DISCUSSION OF FUND POLICY AT THIRD JOINT SESSION[1]

STATEMENT BY THE GOVERNOR OF THE FUND FOR SOUTH AFRICA

Owen P. F. Horwood

I wish to begin by complimenting Mr. de Larosière, Mr. McNamara, and the Executive Directors of the Fund and the World Bank on their achievements during the past year and on their lucid and incisive Annual Reports. I wish Mr. McNamara well on the eve of his retirement after so many years of dedicated service. In addition, I would extend a word of welcome to all the new members of the Fund and the Bank and in particular to our neighboring country, Zimbabwe.

As a founding member of both the Fund and the Bank, my country is proud to have been associated with the work of these great institutions over the years and with the exemplary principles of financial discipline and sound economic development on which their actions have largely been based. It is accordingly a matter of concern to me to note the increasing tendency for international politics to rear its ugly head in Fund and Bank circles. This tendency bodes ill for the international monetary system and for development cooperation. If allowed to gain momentum, it will undermine confidence in international financial arrangements and could greatly reduce the effectiveness and future importance of both the Fund and the World Bank, most of all for those of their member states who are in greatest need of their guidance and support. It is therefore a tendency which should be discouraged. Related to this question is the increasing demand from developing countries for even lower cost and easier financial assistance, not only from the World Bank but also from the Fund. As Governor of the Fund for a country on the African continent, I have some understanding of the dire straits in which many developing countries find themselves at present, and I wish to support their case for increased official financial support to help them overcome their structural as well as their short-term balance of payments problems. But it is of crucial importance to the well-being of all concerned that this assistance be provided through an appropriate

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transfer of real resources and *not*, as has now again been proposed, by creating more paper money through the activation of additional special drawing rights or by relaxing the conditions attached to Fund facilities.

It must be accepted as a fact of life that the rise in oil prices and other related developments call for painful adjustments on the part of most non-oil producing countries. Since the poorest countries understandably find it difficult to make these adjustments, those industrial and oil producing countries which profess a desire to provide assistance should take part of the adjustment burden upon themselves. This necessarily implies that *they* must be prepared to make certain sacrifices. There is no other way to bring about the desired transfer of real resources. Attempts to solve the problem painlessly by using inflationary methods of financing will only be self-defeating in the end. The founding fathers at Bretton Woods in 1944 knew what they were doing when they decided to set up *two* institutions, namely, the Fund and the Bank, instead of only one combined institution. They realized the importance of drawing a sharp distinction between, on the one hand, the function of assisting countries to finance and adjust temporary payments imbalances and, on the other, that of providing development finance. That distinction is still valid today. The Fund must not lose its soul by becoming an international money-creating development agency. It must resist any tendency to slide into softer loans. There is no purpose in paying lip service to the top priority of curbing inflation if, in practice, policies are adopted which must inevitably have the opposite effect.

The situation in the Southern African economic region is almost a microcosm of this international problem. The escalation of energy costs has adversely affected some countries and areas in this subcontinent, while the balancing increases in mineral prices—including the price of gold—have considerably improved real incomes in the mineral rich areas of the region. The way to deal with the problem is not for the monetary authorities concerned to create more liquidity, as that would simply inflate costs everywhere in the region. The sound way to proceed is to recycle part of the true savings in the advantaged areas into new investment in the stricken areas, with the emphasis on *development.*

In accordance with this approach, my Government has, during the past year, joined forces with a number of governments of states in the region, as well as with leading private sector enterprises, in launching a new program of economic development cooperation, as part of a far-reaching initiative to promote the development of a constellation of states in Southern Africa. Included in this program are steps to promote economic development cooperation on a regional basis, transcending the borders of national states; the establishment of a multilateral development bank;

and the systematic promotion of small business enterprises. In the earlier stages, particularly, of this development strategy, agriculture will assume crucial importance. It is perhaps not generally known that South Africa is today virtually the only exporter of food on the vast African continent and that our exports to African countries are steadily increasing.

I turn now to the current state of the world economy. Undoubtedly the overall situation has deteriorated since our meeting in Belgrade last year. Most countries have experienced a combination of accelerating inflation, new recessionary tendencies, and increased payments imbalances. Last year the Fund's Annual Report could still refer to a "mixture of gains and disappointments." This year it is clear that most member countries have lost on both the swings and the roundabouts! And the situation looks as though it will get worse before it gets better.

The only really encouraging feature of the past year has been the greater appreciation in certain important countries of the urgent need to apply more stringent monetary and fiscal policies in order to curb excessive spending and money creation. And it is gratifying to see countries like the United Kingdom persisting with unpopular but fundamentally appropriate financial policies in their efforts to curb inflation and to strengthen their underlying economic position.

The experience in my own country in recent years has once again demonstrated that financial discipline, including particularly the effective restriction of government spending, is an essential ingredient in any policy designed to encourage real economic growth while at the same time maintaining a strong balance of payments and minimizing inflation. Assisted by the higher gold price, South Africa will in 1980 probably combine a real economic growth rate of between 6 per cent and 7 per cent with an inflation rate of about 14 per cent and a current balance of payments surplus equal to more than 5 per cent of gross domestic product. Of course, the very fact that the continuing upswing has now absorbed most of the surplus capacity in the economy must, in the normal course of events, imply both a slowing down in the *rate* of real economic growth and a reduced current account surplus in 1981. But the economy should nevertheless continue to expand rapidly with rising standards of living for all sections of the population.

In commenting on economic developments in my own country, I must in passing express my surprise that the Fund has seen fit to abolish the useful category of more developed primary producing countries and to include South Africa in the category of non-oil developing countries. I would submit that in the new classification too much weight is given to the single criterion of per capita income and not nearly enough to

such factors as the versatility of the economy; the degree of industrialization; the sophistication of agricultural, industrial, and mining technology and of financial institutions; the scope and magnitude of imports and exports; and the dualistic nature of certain economies. One result is that the new category of non-oil developing countries now includes a mixed bag of countries with fundamentally different types of economies in widely divergent stages of development. In the interests of meaningful economic analysis, I would therefore urge the Fund to look further into this whole question of categories with a view to finding a more realistic and a more satisfactory classification of member countries. Viewed objectively, South Africa's classification in the category of non-oil developing countries is quite incongruous.

Finally, I wish to stress the central importance of improving the quality of the world's monetary system and payments arrangements if we are to succeed in the great design to achieve a better world. And in this context I come to gold—a subject which, although conspicuously absent from the public statements made at this meeting, is once again very much in the news and in the minds of delegates.

Gold has clearly reasserted itself still further during the past year as a factor in international monetary affairs. Apart from its continued use in swaps and as collateral for loans, and its role in the pool of monetary reserves backing up the European Monetary System, it presently constitutes about 60 per cent of the total official reserves of free world countries. Moreover, there is no longer any dispute about the relative status of the main reserve assets—the markets have passed a clear verdict in favor of gold. As the General Manager of the BIS put it recently: "Gold may have no official status. But it is not unloved."

What is new is the growing body of opinion in certain influential circles that, as part of a broader strategy to deal with the world's present set of deep-rooted economic problems, a move forward to a new gold-based monetary system of one kind or another might be a useful, if not an essential, step. It is also significant that it has suddenly become respectable again for economists and others to debate the whole issue of gold's future monetary role.

Moving to a new gold-based system will not be easy. The subject requires a thorough investigation by experts, and the relative merits of the different methods of moving to such a system will have to be carefully considered. The Executive Directors and staff of the Fund are ideally placed to conduct such a study, and I would hope that they will not leave this task to others.

The textbooks are right when they state that for any asset to serve satisfactorily as money, it must be able to combine the functions of

means of payment, unit of account, and store of value. The experience of recent years has shown once again that inconvertible paper currencies simply fail to do this. Against this background there is a growing realization that to become truly acceptable as money again, paper currencies must be relinked to commodities in one way or another and that in practice this can best be done via a link with gold. While the U.S. dollar is the world's most important currency, the most effective link must be between gold and the dollar. For me it never has been a case of gold versus the dollar, or the dollar versus gold, but rather of gold and the dollar. But then of course, it must be a convertible dollar. That is a requisite!

By itself, of course, the institution of a new gold-based system will not solve the world's present economic problems. I am in full agreement with those who argue that the main prerequisite for any such solution is the application of more effective fiscal and monetary policies. But it is my sincere conviction that the recognition, clarification, and normalization of gold's monetary role will assist governments in the adoption and maintenance of appropriate policies of financial discipline. Given the present distrust of paper currencies and man-made international monetary arrangements, the monetary authorities of the world have much to gain and nothing to lose by forging sound money policies on the confidence which people everywhere consistently display in gold in a world fraught with uncertainty and changing values.

Statement by the Governor of the Fund and the Bank for Ireland

Michael O'Kennedy

I should like to begin by associating Ireland with the welcome which has been extended to St. Lucia, St. Vincent and the Grenadines, and Zimbabwe as new members and by warmly welcoming also the People's Republic of China.

It is indeed sobering when the International Monetary Fund describes the world economic picture as being grim. The most disturbing aspect of the situation is that the prospect of an early improvement is, at best, qualified. I would agree with the view expressed in the Fund's Annual Report that it is extremely difficult to gauge the balance of expansionary and contractionary forces in the period ahead, and that the possibility of deepening international recession cannot be ruled out. We would all hope that there will be some upturn in the world economy during the course of 1981 but we certainly cannot rely on this.

The implication for policy internationally is that it should be more than usually alert to change and that it should exploit any opportunities that emerge, however small, to strengthen world expansionary forces, while not, of course, rekindling inflation. I would agree with the Executive Board that the proper central focus of national economic policy is the establishment and maintenance of an environment conducive to economic growth with price stability. This formulation gives due weight to the inflation objective and also recognizes that growth must remain a key objective of economic policy.

The main reason why we must continue to attach importance to growth is, of course, that it is crucial to the employment prospects of all our peoples. The Fund's view is that unemployment, having increased in the industrial countries in 1980, is likely to increase still further during 1981, and that the increase will be much more widespread than in 1980. Unemployment involves economic loss and human distress, and the prospect of it increasing further must influence our view as to the direction that policy should take. We have to find ways which will help employment while not worsening inflation. We must attempt this because there is, I would suggest, a real danger that failure to act to contain unemployment could unleash forces that could make it more difficult to adhere to demand restraint as an anti-inflationary device.

The Fund has rightly recognized the particular importance of incomes policy in the control of inflation at the present time. Success in incomes policy depends upon the cooperation of the social partners, and the extent of that cooperation can, in turn, depend upon the social partners' perception of the degree to which government policy takes account of their concerns. Prospects for employment can be particularly important as part of this.

I should like to relate my remarks briefly to our position in Ireland where we have been particularly affected by the international developments of the past year. This year our growth rate is likely to be below 1 per cent and our unemployment level has risen by about a quarter since the beginning of the year. Inflation is at an unacceptably high rate, but there are signs that it is moderating. Our balance of payments deficit, while remaining uncomfortably high, is expected to fall, as a proportion of GNP, by about two percentage points this year. This latter is a welcome development. It is significant against the background of higher deficits in the smaller industrial countries, and in the industrial countries generally for that matter. But this reduction of our deficit has, of course, been accompanied by the substantial increase in unemployment which I have mentioned. We have a rapidly growing, educated labor force, and this, allied to the need to correct our current problems, is a factor making

for our decision to pursue a planned development strategy for our economy, in spite of the setbacks largely stemming from the oil price shock. We see an appropriate evolution of incomes, and greater industrial peace, as key elements in such planning. In pursuing this strategy we will have regard not only to the needs but also to the clear potential of our economy and, in this context, to the overriding importance of funding substantial infrastructural investment.

