital and credit markets; and second the provision of assistance with debt financing, particularly for those countries unable to roll over and refinance existing debt. By standing by to guarantee repayment the IDO could also encourage private banks to lend to those developing countries which had previously been assessed as uncreditworthy. A grant element within the context of private loans could be provided by means of the IDO subsidising the rate of interest paid. Further assistance could be provided by financing the cancellation of accumulated debt.

One of the reasons that existing agencies are not in a position to perform these functions is that they are largely or exclusively financed through contributions. This implies a need either to maintain a constant turnover of funds or continually to seek new contributions. Either way limits are imposed on the extent to which lending may be concessionary and free from conditions.

Though the IDO is not envisaged as exclusively granting free gifts it would require refinancing. The problems experienced by other aid agencies in terms of replenishing their funds lead us to examine alternative ways of financing of IDO. The finance could be provided through the creation of SDRs. This would effectively introduce a link between the creation of international liquidity and the provision of aid. The aid in this instance would be multilateral and would not be subject to the vagaries that beset schemes based on contributions. Aid under an SDR financed scheme would be of a high quality since it would be concessionary, largely unconditional, and untied. The proposed link between SDRs and aid based on an IDO would differ from versions of the link which incorporate direct country allocations and reflect existing IMF quotas in terms of the implied distribution of the aid amongst LDCs. Under the IDO scheme a larger proportion of SDR aid would go to the poorest countries in the world.

### **A New Type of Link**

A common criticism of SDR aid link schemes is that the provision of aid embedded within them depends critically on the adequacy of international liquidity; aid will tend to dry up when extra international liquidity is not required, or if the link is operated irrespective of the needs of the international monetary system inflation will be exacerbated and the SDR downgraded as an international reserve asset. These are valid causes for concern which have to be taken into account. Fortunately it does seem possible to deal with them satisfactorily. The current consensus on international monetary reform is moving in the direction of having the SDR as the principal reserve asset within the system; this in turn implies the substitution of foreign exchange by SDRs and the eventual demonetization of gold. It is within the context of such reforms that an SDR-financed IDO might operate.

As part of a move towards an SDR-based system, official holdings of reserve currencies could be deposited with the IMF in exchange for a special issue of SDRs. In addition to paying interest on this funded debt, reserve-currency countries could then be requested to amortise the debt over time by transferring either allocated or earned SDRs to the IMF. The process of cancelling reserve-currency balances with the IMF would imply a steady reduction in the total quantity of reserve assets in the international monetary system to the value of the SDRs transferred to the IMF by the reserve-currency

countries. This destruction of SDRs could be counterbalanced by the operation of an IDO-based SDR aid link. The unrequited export surpluses required by the reserve-currency countries in order to acquire SDRs could be channelled to LDCs in the form of imports by means of the IMF's issuing to the IDO a special allocation of SDRs equal to the annual amortisation obligations of the reserve-currency countries. By creating SDRs equivalent to the amortisation obligations of the reserve-currency countries the IMF could both prevent the decline in international liquidity that would otherwise take place, and ensure that an aid link would be operative even in years when there was no general allocation of SDRs.

### **Finance Through Gold Demonetization**

The flow of funds to LDCs might also be enhanced through gold demonetization. In 1976 the IMF made certain changes with regard to its policy on gold. First it abandoned the official price for gold. Second it removed the obligation on members to pay a proportion of their subscription in gold. Third it decided to dispose of one third of its gold stock; in part by selling gold at auction with a view to using the profits (i. e. the difference between the official price and the price received at auction) to the benefit of developing countries through the intermediation of a Trust Fund, and in part by restituting gold to IMF members.

Although LDCs have clearly benefitted from the existence of the Trust Fund the IMF's decision to move away from gold has in fact conferred far greater benefits on industrial countries. These benefits have arisen from the capital gain that purchasers and holders of gold have made as the market price of gold has increased. LDCs have not tended to be major purchasers of gold at auction, have had little gold restituted to them and do not hold a significant proportion of their reserves in the form of gold, and have therefore not benefitted from this price appreciation.

It seems relevant to enquire as to whether gold policy could be modified in such a way as to direct more benefits and a larger proportion of benefits towards developing countries. In theory a number of schemes are possible. One would entail viewing byegones as byegones and would involve selling the remainder of the IMF's gold stock on the private market using the profits for the sole benefit of LDCs. Another would involve an attempt to cancel out and recoup at least a proportion of the capital gains that developed countries have enjoyed as a direct result of the IMF's

earlier policy on gold. At root the scheme would reverse current gold policy and would operate initially to concentrate gold in the hands of the IMF as opposed to national central banks. The scheme would embody a gold substitution account. Members of the IMF would be required to deposit their holdings of gold with the IMF in exchange for SDRs, receiving a price below the market price but above the old official price. Payment would however be made on an instalment basis with members receiving only the first instalment immediately upon substitution. The IMF which would over time acquire all the monetary gold within the international monetary system would gradually sell the gold for commercial use with the pattern of sales being dictated purely by the state of the private market rather than some predetermined time schedule. The profit made by the IMF as a result of these activities, in this case the difference between the first instalment paid for the gold and the price received for it on the private market, would then be distributed between the depositing country by way of the final instalment and developing countries. For those developing countries which deposited gold with the IMF a larger proportion of the profit or indeed all of the profit could be paid directly to the depositing country.

The permanent refinancing of the IDO would be assured by the fact that because of the demonetization of gold and amortization of reserve currencies any growth in the quantity of international reserves made necessary by the growth in the value of international trade would be met by allocations of SDRs. At least a proportion of such allocations could be channelled to the IDO. In the long run then the amount of finance available to the IDO would depend on the size of SDR allocations and the proportion of these directed to it.

### **Significant Contribution**

During the earlier years whilst finance was being provided via the demonetization of gold and amortization of reserve currencies the quantity of funds available to the IDO would depend on the amount of gold held by central banks, the official price of gold, the free market price of gold, the purchase price of gold adopted by the IMF and the length of time over which gold demonetization was spread as well as the rate at which reserve-currency countries were prepared to amortise their externally held liabilities. Even by making conservative estimates of these variables it emerges that a very substantial amount of finance would be available to fund the new IDO, which would thereby be in a position to make a highly significant contribution towards financing economic development.