The problems of monetary management

This year's Annual Meeting of the Fund, while not dramatic in itself, discussed the intellectual background to a great deal of work still to be done. This article reports on the issues raised and the problems discussed.

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As the Thirty-First Annual Meetings of the Boards of Governors of the Fund and the Bank were opened by Mr. Mohammed Imady, Governor for the Syrian Arab Republic, in the Philippine International Convention Center on October 4, 1976, hurricane weather succeeded by clearing skies over Manila Bay. This might serve as a metaphor for the economic climate described by many of the speakers, especially from the developed countries.

Mr. Johannes Witteveen, Managing Director of the Fund, suggested that as the weather changed, so Fund members should change their policies; now that economic recovery was under way, it was necessary to ensure that the resulting growth could be sustained. Mr. William Simon, Governor for the United States, supported the Managing Director's analysis. He outlined four tasks in improving the international economic system: to restore stability in members' economies; to make the reformed monetary system work; to tackle development with more courage and understanding; and to strive for an open and free order for world trade and investment.

Few speakers quarreled with Mr. Simon's approach, but there was some hesitation in translating it into action.

For instance, Mr. George Hosten, Governor for Grenada, brought "forcibly" to the attention of the Governors that almost all small developing island economies were still suffering from a weakening of demand in their principal markets, a sharp deterioration in their terms of trade, and a consequent rise in their combined deficits.

Mr. Witteveen had proposed that the developed countries should ensure that their attempted pace of development did
not lead to a resurgence of inflation, and that they should open their markets more widely and add to development aid. On this point Mr. Felix Bandaranaike, Governor for Sri Lanka, remarked that the developing countries for more than a decade had called for dismantling the trade barriers that affected their exports. But barriers were now mainly quantitative and difficult to dismantle. If developed countries pursued demand management policies to control domestic inflation, while at the same time denying export access to developing countries, which were compelled to adjust by means of exchange rate changes, it was virtually certain that world economic activity would slow down, he said. Mr. Bandaranaike added that it was imperative that there should be a commitment from the developed countries to implement measures of import liberalization immediately. Only thereafter could orderly adjustment measures by the developing countries hope to succeed.

Yet there was little disagreement that attempts to fight unemployment by expansionary domestic policies had failed. A strong exponent of this view was Mr. Phillip Lynch, Governor for Australia. His Government at least had learned that it could no longer buy less unemployment at the expense of higher inflation. Governments had become only too used to printing money over the years, but they could not print jobs.

Mr. Per Kleppe, Governor for Norway, said that the Nordic countries considered that the 5 per cent unemployment figure still prevailing in the developed countries implied so much social strain and economic waste that it should be a first priority of all members’ endeavors to achieve a sustained recovery until unemployment had been reduced to more tolerable levels.

The role of the SDR

The Governors—and there were some 50 speakers in all—also devoted considerable time to the ways in which the Fund could help members. As Mr. Willy De Clercq, Governor for Belgium and Chairman of the Interim Committee put it, following the events of the past year—the completion of negotiations on the Articles of Agreement, the decision on the quota increase, the establishment of the Trust Fund, the creation of the Subsidy Account, the liberalization of the compensatory financing facility, and the temporary expansion of access to the Fund’s resources—the time had come for a new process of reflection in two areas: international liquidity and the management of floating rates. The forthcoming amendment to the Fund’s Articles, which would make the special drawing right (SDR) more flexible, was a step in the right direction—the SDR was originally created to ensure a responsible growth in liquidity; but the effective yield of the SDR was still lower than that of dollars invested in the money market. An increase in the yield was therefore essential if it was to become a true reserve asset.

Mr. Bernal Jiménez M., Governor for Costa Rica, remarked that the SDR had in fact been losing ground and now constituted only 4 per cent of total international reserves. Consequently, a portion of any new international liquidity that was created should take the form of SDRs. The second amendment of the Articles would make it easier to use SDRs, but since the policies governing their allocation had not changed, new SDRs could only be allocated if it was agreed that there was a medium-term shortage of global liquidity. That was a short-sighted view, he considered, because it ignored the need of the developing countries for reserves. Moreover, the two main restrictions on the use of SDRs remained. Consequently, the changes made were less important than those not made.

A request for a second allocation of SDRs, small in proportion to total world liquidity but large in relation to the present issue, was a theme taken up by many speakers whose constituencies included countries in the Group of 24. (The Inter-governmental Group of 24 on International Monetary Affairs is an emanation of the Group of 77 set up under the Declaration of Lima, 1971.) Not only would such an allocation endow the SDR with some credibility, it would provide the developing countries with unconditional as opposed to conditional liquidity, while giving the Fund more control over the system as a whole.

International borrowing

Mr. Bernard Clappier, Governor for France, remarked that it was relatively easy to obtain international bank loans, and that any growth in that type of lending could well lead to a relaxation of the monetary and budgetary discipline that was now needed more than ever.