The Irish economy is, of course, particularly open. We are dependent on export markets to absorb about half of our production. The development of the external environment, therefore, is crucial to the success of our efforts. It is my hope that, as a result of the better appreciation which we will gain from this meeting of one another's problems and opportunities, policies internationally will follow a direction helpful to the efforts being made in our countries to resolve current problems and to reduce imbalances. It is important to recognize the impact of policies in the larger countries on the more open smaller economies.

The record high interest rates of the past year are a cause of concern to all countries, including our own, but they are a special burden on the developing countries. For them, high interest rates have serious adverse consequences and their plight deserves our close attention. I believe that the industrial countries must strive as far as possible to construct a policy on interest rates that avoids extremes, one that is based not just on national considerations but takes account of wider international implications. While it is necessary for us all to be on our guard against further inflation, and while increases in interest rates may be inevitable as part of our policies to achieve this, we must be wary lest the cure should have side effects as damaging as the disease.

In our efforts to return to sustainable and balanced growth it is essential to ensure also that official arrangements to assist members through the present difficult period are adequate. The burden of adjustment must be spread over a reasonable period, with countries having access to adequate financing in the meantime. Such access will be vital for many countries, not least the developing countries. Ireland, therefore, welcomes the positive outcome of the discussions on Sunday in the Interim Committee which showed clear support for greater assistance being made available by the Fund and agreement that the Fund should borrow, as necessary, for this purpose. Countries in a strong reserve and payments position should facilitate the Fund in its efforts to provide adequate financing to member countries. . . .

I would like to join with other Governors in welcoming the efforts being made by the Fund and Bank to really come to grips with the task

of helping the poorest developing countries. Within the Fund we have had, as well as the proposed expansion of its normal activities, the imaginative proposal for additional balance of payments assistance to low-income countries affected by a crop failure or a sharp increase in the price of food imports. It is to be hoped that, following the meeting of the Interim Committee, this proposal can now be carried further and implemented speedily....

These efforts by the Fund and Bank must be supplemented both by the industrial and oil exporting countries. As part of this, the line against protectionist pressures must be firmly held. Failure in this area will surely prevent the achievement of our common goals of increased employment and prosperity. I would suggest that the technologies that the developed countries can provide, and the vast resources now becoming available to the oil producing countries, can, if used together, make a major impact on the development process. The needs and obligations of the various economic regions of the world today have to be radically reassessed in view of the major changes that have occurred in the last decade....

It has been traditional at the Annual Meetings to record our thanks to the staffs and Executive Boards of the Fund and Bank for all their work during the past year. I am happy to do so again this year. I should also like to thank the Managing Director of the Fund and the President of the Bank for the excellent leadership they have displayed during the year....

Statement by the Governor of the Fund and the Bank for Canada

Allan J. MacEachen

First of all, it gives me great pleasure to join in welcoming St. Lucia, St. Vincent and the Grenadines, and Zimbabwe to the membership rolls. As well, at this Annual Meeting, China is taking its rightful place in these institutions and we all look forward to its participation in our deliberations.

We meet at a very difficult time. The problems we face are immense and we urgently need new and imaginative solutions. I sense among many members a growing impatience and concern. Indeed, there is a very real sense of frustration at delays in achieving the progress they desire for their peoples. I can understand this impatience. I share these concerns. None of us can rest easy as long as millions of people in the world are living in dire poverty and distress. Nor can any of us be

content with a situation where economic growth is falling and where even the ability of the system to successfully redistribute and recycle funds is being questioned. That is what the Brandt Commission Report was all about. That is why its findings need to be taken seriously.

But I believe our concerns may turn out to be exaggerated, that the frustrations may be misplaced. We are indeed making progress in grappling with these problems. We have already made major changes in the workings of the Bretton Woods institutions. The Bank and the Fund have shown a much greater awareness of the need for flexibility in dealing with the problems of different countries. They are demonstrating their recognition of the very special needs and requirements of the poorer members. It is this willingness to adapt, to consider new programs and new procedures, that we must welcome. It is up to us to ensure that both these institutions have the necessary resources to carry out their essential programs.

But if success is to be lasting—indeed if we are to find the funds needed—we must make sure that the conditions for growth are right. I agree with the Managing Director that present levels of inflation are undermining the prospects for growth. A firm stance against inflation must remain a key element in any economic strategy that is to be of lasting benefit.

I also agree that the energy situation is one we must tackle with resolution. All of us must try to curb our energy consumption. We need to find ways of seeking additional sources of energy. I am very much aware that while the increasing costs of energy may create problems for many, the burden borne by some of the non-oil developing countries is particularly heavy. Higher energy costs often threaten to exhaust their foreign exchange resources. Almost invariably they reduce those countries' ability to pursue their development. Those of us who are better off must help them in shouldering this burden. We must also look for ways to help them exploit their own energy resources.

As a major energy producing country, Canada stands ready to help the poorer countries tap their energy potential. In addition, we support the proposal for an expanded energy development program by the World Bank. We intend to honor the undertakings we entered into at the Venice Economic Summit.

Let me say something more generally about resources. One of our first priorities must be to ensure that the economic system continues to recycle funds effectively to all developing countries and particularly to the poorer countries. The private banks and private capital markets must continue to play the leading role. But we must support and supple-

ment these efforts through our own bilateral programs and through the international financial institutions.

The Managing Director has said that the Fund must be swift in responding to the balance of payments needs of its members and that its financial policies must be sound. I support that view. I am glad that at these Meetings we have been able to reach broad agreement on the need for the Fund to increase the magnitude and extent of its lending, and that there is also a sense of shared urgency about the need to provide the Fund with much greater resources so it can do its job effectively.

It is particularly urgent that we implement the Seventh General Review of Quotas. It is also essential that we begin our discussions on further quota increases. It is indeed vital that the Fund explore all possibilities for obtaining additional funds so that it can finance its activities while this work is going forward. . . .

A word about the proposed global negotiations. I do not know when these negotiations will be launched but I hope agreement on them can be reached shortly. I do know that some of the key subjects which must figure on any agenda for the future come clearly within our sphere of responsibility as Ministers of Finance. We have an obligation to these institutions to see that we press forward with the work.

I am encouraged by the progress which has been made in the past few months. I am impressed by the resolve I detect in both the Bank and the Fund to search out new ways of dealing with our problems. The greatest contribution we can make as Ministers of Finance and Governors of these institutions is to ensure that we are not hostages to the prejudices of the past. We must be prepared and willing to consider new ideas no matter how strange they may appear at first blush. At the same time, we must insist that these proposals, these suggested remedies, are rigorously tested. We cannot afford to fritter away resources. We cannot do things which might undermine the basic integrity of the international monetary system and the workings of our institutions. The proposals that we adopt must be founded on realism. They must be practicable and workable. They must be able to withstand the test of time. . . .

Statement by the Governor of the Fund for Denmark

Ivar Nørgaard

In 1979 we witnessed a renewed surge in energy prices giving rise to a sharp acceleration in the rate of increase in consumer prices as well as a further increase in the balance of payments deficits of oil importing

countries. Concern about these developments has made it necessary for many member countries—including the Nordic countries on whose behalf I am speaking—to adopt more restrictive economic policies. In this connection, I think it gives cause for some encouragement that policy responses in most industrial countries have not—so far—constituted an overreaction, so that we may hope to avoid a recession as deep as in 1974–75. Furthermore, until now it seems that in many industrial countries the sharp increase in consumer prices has not been translated into corresponding increases in nominal incomes. This seems to imply that there is an increased awareness of the interrelation between developments in energy prices and the standard of living, which will also improve prospects for avoiding a further increase in unemployment.

These somewhat brighter features are, however, overshadowed by the bleak outlook for the world economy at least through 1981. The combination in industrial countries of the deflationary impact of the higher energy prices and more restrictive economic policies is expected to lead to virtual stagnation in 1980 and 1981. This also means that in these two years already high rates of unemployment will increase further in many countries, reaching levels exceeding earlier postwar peaks. High and rising levels of unemployment increase pressures for protectionist measures with an inflationary impact and harmful effects upon world trade. With low capacity utilization, unit costs also tend to rise. In order to avoid such a development and the risk of continuous high levels of unemployment, we feel concern over the prospects of a prolonged period of slow growth.

This outlook implies a danger that growth rates in industrial countries may develop more unfavorably than now foreseen. To prevent such an aggravation of the situation there is a need for precautionary measures to support and—in certain cases—even strengthen domestic demand. Such measures will, of course, have to be tailored according to the situation in individual countries, taking into consideration their balance of payments situation and price and cost prospects. One area which readily lends itself to such stimulatory measures is further investment designed to reduce energy consumption and to increase supplies of this scarce commodity.

From the point of view of international adjustment, a preservation of the present fairly even distribution of payments imbalances among the major industrial countries would have clear advantages. Many of the smaller industrial countries, however, are not in a position to continue to absorb so large a share as hitherto of the oil-induced deficit of the industrial countries. Above all, the outlook for current account balances in 1981—as presented by the Managing Director—is disturbing insofar

as it foresees a further increase in the deficit of non-oil developing countries. Against this background it is important that industrial countries which are not confronted with pressing balance of payments restraints should avoid a continuation of present weak trends in domestic demand.

Even if there should be some expansion of demand in industrial countries, there is no escape from the evidence that the serious economic difficulties which already confront many non-oil developing countries are not likely to be appreciably mitigated during the coming year.

Within this group of countries some are in a better position to take the steps necessary for adjustment than others. Assistance to these latter countries—mainly comprising the low-income developing countries—would to a large extent have to be made in the form of increased official development assistance. My Swedish colleague will comment on these matters at a later stage during our Meetings.

We believe that the Fund will have an important role to play in the international adjustment process. While the major part of the recycling of OPEC surpluses will continue to be handled by the private international financial markets, there is a need to strengthen the Fund's lending capacity. We welcome the discussions in the Executive Board of the Fund since April on enlarged access to Fund resources and the financing of such an enlarged access.

The new policy responses emerging in relation to these issues must be seen as dictated by the need to react quickly. However important it is to find solutions to our immediate problems, we find it equally necessary to achieve a permanent expansion of Fund resources.

The documentation prepared for the meeting of the Interim Committee, as well as the statement of the Managing Director, clearly shows a picture of a major change in the world economic situation since the beginning of 1979. On this basis and in view of the likely persistence of major payments imbalances also beyond 1981, we find a case for advancing the Eighth General Review of Quotas. This Review is likely to be both complicated and time consuming, and therefore we welcome the agreement reached at the meeting of the Interim Committee to begin preparatory work on this Review. In addition, the Fund has in recent months initiated discussions on the program proposed by developing countries for reforms of the international monetary system and of the Fund.

But we must not forget that international monetary rules cannot in themselves solve the development problems which the world is faced with. If consolidated in an effective global system they can, however, make an important contribution to the solution of such problems by pro-

viding a stable but adjustable framework for conducting trade and making financial transfers, and thereby creating a favorable climate for worldwide economic growth and prosperity. The alternative, it seems to us, is not a speedier solution to the enormous international economic problems but rather a fragmented monetary system, which is not viable and therefore will make it even more difficult to make the desired progress in other areas.

All member countries have a common interest in a well-functioning international monetary system. We find that improvements in the present system can be made, for instance in the directions of a higher degree of exchange rate stability as well as a better international coordination and surveillance of adjustment policies. In the process of achieving such improvement we need to maintain the Fund as the principal international body in this field. We continue to attach great importance to the principle of universality as laid down in the Articles of Agreement; this principle does not—as we have seen in the past—exclude dealing with special problems, but it does require us to adopt well-balanced solutions to the problems facing us. This is the only way we can expect member countries to participate effectively in the work and decision-making process of the Fund, thereby securing that adopted solutions serve their purpose of making the international monetary system function more effectively.

We all know that there are differences in views on some of the issues that we shall discuss in the coming months. However, the Nordic countries are confident that—in the tradition of the Fund—we shall manage to reach constructive solutions for the benefit of all member countries.

Statement by the Governor of the Fund and the Bank for the United States

G. William Miller

The Bretton Woods institutions continue to grow in stature and in membership. The People's Republic of China, representing nearly one fourth of the world's population, now participates with us as a fully active partner. Our newest member, which joined yesterday, is Zimbabwe, a nation whose struggle to gain independence and freedom has engaged our high admiration and support. To all those who sit in this assembly for the first time, I offer a special welcome. . . .

Bob McNamara has led the World Bank to giant accomplishments, but he is the first to point out the towering challenges ahead. He and

Jacques de Larosière have detailed for us a sobering outlook for the world's enonomy and people. Their perspective is not seriously contested by any of us. Together our nations face a formidable collection of problems.

—First and foremost, persistent inflationary pressures.

—Weak economic growth.

—Low productivity improvement and capital stocks threatened with obsolescence by world energy developments.

—High, in many cases rising, unemployment.

—Sharply higher oil import bills, which siphon funds from investment, development, and growth to pay for essential energy imports.

—Massive payments imbalances and financing needs.

The difficult global energy situation is a factor in all these problems. And it will not cure itself. After the oil price increases in 1973–74, the world failed to adjust sufficiently to the new situation. Instead, oil demand was temporarily reduced by a global recession. Thereafter, the oil importing world to a large extent succeeded in financing a continuing high level of consumption, but it did not put in place the new investment needed to reduce dependence on imported oil. In many cases, the hope seemed to be that the oil and financing problems were temporary and could be resolved without fundamental changes. Indeed, there appeared to be some success, as for a brief time world inflation receded, economic activity recovered, and payments imbalances narrowed.

But a second round of massive oil price increases beginning early last year brought a renewal of the earlier difficulties. The new shock compounds the problems for a world economy already beset by strong underlying inflationary pressures and laboring under heavy external debt burdens accumulated during the 1970s.

There is no prospect of avoiding repeated oil shocks unless the oil importing world recognizes and adjusts deliberately to a radically altered global economic and energy balance. The required adjustments involve both energy conservation and development of new energy sources. But they must also encompass measures to stimulate investment and productivity in circumstances of greatly increased energy costs. And they must be carried out in an environment of financial stability within individual national economies, to facilitate movement of resources to more productive sectors and to ensure continued flows of external financing.

We look to the oil exporting nations to follow responsible price and production policies. And each nation represented here must face and

act upon the need for internal adjustment. Many have done so. Most have at least started the process. None, including the United States, has yet done enough to assure its satisfactory completion.

The United States is taking strong steps to reduce oil imports, to control inflation, and to improve productivity. A broad array of policies—most important, decontrol of domestic oil and natural gas prices—has been marshaled to encourage energy conservation and stimulate domestic energy production. Principally as a result of these efforts, U.S. oil imports are about 25 per cent below the average of 1977, the peak year. This reduction is primarily the result of improved efficiency in energy use, not reduced economic activity. The amount of energy needed to produce a unit of national output has been lowered by about 10 per cent since 1973.

The United States continues to pursue fiscal and monetary policies designed to limit and then reduce inflation. In addition, the President has recently proposed measures to increase the share of national output devoted to investment. Our efforts to reduce oil imports and strengthen the U.S. economy have supported a welcome improvement in our external accounts. They have also provided a firm basis for stability and strength of the dollar on the exchange markets.

We must all recognize that our individual efforts form part of a collective international response that ultimately can succeed only if it is coordinated and cooperative. The Bretton Woods institutions originated as just such a cooperative effort. Their task was to guide the world economy from the devastation of World War II, and their success was remarkable. In subsequent decades they have adapted flexibly and imaginatively to changing needs and circumstances. But a major test lies ahead. As we enter a new decade, we must again call upon these institutions for guidance through a difficult and dangerous period.

A world accustomed to strong growth and rising living standards now faces the prospects of a decade in which performance may fall short of expectations and aspirations. Large persistent imbalances in international payments are likely. And the associated financing requirements are huge. In 1980 alone, the aggregate of current account deficits that need to be financed could reach $150 billion.

In light of these prospects the Fund and Bank face a complementary task: the Fund to assure a judicious blend of financing and adjustment; and the Bank to assist in restructuring economies to permit development to continue as rapidly as possible.

Let me outline the U.S. view of the roles of each of these institutions.

The International Monetary Fund

Looking ahead, the Fund faces truly awesome tasks. It must oversee the operation of the international monetary system at a time when pressures on that system are severe. It must encourage each member toward policies for orderly growth and price stability, in a period when the attainment of those goals is more difficult than ever before. It must see that nations follow exchange rate policies compatible with their international obligations, under conditions of enormous global payments imbalances and great uncertainty.

No one expects the Fund to fulfill these responsibilities to perfection. Our knowledge and foresight are imperfect. The Fund's authority over sovereign members is circumscribed. Its tools are limited.

But we must make sure that the Fund—the international community operating collectively—is in a position to make a maximum effort. Its approach must be right, its advice sound, its resources adequate. And we must keep in mind the longer-term objective of international cooperation: in designing our approach to immediate and pressing problems, we must not lose sight of the broad goals we have set for the evolution of the international monetary system.

Let me state my message plainly: the Fund's main job will be to encourage the appropriate blend of adjustment and financing by member nations; to facilitate forms of adjustment and financing that are most supportive of a strong world economy; and to continue progress toward the kind of international monetary system we need for a secure and prosperous future.

That means improving the Fund's ability to provide financing to those countries undertaking difficult adjustment efforts. It means a greater role for the SDR and progress toward an SDR-centered international monetary system. And it means improving Fund surveillance over members' policies.

In the past several months, discussion has focused on the role of the Fund in meeting prospective financing needs and in supporting the efforts of individual nations to come to grips with adjustment problems. In Hamburg last spring, the Interim Committee endorsed in broad terms the view that the Fund should be prepared to play a much larger role in adjustment and financing. The Executive Board has worked hard to define that role in the design of adjustment programs and the expansion of members' access to Fund resources. Clearly, present circumstances call for adjustment programs with a longer-term orientation than in the past. Larger amounts of Fund resources will need to be committed to countries adopting such programs over a longer period of time. The

United States strongly endorses the results of the Board's work and urges its early implementation.

The Fund is presently in a satisfactory position to meet expanded calls on its resources. I am particularly pleased that the Congress has just completed final action on authorizing U.S. participation in the seventh quota increase. We will work with the Congress to complete the appropriation process, so that the general quota increase—which totals about $25 billion—can take effect at a very early date. This will be a welcome and needed addition to the Fund's resources.

We are all agreed that quotas must remain the basic source of Fund financing. But potential demands on the Fund are substantial. As a precaution, the Managing Director has already begun to explore the possibility of Fund borrowing from surplus countries to supplement the Fund's resources in case of need.

We should also consider other prospects. The time has come for a careful examination by the Fund of the possibility of borrowing from private sources. A number of technical and legal questions must be reviewed, and there are factors that may limit the Fund's recourse to the private markets, at least over the short run. But Fund borrowing from the capital markets on a moderate scale may prove to be desirable, and I urge that the necessary preparatory work be initiated promptly.

Fund borrowing from the private markets would be fully in line with the effort to enhance the role of the SDR in the international monetary system. We welcome the recent decision by the Executive Board to adopt a five-currency basket as the uniform basis for both valuation of the SDR and calculation of the SDR interest rate. This will provide an SDR that is more compact and understandable, easier to trade and work with in foreign exchange and capital markets, but still a reserve asset that is internationally backed and representative of a large segment of the world economy.

We should go farther, and consider other steps to promote the role of the SDR in the system.

—The Executive Board has been examining the question of SDR allocations for next year and the fourth basic period, beginning in 1982. Clearly, there have been major developments in the world economy since the decision was taken in 1978 on allocations for the three years ending in 1981. But in my view, the most effective approach to expanding the SDR's role is a relatively steady expansion of allocations, from basic period to basic period as the world economy grows. We are not persuaded that an effort to "fine tune" a single year's alloca-

tion would be appropriate or consistent with our view of the longer-term evolution of the SDR's role. It is of paramount importance that we develop the credibility and reliability of the SDR as a reserve asset. We should not give the impression of tinkering with it. We will look toward a careful analysis by the Managing Director and the Executive Board of the question of allocations in the next basic period, and will consider positively a proposal by the Managing Director next spring.

—The yield on the SDR has an important bearing on attitudes toward acceptance of the asset and decisions on allocations. The rate of interest on the SDR has been increased by a substantial amount over the years. I believe that it would be useful to raise further the rate of interest on the SDR, to the full market level, in order to enhance the attractiveness and therefore the usability of the asset. At the same time, we should raise the rate of remuneration to 80 per cent of the full market SDR rate and eliminate the remaining residual SDR "reconstitution" obligation. Market-oriented characteristics and elimination of encumbrances can only enhance the usability and attractiveness of the SDR.

—The prospect of Fund borrowing from the private markets raises in concrete terms the possibility of greater private use of SDR-denominated assets. From a longer-term perspective, we urge the Executive Board to initiate a study of other measures that might be taken to expand the use of SDR-denominated instruments by the private sector. As the private market in SDRs develops and takes hold, we propose that the World Bank give consideration to borrowing in the form of SDR-denominated securities and lending correspondingly in SDR terms, both as a means of giving further impetus to the instrument and as a technique of moderating exchange risk for the Bank's borrowers.

As another step toward expanding the role of the SDR, we urge the Executive Board to continue its work on the concept of a substitution account, which I believe would be better named a "monetary reserve account." We should not be surprised that the development of this idea takes considerable time. The SDR itself took years to define and introduce.

The steps I have mentioned today can, together, make a useful contribution to strengthening the SDR and promoting its use as a respected and effective international monetary instrument. The United States has also given attention to the renewed suggestions that a link be established between the creation of special drawing rights and the provision of development assistance—a so-called SDR-aid link. Our view remains that the establishment of the proposed link would be

harmful to what we regard as the fundamental objective—to develop the SDR's role as an important monetary instrument and promote orderly evolution of the international monetary system.

As the Fund carries out its expanded responsibilities in the current situation, we believe it important that it give renewed attention to strengthening its role in surveillance over the international monetary system and the policies of member countries. The United States has suggested a number of steps that could be taken toward this end. For example:

—It seems to us natural that, in seeking to promote greater symmetry of adjustment responsibilities, the Fund should seek adjustment policy statements and analyses from any country experiencing a large imbalance, whether surplus or deficit.

—We have suggested that the policies and performance of individual countries be assessed against a broadly agreed global economic framework.

—We believe the Managing Director should be invited to take the initiative in consulting members where he has concerns about the appropriateness of their policies.

The Executive Board has made some progress in developing its surveillance procedures over the past year. But that progress has been disappointingly modest. We all seem to agree that effective surveillance is the essence of a smoothly functioning international monetary system. Yet, I have noticed that many who are critical of the system are the most resistant to the development of surveillance, which is at the heart of its effectiveness.

The world faces extraordinary economic and financial problems and challenges. The Fund is at the center of our response. Its ability is proven. Its resources are expanding. Its policies are being adapted to changing needs. Its objectives and purposes have been endorsed by every country represented here. We have endorsed a global strategy based on the Fund's financing and adjustment policies. Now we must make it work. I urge all member nations to help the Fund give substance to its agreed role in overseeing the operations of a sound international monetary system. . . .

Bank/Fund Collaboration

There is one additional area where I think there is a need for innovation: that is, in the collaboration between the Fund and the World Bank.

When we established these twin institutions in 1946, the world was different, and the functions of the Fund and Bank were clearly separated and defined. Now the problems of short-term adjustment and the problems of development have become more intertwined, and the activities of the Fund and the Bank are focusing more on common problems.

Both developing and industrial countries have learned that an effective program of adjustment to achieve the multiple and sometimes conflicting objectives of economic policy requires attention to both demand management and the supply side of the equation. Over the years since Bretton Woods, the Fund has worked with its members in the design of demand management policies to achieve economic stabilization. The Bank has focused on the supply side in its effort to promote growth through development of sound investment strategies. In the years ahead, it is essential that the unique capabilities of these two institutions be brought to bear in a complementary and positive manner to assist countries in their adjustment efforts. The Bank and the Fund should be prepared to collaborate with one another to assist member countries in assessing their economic prospects, developing effective economic programs, and providing appropriate financing.

At the same time, it is also essential that the Fund and the Bank remain as autonomous institutions with distinct functions and purposes.

I know that the staffs of these two institutions have made significant strides in collaborating on adjustment programs in specific countries. At this stage, I think it would be useful to review what has been accomplished, with a view to improving the form and substance of this collaboration in the future. This review might best be undertaken under the auspices of a joint committee of the Executive Boards, supported by the staffs of both institutions.

Effective collaboration between these two institutions will help ensure their continued responsiveness to the changing needs of the world economy. We also urge consideration of steps to assure proper coordination of the borrowing policies of the two institutions. The prospect that both could be borrowing in world capital markets in the same time frame suggests the need for specific steps to assure a smooth coordination of those activities.

Conclusion

The record clearly shows that the Fund and the Bank have demonstrated repeatedly their capacity to evolve, adapt, and respond flexibly during periods of major economic and financial strain. The institutions

work efficiently and well. They deal in realities and give practical content to the high objectives set forth in their Articles. But their ability to continue to perform their indispensable tasks depends on the commitment of their members to maintain their integrity and competence and to avoid injection of political issues into their work.

Difficult problems and challenges confront us. The Bretton Woods institutions are the central focus of our collective effort to meet those challenges successfully and cooperatively. The United States pledges its vigorous support to the Fund and Bank as they address the tasks before them. With the support of other nations represented here today, I am confident that lasting success will be achieved.

These institutions have never been more needed. Their compelling mission is not now, and we hope and trust will never be, to reconstruct a war-torn world. Rather, it is to construct a sound world economic system that meets our common aspirations, the aspirations of all mankind for prosperity, for security, and for peace.

Statement by the Governor of the Bank for the People's Republic of China

Wang Bingqian

I am very happy to be addressing today the Annual Meetings of the Boards of Governors of the International Monetary Fund and the World Bank. I would like to extend my heartfelt thanks to Mr. Jamal, Mr. de Larosière, Mr. McNamara, and the other Governors for their kind words about the Chinese Delegation. I wish to congratulate Mr. Jamal, Chairman of the Board of Governors, for his address at the current Annual Meetings. I also listened with interest to the welcoming remarks of President Carter and to the speeches of Mr. de Larosière and Mr. McNamara. I associate myself with other Governors in extending a warm welcome to the new members of our two institutions, Zimbabwe, St. Lucia, and St. Vincent and the Grenadines.

This is the first time that a delegation from the People's Republic of China is attending the Annual Meetings of the Boards of Governors of the Fund and the World Bank. Both institutions sent missions to Beijing earlier this year at the invitation of the Chinese Government for negotiations on the representation of the Government of the People's Republic of China in the Fund and the World Bank. A quick resolution of the matter was achieved thanks to our joint efforts and the warm support of many fellow Governors. Resolutions on an increase

in China's quota and subscription and on an additional Executive Director were also adopted by the Boards of Governors before these Annual Meetings began. On behalf of Mr. Li Baohua, Governor for China in the Fund and President of the People's Bank of China, and in my own name, I would like to express our thanks to Mr. de Larosière, Mr. McNamara, and all the Governments and Governors who gave China their warm support.

In coming to attend these Annual Meetings of the Boards of Governors of the Fund and the World Bank, we on the Chinese Delegation seek to promote international economic cooperation, foster mutual understanding and friendship, and learn from the good experience of other countries. Henceforth, enjoying its rights and fulfilling its obligations, China will do its part to further the cause of international economic cooperation in conformity with the purposes of these institutions.

We, in China, are marking the thirty-first anniversary of the founding of the People's Republic of China. During these 31 years, signal achievements have been scored by our people through their diligent efforts. Agriculture has become more developed; in industry, a foundation has been laid for further growth and expansion; and the quality of life of the Chinese people has improved. But the level of economic development in China is still quite low compared with the advanced agricultural-industrial countries. Ours is still a developing country.

China's economic development experienced ups and downs for many years. The period from 1966 to 1976, in particular, was a decade of chaos, during which our economy suffered grave disruption. Since that chaotic situation was brought to an end, stability and unity have prevailed in the country; the economy has been quickly rehabilitated and growth resumed. With single-minded purpose, the Chinese people are now working confidently and unswervingly for the achievement of their grand goal of modernizing agriculture, industry, science and technology, and national defense. Though we are sure to meet with difficulties in the future, we are confident that these will be overcome through our efforts. Prospects are bright for China's economic development.

We embarked last year on a program of adjustment, reform, consolidation, and improvement of the national economy. By this we mean to carry out structural adjustments to correct the major imbalances in the national economy, to reform our system of economic management, to consolidate our existing enterprises, and to improve the level of our science, technology, and economic management, so that the economy

as a whole may develop more soundly and in a coordinated manner. Our efforts during the last year have yielded some initial results. Agricultural and industrial production have made progress. Particularly after the initial measures we took to carry out adjustment and consolidation, our manufactures have improved in quality, there is a greater variety of goods, and there has been a reduction in the use of raw materials and energy consumed in the production process. Industrial production is expanding on a more solid foundation. Meanwhile, we have raised the procurement price of farm produce and by-products, reduced some rural taxes or declared a tax holiday, given workers an increase in wages and other benefits, and created job opportunities in cities and towns. During the short space of one year, we took all these important and absolutely necessary measures in order to improve the livelihood of the people in town and country. However, it was impossible to cut down all at once on the outlays for capital construction. Moreover, owing to shortcomings and mistakes in our work, a deficit appeared in the state budget for the year 1979. This we will work to reduce step by step and eventually to wipe out altogether in the course of further economic adjustments and expansion of production and construction. Meanwhile, our economy is developing in a sound manner. Agriculture, light industry, and heavy industry are regaining a better balance through structural adjustments. The output of consumer goods has grown visibly; the market is plentiful and flourishing. There has been a noticeable increase in personal savings both in town and country due to higher incomes, and faith in the renminbi is strong. Facts show that the important measures we have been following for the last year or so have imparted new dynamism to our national economy.

However, there are still a host of problems to be ironed out gradually in the course of our economic development. China is not well off. Its per capita GNP is quite low. Subsistence agriculture is still more or less the case. The country's infrastructure is inadequate. In industry, production technology and management techniques are still rather backward. We lack trained scientists and managers, and our educational system is still relatively backward. In order to step up economic development, we are undertaking reforms in economic management concurrently with the structural adjustments that are being made. We are going to give the enterprises a greater say in running their own affairs, and we will apply the economic leverage exercised through fixing prices, setting taxes and interest rates, and having recourse to bank credits under the overall guidance of state planning, thereby giving full play to the positive aspects of a market economy.

Through these measures of economic reform, we will try to promote the comparative advantage of different localities and departments, protect competition between different regions and enterprises, and encourage all forms of mergers and joint ventures that are in the mutual interest of the participants, and in this way stimulate the enthusiasm, initiative, and creativity of the localities, departments, enterprises, and working individuals. We have carried out experiments along these lines in the last two years in a number of enterprises. They have in all cases boosted output and improved economic efficiency. The Fifth National People's Congress at its recent third session has endorsed this approach of reforming economic management, and we will be systematically pushing these measures in every sector.

In order to hasten China's modernization program, we will keep to the premise of relying mainly on our own efforts, but at the same time endeavor to develop our foreign trade, import advanced technologies, make use of foreign capital, expand economic cooperation and technical exchanges with other countries, and learn from their advanced expertise in science, technology, and management techniques. This is not a makeshift measure but a long-term policy that we will be following. The total volume of China's import-export trade has grown rapidly in recent years, and our economic cooperation with other countries has expanded both in scope and form. Considerable headway has been made in such areas as the import of advanced processes and complete sets of equipment, compensatory trade, joint exploitation of resources and manufacturing of goods, joint ventures, bidding for construction projects, technical consultation, and the training of personnel. The Bank of China has established correspondent relationships with 975 banks in 144 countries and regions, and signed loan agreements with some foreign banks. Recently, the Chinese Government started to accept long-term, low-interest official loans, signing agreements of this sort with some countries. Before accepting foreign credits, we in China of course take into full account our ability to repay. With a view to developing our foreign trade and economic technical cooperation with other countries, we have already adopted and are continuing to draft relevant economic legislation to guarantee the legitimate rights and interests of foreign investors and collaborators. There is wide scope for the expansion of trade and economic and technical cooperation between China and other countries.

The economic picture of the world is very grim indeed. Inflation, a slowdown in economic growth, and international payments difficulties are problems of a widespread nature. The developed countries are

facing stagflation and a new recession. Numerous developing countries are painfully aware of a shortage of international liquidity and a lack of credits with long maturities for development purposes. The energy problem is a matter of growing concern to everybody. Hegemonist aggression and expansion pose a further grave threat to world peace and security, and are factors contributing to greater instability of the world economy. Unless hegemonism is checked, world peace cannot be secure, and the economic development of the world will be seriously impaired.

Great changes have taken place in the world, politically and economically, since the establishment of the Fund and the World Bank. Many countries have gained independence, and they are seeking to accelerate their economic development. The international monetary system established at Bretton Woods can no longer meet the needs of our new conditions and must be reformed so as to bring about the early establishment of a new, equitable, and rational monetary system.

The North-South relationship is a crucial element in the endeavor to build the New International Economic Order. Economically, there are conflicting interests as well as interdependence between the North and the South; reasonable solutions to their differences should be sought through dialogue and negotiations on an equal footing. We hold that it is necessary to set up at an early date a rational and stable international monetary system, so as to facilitate the expansion of international trade and the world economy. We hold that the developed countries should abolish restrictive trade barriers against the developing countries, so as to improve the latter's terms of trade. The industrially advanced countries should be more forthright in undertaking the commitment to increase concessionary economic and technical assistance to developing countries. All these measures are, of course, in the interests of the developing countries, but in the final analysis they will also help to promote the stability and growth of the developed countries themselves.

China shared, in many respects, the plight of other developing countries in the past and confronts today the same task of trying to accelerate economic development. As a developing socialist country, we in China will work in friendly collaboration with and seek to learn from the good experience of other member countries of the Fund and the World Bank, especially the developing countries. We are prepared to join with all of you in a common effort to enable the Fund and the World Bank to play a greater role in providing developing assistance.

Statement by the Governor of the Bank for Belgium

Paul Hatry

As this is the first time that I have participated in the Annual Meetings of the Fund and the Bank, I cannot refrain from prefacing my remarks with one or two personal reflections.

I cannot help comparing the mental picture I had of your institutions with what I actually find today. Among the principles and objectives that inspired the founders of the Bretton Woods institutions we find the following:

—relative exchange rate stability;

—widest possible freedom in international trade relations, devoid of discrimination between countries and of protectionism;

—pursuit of balance of payments equilibrium through use of the established regulatory mechanisms;

—and, of course, reconstruction in the countries affected by World War II,

—together with development.

Circumstances have altered the relative importance of these various objectives, and first priority has shifted to development and everything associated with that concept.

On that subject two personal thoughts come to mind:

1. At a time when annual growth of world trade is down to less than 5 per cent, it is important to take a closer and more critical look at all the obstacles that exist to international trade, whether hidden or overt and whether attributable to developed or to developing countries, with the object of restoring to international trade its role as a growth factor.

2. As the Minister of Finance of an industrial country I cannot help noting that such countries are finding it more and more difficult to act as the locomotive of world growth as they did in the 1970s. The two oil shocks of 1973–74 and 1978–79 have resulted in a marked deterioration in the financial situations of our countries, bringing appreciable balance of payments deficits, a halt to GDP growth, and substantial budgetary shortfalls in the public finances.

This state of affairs has obvious consequences particularly for relations with the developing countries, toward which the industrial countries can no longer play their former role of growth poles. I believe that the developing countries need to be aware of the disastrous consequences

that the oil shock means for them, not only directly, in balance of payments terms, but also indirectly, through the restrictive effect exerted by the transfer of resources from the industrial to the oil producing countries.

Our meeting is being held under thoroughly inauspicious circumstances. Since last year's Annual Meetings, there has been no letup in worrisome developments on the international economic front—the size of the imbalances following the second oil shock has exceeded predictions, economic activity remains stagnant, inflation remains strong, doubts are expressed as to the ability of the capital markets to play a regulating role, and protectionism remains a menace.

Despite this pessimistic picture, international solidarity remains more crucial than ever. It is indispensable if the international community wishes to cope with the present challenges—the consistent development of economies as well as the struggle against inequalities.

Financial institutions, representing countries at different stages of development, are the arenas in which international solidarity can best be expressed and the required resources can be mobilized. In the past, the Bretton Woods institutions have been at the forefront of the search for solutions to the financing problems of their members. They have demonstrated their ability not only to meet needs but also to adapt to new circumstances. . . .

The intervention of the World Bank will fully bear fruit only if it is accompanied by complementary action on the part of the International Monetary Fund, on which I should like to express a few thoughts at this point. After the major disturbances that took place in the first half of the last decade, the Fund progressively adapted its efforts to the new circumstances. Through successive innovations, it succeeded in preserving its essential role in international payments, when many people feared its disintegration. Thus, it was realistic and farsighted enough to pursue its efforts and take steps to place the SDR at the center of the international monetary system, to integrate the new *de facto* situation with respect to exchange rates into its legal structure, and to create additional financing mechanisms to alleviate the insufficiency of its own resources.

Are all these adjustments of recent years still sufficient to meet the needs of the present economic situation, profoundly disturbed by the latest oil shock? Does not the existing legal structure pose an obstacle to the implementation of the more basic reforms that may be needed? These questions deserve in-depth consideration by all of us during the coming year. I shall limit myself to stressing the need for the Fund to undertake certain concrete actions in the coming months and to saying something about the type of International Monetary Fund that Belgium would like to see develop in the future. Basically, it would be a Fund

with increased resources, an enlarged field of action, and strengthened cohesion.

The size of today's deficits has exacerbated the marked reduction in the ratio of quotas to total financing needs. This situation must be remedied. It requires the prompt entry into force of the Seventh Review of Quotas and, in my view, fully justifies opening, in the near future, negotiations on the Eighth Review of Quotas. In view of the need to reach agreement within a reasonable time, the new review of quotas could be undertaken in two stages. The first stage would include an agreement in principle on the size of the needed increase and on the desired apportionment of the increase between an equal-percentage portion and a selective portion. If it turned out in the course of the negotiations that general agreement could not be reached to carry out these measures simultaneously, or that the effort to reach such agreement would endanger the agreed timetable for implementation of the Eighth Review of Quotas, the proportional increase should go into effect as soon as possible while any needed discussion of a selective increase was pursued. These increases, both proportional and selective, would provide the Fund with the resources required to cope with the magnitude of the need, while protecting a level of conditionality appropriate to fostering the required adjustments.

To enable the Fund to fulfill its basic role as a recycling institution, its resources could be supplemented by borrowing on a larger scale. Such borrowing should be facilitated by enabling the Fund to negotiate lines of credit with potential lenders and to accept sufficiently transferable deposits. In its choice of financial sources, the Fund should be flexible and independent enough to borrow the agreed amount of money on the most appropriate terms. In this connection, I believe that the opportunity for direct recourse to the international capital market should be held open. To permit the Fund to make short-term placements of the money it borrowed, such provisions of the Articles of Agreement as those limiting the investment account might be amended.

Finally, I would suggest consideration of the possibility that the Fund be empowered to allocate SDRs for purposes of financing drawings by members facing structural balance of payments deficits, so as to achieve a solution reconciling the requirements of conditionality with the need to provide developing countries with funds at a cost appropriate to their situation. This formula would have the advantage of freeing the Fund from the need to borrow in order to cope with requests for drawings which it cannot meet with its ordinary resources.

With respect to the Program of Action of the Group of Twenty-Four, we believe that the Executive Board must actively pursue its examination

of the questions posed. In this connection, it appears to us that the idea of a link might usefully be considered anew, adapting it to the specific requirements of the present situation, that is, to the situation of the developing countries, and especially the poorest among them. These countries are confronted with persistent payments imbalances, deteriorating terms of trade, and, in some cases, a relative lack of access to the resources of the capital market. The formula which seems most appropriate to us would involve the distribution of allocated SDRs in a manner more favorable to the countries most in need of them. The amount of SDRs allocated to each participant would still be determined on the basis of their quotas, but the percentages used would no longer be the same for all participants. The total size of the allocations, however, would continue to depend on the need for reserves.

The expanded support, which thanks to an increase in its resources the Fund will be able to provide to its members with balance of payments deficits, would be reinforced and facilitated by an expansion of the Fund's field of action relating to its surveillance activity and the composition of its members' reserves. In the great majority of cases, the adjustment burden rests solely on the deficit countries. Logically, the members with a surplus should contribute more to the achievement of overall equilibrium through appropriate policies, thus promoting a more balanced and symmetrical adjustment process. In addition, the multiplication of decision-making centers, and of currencies used, calls for the pursuit of greater internationalization and improved stabilization of reserves. It is in pursuit of these objectives that our country has actively supported consideration of substitution mechanisms, which would substitute special drawing rights for the reserves of members. We think it desirable that work on these mechanisms be actively pursued without delay.

The increase in the Fund's resources and the expansion of its field of action must be accompanied also by a greater internal cohesion of the institution itself. If we actually want to carry out the decision to make the SDR the central element in the international monetary system, it would be logical for the Fund to make it the true kingpin of its structure. To this end, active thought should be given to the possibility of merging the General Resources Account with the Special Drawing Rights Account, so that the Fund could conduct all of its operations in SDRs.

These then are, in brief, the paths I think need to be followed to meet more fully the needs of the members in a changing world. Achieving the objectives I have just described will not be easy, I agree. If the present legal structure poses a barrier to implementation of the needed reforms, it is our job to remove the barrier by amending our fundamental Agreement.

STATEMENT BY THE GOVERNOR OF THE FUND FOR THE UNITED KINGDOM

Sir Geoffrey Howe

Introduction

May I begin by joining with others in welcoming to the Fund and Bank the new members, St. Lucia, and St. Vincent and the Grenadines, and, with particular pleasure, our newest member, Zimbabwe. May I express too my satisfaction that the People's Republic of China is now participating in the Fund and Bank. This is an event of great significance and represents a major broadening of the two organizations.

Economic Outlook

The world economy is still adjusting to the effects of the recent oil price rises. At Belgrade last year, and again at Hamburg, the Fund consistently stressed the need to give priority to the fight against inflation—and particularly to prevent higher oil prices from having an inflationary impact on other domestic costs. Events since then have shown the wisdom of that advice. There are signs that inflation in the industrial countries has now peaked and may be beginning to subside.

But inflation, although declining, still remains far too high. The first movements in the right direction provide no kind of excuse for more relaxed policies. For each successive cycle in recent years has started from a higher rate of inflation than its predecessor. We must make a decisive break in this upward trend.

Fighting inflation clearly involves sacrifice in the short term. This is no doubt why the Managing Director remarked, in his report to the Interim Committee, that the commitment of many governments to the containment of inflation might soon be severely tested. But short-term sacrifice is unavoidable if we are to lay the foundation for more sustainable growth. The costs of the alternative course of more accommodating policies, whether in the national field or in the management of the world monetary system, would ultimately be greater. The value of currencies, and the international monetary system, would be progressively undermined. Inflation would flare up again with still more serious effects on growth. In its communiqué this week, the Interim Committee rightly concluded that the top priority being given to the fight against inflation must not be relaxed.

The False Division Between North and South

The increases in the price of oil have also transformed the pattern of economic relationships in the world. But we have been slow to

change the way we think about world economic problems and slow to realize that the pattern of roles and responsibilities has fundamentally altered. For many years now the world has commonly been divided into "North" and "South." This classification into two mutually exclusive groups was always oversimplified. Today I doubt whether it is helpful or even accurate in analyzing the world's problems. We must always beware of the dangers of simple categories. Nations are like people, they have different personalities, endowments, problems, and attitudes. They have roles both as individuals and as members of groups.

Take first the non-oil developing countries. Nobody should any longer make the mistake of treating them as though they were all identical; for we must all recognize their great diversity. Some have become major exporters of industrial goods and have achieved rapid increases in living standards. They consume the greater part of the oil used by developing countries. They account for a high proportion of borrowing from international capital markets. With the right policies their ability to raise credit on the market should remain considerable. Some countries in this group have a good resource base as major producers of important raw materials.

But others are less fortunate, with low and, in some cases, even declining GNPs, and rely very heavily on official flows of one kind or another. Their problems are indeed serious. They have generally been unable to increase their borrowing as fast as the average for developing countries, but because of slow growth in export earnings their debt-service ratios have worsened more than the average. It is in these countries that the greatest needs are found, and it is on these countries that we need to concentrate the concessional assistance that is available.

Even the relatively small group of oil producers is far from homogeneous. Some find it easy to spend their extra revenues. In consequence they may not have much of a surplus to recycle. Others have a substantial surplus. These too have a strong community of interest with the rest of the world. They depend for their markets and the value of their investments on growth and prosperity elsewhere; their savings suffer also from inflation and exchange rate instability; and they depend on the continued soundness of the international banking system.

Finally, there are the industrial countries that have so far passed under the collective name of the North or the West but that are in fact to be found all over the world. There is, is there not, something

strange about the way in which I have described—as many of us tend to do—the various categories without having said one word about the industrial countries of Eastern Europe which are not members of these institutions. They play a very small part in the transfer of resources to the developing countries.

It is in fact the free industrial countries that have been the biggest aid donors, accounting in recent years for 80 per cent of official flows. But there are limits to what they can achieve and still stricter limits to what their governments can do. The impact on the developing countries of an oil price increase of the order we have seen over the last year and a half far outweighs the benefits from the aid the industrial countries have been giving. In addition, it imposes on the industrial countries an adjustment burden which sharply reduces their capacity to increase, even to sustain, aid programs and open trading policies.

We see then diversity between different countries. And yet the changes wrought in the world economy brought about by higher oil prices have obliged most countries to face new and formidable problems, which we now must share together. In these circumstances, it is quite frankly a misleading mistake to go on discussing world economic problems exclusively in traditional North-South terms. The oversimplified division now masks the true nature of the situation. Oil and the new patterns in the world economy have created a new dimension. We need to break away from a debate about aid on its own, and look instead at total resource and trade flows.

In any event we should recognize that the true size of the contribution of industrial countries to development is not adequately measured by looking solely at official flows. It should not be forgotten that, in addition to the 0.7 per cent official aid target, there has been throughout the 1970s a second target of 1 per cent of GNP for the transfer of resources through total financial flows. This wider, and inclusive, target has been substantially exceeded by a number of countries. The average for the industrial countries in 1978 was 1.2 per cent of GNP. Private flows to developing countries, which rose during the 1970s from $7 billion to $43 billion—about double in real terms—are now around twice as large as official aid flows.

Let me say a word about the facts of the U.K. aid program. I think I heard the President of the Bank say yesterday that by 1985 our aid as a percentage of GNP would fall by 25 per cent below the average of 1977–79.

In 1979 our aid was 0.52 per cent of GNP. This was well above the OECD average and compared favorably with other major countries. Around 70 per cent of our program, bilateral and multilateral, goes to

poorer countries. This emphasis is exactly in line with Mr. McNamara's exhortation to us yesterday.

As to the future, he was right to say that in real terms we are having to reduce our program from present levels. We cannot escape the need to reappraise rigorously all our public expenditure programs, including aid, as part of our difficult fight against inflation. Our present policy is essential to the restoration of our economic health, on which depends the scale of our future contribution to the developing world.

However, I do not begin to recognize a 25 per cent reduction in GNP share for aid. We have not yet determined our aid program for 1985. The 25 per cent reduction appears to assume an average rate of growth for our GNP between 1980 and 1985 of about 3 per cent per annum. We have made no such forecast. We face a fall of 2 per cent or more in GNP this year, which is all too likely to be followed by a period when growth is slow. So I am afraid that I do not regard the figure of 25 per cent reduction as valid.

Responsibilities of Different Countries

The growing diversity of the world economy points up the need for an approach which recognizes our widely varying responsibilities in managing our economies. Starting with the industrial countries:

—We must, above all, curb inflation—and so help check the rise in import prices for the developing countries and oil producers, as well as restore the health of our own economies.

—We must maintain open trading markets, particularly for the exports of developing countries.

—We must maintain open capital markets, both to allow surplus countries to acquire a wide range of financial assets and to give developing countries access to finance for their deficits. The United Kingdom is practicing what it preaches. We have maintained one of the most open major economies in the world. We have eliminated exchange controls, freeing the flow of investment to developing countries.

—And we have a special responsibility to maintain confidence and stability in international capital markets, in the interests of borrowers as well as lenders.

In considering the oil importing developing countries we must keep in mind the wide differences between them. They include, as I have said, many with the most serious problems, which will need substantial help from the international community. But three points are important:

—These countries cannot avoid the need to adjust to changing conditions, often at heavy and painful cost to development. This adjustment can be eased by help from the international financial institutions and, in particular, by early and full use of Fund resources.

—It will help if oil importing developing countries maintain a climate which is favorable to private capital and to external borrowing. This is not only a question of investment incentives or tax structures; above all, it is a matter of prudent and consistent economic management and political stability.

—The poorest developing countries have grown more slowly than the average, and in some of them growth per capita has been relatively even more depressed because of the rapid rise in their populations.

As for the oil producing countries, their responsibilities have increased in line with the power and wealth which higher oil prices have brought them:

—The world looks to them not only to maintain the flow of oil and to avoid sharp increases in its prices but also to pay full regard to the impact of both on the world economy.

—Alongside the important part they can play in strengthening the resources of the international financial institutions, we must expect them to assume more direct responsibility for recycling, whether bilaterally or through OPEC institutions.

What I am suggesting, then, is that we should get away from the misleading overtones of confrontation—of "haves" versus "have-nots"—which have all too often been implicit in the old North-South framework. Of course, I acknowledge and understand the misery that is involved in poverty. It is for the sake of the poorest nations as much as any that we need to think of the world economy not simply as a redistributor of limited resources but as the generator of additional wealth. We live in a network of obligations certainly; but it is a network of opportunity as well. This is the full meaning of the interdependence of the world economy of which the Brandt Commission has spoken.

International Capital Markets

I have emphasized the important role of international capital markets. The ability of the private capital markets to carry the burden of recycling in the way they did after 1973 has been the subject of some debate. We cannot ignore such factors as the strain on banks' balance sheets and high exposure to a limited number of countries. Certainly it will not be easy to maintain the necessary momentum. For some banks and for

some borrowers in the forefront of the growth in international bank lending, there may well have to be some reining back. Borrowing countries will need to follow policies which continue to command the confidence of lenders. The greatest threat to recycling would be any loss of confidence in the system. So I regard emphasis on prudent lending as a help, not an obstacle, to recycling. Since 1973 the markets have developed in both size and depth, and this will enable them to continue to play a major role in recycling.

International Financial Institutions

Even so, it will clearly be necessary to strengthen the role of the international financial institutions. I have no doubt that we should build upon those which already exist, adapting them to meet changing circumstances. They have accumulated a massive body of experience. It would take many years for new institutions to become as effective. It is fewer bureaucracies that we need—not more. . . .

The Fund

It was agreed at Hamburg that the Fund too should take steps to make more resources available. I therefore welcome the proposals that have been made to lend more money in relation to quota than in the past. As we noted at Hamburg, financing and adjustment still need to go together. Alas, the fact that a deficit is caused by external factors beyond a country's control does not remove the need for policy changes in that country. In the real world the price of oil, for example, is very unlikely to revert to the old level; and adjustment may be more painful and take longer than it has done in the past. The Fund should be sensitive to this situation by making assistance available over longer periods, agreeing programs to be implemented over several years in conjunction with a series of stand-by agreements. The basic principle of conditionality should be maintained, but in each case the agreed program ought to, and I am sure will, take careful account of the applicant country's specific circumstances. This was one of the points which clearly emerged from the recent meeting of Commonwealth Finance Ministers, of which I had the honor to be Chairman.

I detect in many papers and in the interventions of a number of speakers a wish to turn the Fund into an aid-giving organization. I urge my colleagues not to move down this path. We must distinguish the aid functions of the Bank from the work of the Fund in sustaining the international monetary system. If the Fund provides resources to cover persistent general balance of payments deficits without adjustment programs, it only makes it harder for the borrower to adjust when the

moment of truth comes, and at the same time it may risk giving a further impulse to international inflationary forces. We must be vigilant to avoid that danger. We shall all be best served if we resolve to sustain the Fund as an institution which promotes the process of adjustment in a difficult world rather than one which helps to postpone it.

If the Fund is to lend more, it needs the resources to do it. Quotas should remain the primary source of funds. The United Kingdom has now ratified its seventh quota increase and urges others to do so quickly. But we also accept the need to supplement the Fund's resources by borrowing. We continue to attach importance to direct borrowing from surplus countries and hope that present difficulties can be soon overcome. But if they cannot, the Fund should certainly be prepared to look more closely into the question of other kinds of borrowing.

International Monetary System

Recent discussion has been dominated by the position of developing countries in the world economy. But we must not forget the more traditional concerns of the international monetary system. The past year has seen a number of measures taken which represent further steps toward the emergence of a multicurrency reserve system. I see this, in present circumstances, as an inevitable development which reflects the changing distribution of economic strength in the world and of the responsibilities which go with it. I do not believe governments can for long resist it.

But to function successfully a multicurrency reserve system will almost certainly require a general acceptance and understanding of the responsibilities which rest on reserve currency countries and the reciprocal responsibilities which are owed to them. It should be accepted that countries whose currencies have a significant role in the international monetary system have a duty to pursue policies which do not undermine the value of those currencies. Conversely, it should be incumbent upon the major holders of those currencies to manage their official reserve portfolios in a way which helps to minimize volatility. In this way a stable framework for private as well as official holdings will be created. Essentially, these were the principles of Bretton Woods—but adapted to a new environment in a world of floating exchange rates.

In a multicurrency world, there is an important and growing role for units like the SDR and the ECU. It is still my view that the substitution account has a useful role to play and I hope that discussions will be resumed before very long. I welcome the steps which have already been taken to enhance the attractiveness and use of the SDR, such as the extension of the list of bodies eligible to hold it and the reform in its composition.

Conclusion

I would like to end by expressing my belief that existing institutions and structures, as they evolve, can respond to the challenges that are being presented, despite real and justified dissatisfaction with our present lot. We must resist the temptation to write off the world economic system, to tear it up and start again. Our economies and financial markets have demonstrated their adaptability and resilience. We must not be tempted by any quick fix solution. Rather we must work together with a sense of mutual obligation. Between us we have the capacity to cope with the problems that will continue to beset us.

Notes

These notes amplify some of the remarks made in the Chancellor of the Exchequer's speech to the Fund-Bank Annual Meetings.

1. The substantial difference in the growth performance of different groups of developing countries is illustrated by the following figures:

	Annual Percentage Growth, 1970–80		
	GNP	Population	GNP per capita
All developing countries	5.3	2.4	2.9
Low-income countries			
Sub-Saharan Africa	3.0	2.8	0.2
Asia	4.2	2.2	2.0
Middle-income countries			
East Asia and Pacific	8.0	2.3	5.7
Latin America	5.8	2.6	3.2

Source: World Bank, *World Development Report, 1980,* Table SA.1, page 99.

2. The difference in the structure of balance of payments financing (current account deficit plus reserve growth) of different groups of developing countries is shown below:

	Average Percentages, 1976–79			
	All non-oil LDCs	Major exporters of manufactures	Low-income countries	Other oil importing LDCs
Nondebt-creating flows, net	30	26	35	25
Official long-term capital, net	28	22	42	24
Total official flows	58	48	77	49
Private long-term capital, net	40	55	3	29
Other financing capital flows, net	2	−3	20	22
Total	100	100	100	100

Source: IMF, *World Economic Outlook*, May 1980, Appendix C.

3. Indebtedness and debt-service ratios (payments as a percentage of export of goods and services) of groups of developing countries, 1973–80:

	Debt-Service Ratios		Debt in 1980 as Percentage of 1973
	1973	1980	
All non-oil developing countries	8.9	11.1	368
Major exporters of manufactures	7.7	8.2	305
Low-income countries	9.0	15.4	348
Other net oil importers	7.2	9.3	384

Source: IMF, *World Economic Outlook*, May 1980, Appendix C.

4. The relative size of trade and financial flows to developing countries is illustrated below:

	1979 (*In billions of U.S. dollars*)
Official development assistance	22.3
Other official flows	3.0
Private flows	43.2
Export earnings	177.7

Source: OECD, DAC Press Release No. 80/39, June 1980.

Statement by the Governor of the Fund for Italy

Filippo Maria Pandolfi

During the past year, the representativeness of our institution has been strengthened by the association of countries which have reached statehood or which were previously not represented. We welcome the new members of the Fund and the Bank. I would also like to extend a warm welcome to the Governors for the People's Republic of China, who have brought into our institutions the voice of over one billion people. Finally, I would like to thank the staffs of the Bank and the Fund for the excellent organization of the Meetings, and President Carter for his introductory address as well as for the gracious hospitality extended to us by the United States authorities.

Italian Economy

The rejection by Parliament on Saturday last of a Decree-Law containing a set of economic stabilization measures led to the resignation of the Italian Cabinet. This, inter alia, created a situation of conflict be-

tween my immediate domestic and international duties. I hope I have reconciled this conflict at least to some extent by being present here today to address my fellow Governors. I was needed in Rome over the weekend to introduce a number of urgent measures of a precautionary nature. These measures are tough ones, as they include a further raising of the discount rate to a historically high level and a tightening of regulations governing foreign trade financing. The speed with which such preemptive actions were undertaken clearly shows that we have not lost our determination to cope with difficult circumstances. Our economy has gone through difficult periods in the past, showing both resiliency in the face of adverse developments and vitality in meeting new challenges. I believe that the time has come again to show our ability to react, and I trust we will do so.

Indeed, over the recent past the performance of the Italian economy has been strong. The period of rapid expansion, which started at the end of 1978, has continued well into 1980, in the wake of a long-awaited recovery of fixed investment, with the result that over the two years 1979–80 the economy will show a growth of as much as 10 per cent.

The combination of rapid growth in a context of declining world activity and of the impact of the oil price increase has caused a sharp swing in our balance of payments: the current account is now expected to record a $7 billion deficit in 1980, after a large surplus in 1979. As signs of overheating became apparent and inflation accelerated, our monetary policy was progressively tightened.

The policy of high interest rates has favored foreign financing of the balance of payments, with the result that international reserves in convertible currencies, ECUs, and SDRs have remained at a level which is fully adequate for our prospective needs. Our economy is now expected to slow down considerably, and this in itself should help to reduce substantially the high demand for imports which has prevailed recently and thus to relieve pressures on our balance of payments.

I am in no position at present to outline the strategy of economic policy in Italy for the period ahead. There are differences of views among the political parties on the components of the economic policy program. But there is substantial consensus on the need to reduce inflation; besides being in itself one of the ultimate policy objectives, this will help us to strengthen the productive structure of our economy and, as in the past, to maintain our external payments in reasonable balance over the medium term. I believe these goals are within reach if the consensus on the objectives can be translated into concrete policy actions.

World Economy

For the second time in a decade the world economy has been hit by a major oil shock. As indicated by the Managing Director, Mr. de Larosière, in his address, imbalances are re-emerging in international payments, and slow growth of output and of employment are in prospect in both industrial and developing countries.

The full deflationary effects of the oil price increase have yet to work their way through the economy, but the direct impact is already estimated at about 2 per cent of the aggregate GNP of oil importing countries. At present the relative cyclical positions of major countries make it unlikely that a severe recession will ensue as it did in 1975. It is also unlikely, however, that the behavior of the relative prices of oil and manufactures will follow the same pattern as in the post-1975 period.

Under these circumstances, the risk of a protracted stagnation of economic activity cannot be ruled out. This would only aggravate social tensions, as the number of unemployed is already exceedingly high in both industrial and developing countries. But a slackening world economy would not entail per se a significant abatement of inflationary pressures. Although price increases are expected to slow down somewhat in 1981, inflationary expectations remain strongly entrenched in our economic system.

The process of adjustment to this new situation has barely started in most countries, but we already know what lies ahead. Adjustment will involve large transfers of resources and severe sacrifices. Adjustment will require that top priority be given at this juncture to a reduction of the inflation rate and that the domestic causes of inflation, such as institutional rigidities that hinder the needed redistribution of resources and of incomes, be attacked.

Adjustment means that an appropriate degree of restraint in monetary management should be accompanied by determined efforts to reduce public sector deficits and to remove price distortions which discourage efficient uses of resources and savings.

"Real" adjustment means the introduction of policies designed to elicit supply responses, to increase investment and productivity, and to free resources for export. It means also the transfer of higher oil costs to final users to bring about significant energy conservation and encourage the development of alternative energy sources.

These are great challenges, but the future of the world economy over the next decade is crucially dependent on our ability to meet them courageously and effectively.

The re-emergence of large imbalances in international payments and the prospect of having to live with them for a protracted period raise fundamental questions for the future of the international monetary system and of our Bretton Woods institutions.

We can, on the whole, be reasonably content with the way the recycling process has developed so far. But the outlook is not entirely bright. Private capital markets have shown in the past their resiliency and flexibility in accommodating a rapidly growing demand for financing. No doubt they will continue to play their role. However, increasing reluctance by international banks to continue expanding their exposure in highly indebted developing countries is becoming apparent in the form of a marked slowdown of new commitments and widening lending spreads.

Such developments are not inappropriate in light of the need for continued stability of the international banking system, and we should see to it that the expansion of lending does not foster inflationary financing of the imbalances and remains within prudential limits both as regards risk concentration and lending-to-capital ratios. Against this background, we reaffirm the view expressed in Hamburg by the Interim Committee that a larger role for multilateral financing institutions is called for in order to ensure that financing of the imbalances is accompanied by appropriate adjustment policies.

Policies of the Fund and the World Bank

The scope for multilateral action in this area is very broad. And while the Bretton Woods institutions should continue to play the central role, there is ample room for supplementary and mutually supporting initiatives at a regional level, such as those the European Community is at present undertaking.

The Fund and the World Bank, for their part, are adapting their lending policies so as to increase the financial resources available to members in support of appropriate adjustment programs and to take into account the nature of the imbalances. We have endorsed the consensus which has emerged during the past few months as regards enlarged access to Fund resources by members as well as the adoption of a new "program lending" policy by the World Bank. Significant increases in the development institutions' capital have been agreed upon, while the seventh quota increase is approaching completion in the Fund. In this connection I should note that Italy has recently completed the parliamentary process for its quota increase and will shortly notify the Fund accordingly.

But we are aware that the resources needed to implement the adjustment process are enormous, certainly well beyond what many members

of our institutions will be able to mobilize internally. A further substantial increase in the resources made available by the World Bank and the Fund to oil importing developing countries must be envisaged. To this end we have supported an increase in the gearing ratio of the World Bank and the early start of the Eighth Review of Quotas process in order to restore the centrality of quotas as sources of Fund financing. The Eighth Review of Quotas will also offer a proper opportunity to consider the requests to raise the quotas and voting power of developing countries in the Fund.

The resumption of SDR allocations in the fourth basic period may also be envisaged in light of the aggregate need for reserves. It would serve the purpose of strengthening the role of the SDR as a reserve asset. The changes recently introduced in the SDR basket are intended to enhance the attractiveness and marketability of the SDR and thereby facilitate Fund borrowing.

Two priority areas for the developing countries in which our efforts should be concentrated are food and energy. We support the proposals recently put forward by the World Bank for the establishment of a new energy affiliate, along the lines suggested at the Venice Summit, and by the Fund's Managing Director for special financial assistance to members adversely affected by higher food import costs.

Any proposal to substantially increase the resources of the Fund and Bank will need the support of the oil surplus countries, and I am sure they will show in this manner their willingness to take responsibilities commensurate with their newly acquired wealth for the continued effectiveness of our institutions and the solution of development problems. Such an increased role on the part of oil surplus countries is especially needed at a time when industrial countries, faced with severe domestic adjustment problems, are finding it difficult to maintain targeted levels of ODA. And I say this, coming from a country which has been severely hit by the higher oil prices and still has been able to substantially increase its appropriations for assistance to developing countries. Difficulties do not exempt us from our responsibilities.

A decade has just ended, one which many observers thought would witness the demise of the Bretton Woods institutions. A new decade has just started and I believe it will show the continuing vitality of these institutions and their ability to adapt themselves to new realities without losing their fundamental character. The outcome of our deliberations in these Meetings is a first indication that we can indeed blend the urge for change and the desire to preserve into a viable and progressive line of policy. This is the avenue we should endeavor to follow in the years ahead. . . .

STATEMENT BY THE GOVERNOR OF THE FUND FOR NEW ZEALAND

R. D. Muldoon

Mr. Chairman, first of all I wish to congratulate you on the theme of your opening address. We have had too many words, and what the world now needs is action and the political will to act.

Two closely related and equally depressing factors determine the outlook for the world economy. First, there are massive imbalances between the surpluses of the oil producing countries and the deficits of the oil importing countries. Second, adjustment to higher oil prices and action to stem inflation have resulted in depressed economic conditions in the major Western economies.

I do not propose to discuss here the pattern of events that has produced these conditions. There has been endless debate in various institutions over the last year apportioning blame for what has happened. Rather, I want to talk about the consequences of payments imbalances and depressed economic conditions.

Countries which depend heavily on imported oil and which also have low per capita incomes view the future with foreboding—foreboding which was clearly apparent among Ministers speaking at the Commonwealth Finance Ministers' Meeting in Bermuda last week. At that meeting there was agreement that "funds available for developing countries were not growing as fast as the problems to be solved with the aid of those same funds."

There is an urgent need for finance to be available on conditions and for terms which will enable the deficit countries, particularly the poorer ones, to adjust to the new situation by increasing production from their own resources without at the same time holding back development by limiting demand. Countries whose people are already near starvation cannot suffer a further reduction in the level of real personal incomes. Only by making available the means of improving the supply side of their economies can the necessary adjustment be made in an acceptable way. Action to achieve this takes time. Indeed, it will not even begin unless the governments of such countries have the assurance of adequate finance for sufficient periods.

As Governors of the Fund and the World Bank, we have a responsibility to the world community to cooperate in putting together a plan of action which will provide a practical way of helping countries hard hit by the increase in the price of oil. If help is to be effective, however, it must be based on acceptance of the fact that adjustment to the impact of higher oil prices will take time. Finance must not be so restrictive as to

cost, term, and conditionality as either to inhibit the adjustment itself or cause undue political restraints. We are not planning in some philosophical ivory tower but in the real world of threatened political and social dislocation. Whatever solutions are produced must be practicable in the domestic political sense as well as in the banking and economic sense. Above all, our approach has to be positive. There are countries that are on the point of losing hope. That in itself suggests that the system may not be working as well as it should. We should therefore be prepared to contemplate change before that lack of hope turns to despair.

I have followed with interest the debates on the conditionality requirements attached to the use of Fund resources. The move toward more flexible conditionality requirements by the Fund and toward structural adjustment lending by the World Bank are welcome. There is debate about whether we have yet gone far enough. Attitudes to this question are influenced by our approaches to political issues. There are sharp differences in the ability of countries to absorb the balance of payments effects of oil price increases by restraining demand. The incomes of the people of some countries are already so low that traditional demand management policies are inappropriate; for if they are implemented, they will make the structural changes needed in the longer term more difficult to achieve.

The process of recycling goes beyond a simple shifting of oil producers' surpluses back into the world's capital markets. The terms and conditions under which recycled funds become available to developing countries will, in the last analysis, determine whether recycling is successful. Recycling is of little long-term benefit to the non-oil producing developing countries unless it can result in additional output. Finance must be available for such periods and on such terms as will encourage rather than discourage a fuller use of resources.

The experience of the early 1970s taught us that the major developed countries with deficits should not close the gap by adopting measures which pass the burdens to those who can ill afford to shoulder them. Their very strength both enables them, and places them under an obligation, to accommodate their deficits in a way that has the least adverse effect on the balances of weaker economies. But major economies cannot by themselves shoulder the burden of adjustment. The welfare of all, including the welfare of the surplus countries, will benefit from an orderly and equitable adjustment to the situation with which we are faced. In their own self-interest, the oil producing surplus countries should bear a part of the burden. This would best be achieved by a willingness to lend through the Fund at less than a normal market rate of interest.

There is another area in which all countries could make a contribution. Many deficit countries, and New Zealand falls into this category,

intend to make the adjustment by improving the performance of the supply side of their economies with particular attention being paid to the production of internationally traded commodities. It is therefore of critical importance that opportunities to trade internationally should not be obstructed by restrictive trade and payments practices. Protectionist policies may seem to lighten the individual burden of adjustment by shifting it to others—but these others usually turn out to be those least able to cope with the burden.

Recycling, therefore, demands a truly cooperative approach on the part of all countries, large or small, oil exporting or oil importing, surplus or deficit. It also demands a positive and constructive approach. There is no alternative to an enlarged role for the Fund. No other institution has the Fund's international stature, coverage, or technical expertise. This unique position, however, is matched by a responsibility to respond quickly and appropriately to the economic needs of the international community.

There are several paths which the Fund can now take to finance its expanded role:

— Further increasing quotas so they are again a significant proportion of international trade.
— Further allocations of SDRs.
— Borrowing directly from the surplus countries, preferably on concessional terms.
— Borrowing from the market.

We would support movement in each of these directions, as appropriate. The Fund has responded well in the past to the changing demands that have been made on its resources. The task now is to ensure that the resources are available to enable the Fund to respond to the demands that it is going to face in the future.

The Fund must maintain its present role of financing temporary trading imbalances brought about by, for want of a better word, "normal" fluctuations in the world trading patterns. In this context, the traditional role and facilities of the Fund, and the conditions attached to their use, are reasonably appropriate. However, high oil prices have imposed a fundamental and long-term shift in the world's trade flows. The resultant deficits cannot be financed entirely from commercial sources. Also, in many cases, the adjustment cannot be financed from within the Fund's present facilities as the terms and conditions are inappropriate for the long-term nature of the process. The demand management economic policies traditionally required for short-term fluctuations run the risk of restricting growth, aggravating social tensions, and thereby undermining the necessary adjustment process.

In assessing possible directions for Fund policies we must maintain as fundamental the need to encourage countries to increase the efficient use of their own resources. Only by increasing the supply of goods and services, particularly those which are internationally tradable, can the necessary adjustment be made in a satisfactory way. Continuing access to Fund facilities could be related to the progress countries were making toward this longer-term objective.

In many cases the poor availability and the cost of money from commercial sources inhibits rather than encourages the kind of adjustment that is most needed. The recycling process has the potential to benefit both the lender and the borrower. The Fund has the attribute of shared liability which enables it to attract funds which might not be available to individual members. The Fund should exploit this attribute to the benefit of those countries most in need of assistance. Whether we are talking in terms of new facilities or the further development of existing facilities, the Fund's policies should be based on the need for both oil surplus countries and the rest of the international community to share the responsibility for financing the deficits of countries most affected by the oil price increases of the last two years.

In this statement I have concentrated on the issues of recycling and Fund policies. . . .

I deeply regret the failure to make progress on the proposal for a substitution account. The danger posed by the overhang of stateless currencies remains as a major threat to international economic stability.

We have heard in the current debates in the United Nations forums some hard words about the International Monetary Fund and the World Bank. I do not fully subscribe to that criticism although I have some criticism of the lack of appreciation of the human and political factors in adjustment which has from time to time been shown by the Fund. Nevertheless, unless the Fund and Bank can get the support of their members to respond quickly and positively to the changed economic circumstances of the 1980s, then that widespread criticism may well prove justified.

Statement by the Governor of the Fund and the Bank for India

R. Venkataraman

At the outset, I would like to welcome the new members who have joined the Fund and the Bank family since our last meeting: St. Lucia, St. Vincent and the Grenadines, and Zimbabwe. We are also happy to

welcome the People's Republic of China, whose statement we have heard with deep interest this morning, to the Fund and the Bank and look forward to its active participation in the two institutions.

When we met at Belgrade a year ago, only the most optimistic among us would have expected the intervening period to be less than grim. Economic projections made by the Fund staff last spring and updated very recently offer little comfort. More countries would now be facing pressing financing problems and those which were already in the red last year would find themselves in a near distress situation.

The World Economic Outlook prepared by the Fund rightly focuses attention on three problem areas: price projections, growth, and the external accounts. Developments in all three fields interact on different parts of the world. Inflation and sluggish growth in the industrial countries affect growth and prices in developing countries and, through these, their external balance. Therefore, all regions of the world, developed and developing, rich and poor, have a part to play in securing the needed adjustment. Policies to contain inflation should be domestically oriented, and any temptation to resort to restrictionist external policies should be avoided.

The situation confronting the low-income, non-oil developing countries is much more serious than in the past. Their terms of trade have been adversely affected by the energy situation and their current account deficits have not only been persistently large but are bound to worsen. The difficulties of non-oil developing countries in achieving minimum growth rates are compounded by the deterioration in the international economic environment and, even under the best scenario envisaged by the Fund or the Bank, they are expected to face serious problems in regard to growth and balance of payments financing in the next few years. It is therefore only natural that the principal focus of our deliberations should be on reaching an agreement on the role that the international institutions and the industrial and surplus countries should play in solving the problems of non-oil developing countries.

While these countries would be able to finance their 1980 deficits only at the cost of their international financial position, there is little prospect of their finding the requisite resources for financing the deficits in the coming years. They have limited access to international financial markets and the outlook for official assistance is not promising. Their real export earnings have been declining in recent years, and the scope for export expansion is limited, due to recessionary conditions and growing protectionism in industrial countries.

The problems of the low-income countries are not amenable to short-term solutions. The scope for any immediate curtailment of oil imports

in many non-oil developing countries is small, because these are even now limited to essential infrastructure, industrial, and agricultural uses. On the contrary, the economic growth of these countries would require more use of oil. Therefore, the only appropriate solutions are expansion of exports and development of energy resources. These call for structural adjustment, which is bound to take time and need heavy investment. Industrial countries, oil exporting countries, and international financial institutions should, in their turn, adopt policies which would create a climate conducive to the orderly pursuit of adjustment policies.

There has been no effort in the industrial countries to lower trade restraints, and existing mechanisms to control low-cost imports have become institutionally entrenched. It is particularly distressing that such sectors include those in which developing countries are competitive suppliers, such as clothing, footwear, and hand tools. A curtailment of these imports not only reduces their export earnings but also produces, owing to their labor-intensive nature, harmful social consequences, particularly for the poorer sections of society. We are also disturbed by the failure on the part of some developed countries to understand the rationale of export subsidies in developing countries and unilaterally to deny them some of the benefits under the GATT. We earnestly hope that enlightened self-interest will reverse this protectionist trend. It is now well established that an increase in the exports of developing countries brings in turn an increase in the external demand for goods of developed countries. This would also provide an opportunity to industrial countries to shift workers from unskilled, low-productivity jobs to those involving more sophisticated technology and higher productivity. The cost of such adjustment will be more than compensated for by the benefits of growth in trade, lower inflation, and higher welfare all round.

The mounting payments deficits of developing countries need unprecedented amounts of external financing during the period of adjustment. The Fund should, therefore, play a greater role in the recycling of capital surpluses in the world economy. It should ensure that countries which do not have access to capital markets or cannot afford the cost of commercial borrowings are assisted. We are glad that the Interim Committee has broadly endorsed the need for enlarged access to Fund resources to support balance of payments adjustments and the financing of such requirements by borrowing. We wish the Managing Director all success in his efforts to secure the needed amounts from potential lenders.

The developing countries are already threatened by a rising debt burden. The cost of borrowing from the Fund should therefore be lowered. We are happy that the Interim Committee has endorsed this principle in respect of the supplementary financing facility. The interest subsidy should, in our view, be financed entirely by voluntary contributions from

industrial and surplus countries, rather than from the resources of the Trust Fund. Considering that the circumstances of developing countries have deteriorated since the setting up of the Trust Fund, there is a clear case for continuing to provide this type of aid without excessive preoccupation with the functional aspect of Fund assistance.

The Program of Action of the Group of Twenty-Four has proposed an interdependent international monetary order that would be conducive to the growth of both the developed and the developing world. The Brandt Commission has also made similar recommendations. We hope constructive decisions in this regard would be taken expeditiously.

We would urge that in view of the unforeseen economic developments resulting in protracted and huge imbalances, a timely decision should be reached on a supplementary allocation of SDRs in 1981. It is our view that considerations like the global demand for increased liquidity and the balance between conditional and unconditional liquidity would warrant an allocation of SDRs in the fourth basic period on a scale far larger than in the past. With the recent improvements effected in the uses and characteristics of the SDR, a sizable allocation would be a positive move toward promoting the SDR as the centerpiece of the international monetary system. The revival of the proposal for an SDR link is appropriate, and the contribution a link could make to the international adjustment process has come to find wider acceptance. We hope that the link would become an accomplished fact of international monetary relations very soon.

In the context of world trade needs and growing payment deficits, there is an urgent need for early implementation of the seventh general quota increase and for advancing action on the eighth quota review. We hope that the opportunity will be taken at that time to review the formula for quota determination. In this context, we fully endorse the valuable suggestions made by Chairman Jamal yesterday. We would also strongly urge increased participation of the developing countries in the staffing, management, and in the decision making of the Fund. This holds good for the Bank as well.

Before I leave this part of my statement I should like to pay a tribute to Mr. de Larosière. These are deeply troubled times for the world economy, particularly for the developing countries. We in the developing countries greatly appreciate his understanding, sympathy, and quiet determination to make the Fund more responsive to our problems and needs. . . .

The World Development Report presents a gloomy prospect for the developing countries in the medium term. Developing countries would need to undertake a structural adjustment of their economies to meet the change in their external payments position brought about by factors

exogenous to them. The character of change would have to be so far-reaching that it would be more accurate to describe it as structural transformation. This transformation would require not only a massive step-up in investment but also a change in its composition.

In the ultimate analysis, the developing countries need to be more self-reliant and meet the challenges by increasing their savings and reducing their external deficits in a manner most appropriate to their economic circumstances. But this is not to gainsay the importance of external assistance for low-income countries, in particular, of official development assistance. The performance of ODA has, however, been depressing in the extreme. The current levels are less than half of the internationally accepted target of 0.7 per cent of GNP. Aid has become the inevitable casualty of the efforts of industrial countries to adopt appropriate demand management policies. In our opinion the resilience and strength of the economies of developed countries should enable them to adopt a different solution. . . .

I am attracted by the suggestion that the increase in ODA should be related to incremental GNP. A figure of 3 per cent for this incremental ratio cannot be regarded as a burden, given, of course, the political will. While on the subject of concessional assistance, I should like to state that the logic of several DAC countries putting their assistance to low-income countries on a grant basis needs to be extended to debt relief through retroactive application of currently prevailing soft terms to past credits.

I would also like to express our hope that the distribution of assistance from both the developed and the capital-surplus oil countries would be more broad based and more of it would go to the low-income countries. These countries, despite containing the greater part of the population of the developing countries, account today for very much less than half of the total ODA going to all developing countries. The distribution of concessional assistance clearly needs to be altered so as to make the greatest impact on poverty alleviation. . . .

I referred earlier to the Brandt Commission Report. I believe I would be echoing the sentiments of many around here in saying that the Brandt Commission has given us a framework for international economic co-operation based on the premise of mutual interdependence between the South and the North and the need for appropriate policies for the interconnecting range of issues of food, energy, international trade, and development assistance. I hope the recommendations of the Brandt Commission will receive the earnest consideration which they so obviously deserve and also the positive political support which they equally clearly need.