Madame Marie-Christiane Gbokou, Governor for the Central African Republic, responded that while some countries had been able to adjust their current payments by reducing their already small foreign exchange resources most of them had had recourse to external borrowing, often available only on onerous terms in private financial markets. Africa’s external public debt, she said, had risen from $9.2 billion in 1967 to $28.5 billion in 1974, and the debt service burden for a number of African countries now equalled 20 per cent of their export receipts.

As more than one speaker noted, members’ borrowings from the Fund had amounted to a record SDR 4.7 billion during calendar year 1975 and had been more than SDR 4.9 billion during the first half of 1976 alone. This increased rate of lending had caused the Executive Directors to look into the question of the adequacy of the Fund’s liquidity for the future. Although some speakers felt that the Fund’s liquidity was adequate for the immediate future, Mr. Jiménez, for instance, remarked that the Fund’s liquidity position could prevent it from meeting fully the foreseeable financial needs of the member countries, especially as an industrialized country had recently applied for a large drawing. (The Alternate Governor for the United Kingdom confirmed during the meeting that his country would draw the resources available to it under the Fund’s credit tranche policies.) In the circumstances, speakers agreed that there might be no alternative to activating the General Arrangements to Borrow. (See David Williams, “Increasing the resources of the Fund: borrowing,” Finance & Development, September 1976.)

Mr. Donald S. Macdonald, Governor for Canada, felt that more countries should as a matter of urgency make their currencies freely usable for Fund transactions. (When the amended Articles come into effect, all members’ currencies will be usable in accordance with the policies of the Fund.)
There was fairly general support for the statement in the communiqué of the Interim Committee issued on Saturday, October 2, 1976, that with the improvement in world conditions, drawings from the Fund would as a general rule take place in the Fund’s regular credit tranches and through the extended Fund facility. (This latter provides financing for longer than the Fund’s usual three- to five-year period and is intended for member countries making structural changes in their economies.) Madame Gbokou, and others, asked that the facility be reviewed in order to bring about an easing of the conditionality attached to it.

Mr. N’Faly Sangaré, Governor for Guinea, considered that even the other new facilities—the compensatory financing and the buffer stock facilities—had such stringent conditions attached to them that most of the countries for which they were originally intended were obliged to do without them.

On the other hand, Mr. Karl Otto Poehl, Governor for the Federal Republic of Germany, remarked that the regular facilities of the Fund had been used amazingly little. Only six members had drawn in the second credit tranche, where conditionality really begins. In his view conditionality was a helpful guide to better economic performance, a useful instrument for improving the investment process, and a support to the credit standing of a country.

**Surveillance**

One of the subjects to which many Governors were clearly devoting considerable thought was how the Fund would carry out its enlarged powers of surveillance of members’ exchange rate practices once the new Article IV came into force. One of the major changes to be brought about by the new Article would be that the cases of individual countries would be discussed at the political level, namely, in the Interim Committee. As Mr. Macdonald put it, “there may well be need to discuss specific situations from time to time, and this is why Canada supports strongly the surveillance responsibilities vested in the Interim Committee of the Fund.” Mr. Mohamed Zaki Shafei, Governor for Egypt, considered the new Article IV to be of profound importance because it would give members the freedom to choose their own regimes. Nevertheless, the ultimate goal—also provided for under the new Article IV—ought to be progress toward a more stable monetary system, which might be one based on a system of stable but adjustable par values. Mr. Clappier insisted that the Fund could only fulfill its obligations if it exercised “firm” surveillance equally over surplus countries and deficit countries alike. He reminded Governors that, behind the exchange rate undertakings, every member had accepted a commitment to direct its economic and financial policies toward fostering orderly economic growth with reasonable price stability.

**Exchange rates**

On the role of exchange rates themselves, Madame Gbokou considered that the risks inherent in a system of floating exchange rates were very costly to the concept of an orderly international monetary system. She considered the developed countries were better prepared to absorb the risks of erratic exchange fluctuations than were the developing countries with their limited room for maneuver. Mr. Simon, in contrast, devoted a passage to asking his listeners to imagine the disasters that would have befallen the world in recent years under a par value system. Mr. Poehl felt that floating rates were not the cause but the result of instability, and he subscribed to the communiqué of the Interim Committee that said that “exchange rates should be allowed to play their proper role in the adjustment process.” Mr. Xenophon Zolotas, Governor for Greece, considered that as long as high rates of inflation persisted, no international monetary superstructure would be viable, and that the present nonsystem was likely to continue indefinitely. And Mr. Bandaranaik explained that in the case of developing countries, whose economies were relatively more rigid than those of the industrialized world, exchange rate changes took considerably longer to promote investment in new production capacity of the right kind—a case of the lag which Mr. Simon had described as a politician’s nightmare.

The Fund being above all a financial agency, questions of aid as such were little discussed. One interesting view on aid was, however, put forward by Mr. Julius Chan, Governor for Papua New Guinea; he said that he was concerned about any developments that might create an incentive for the accumulation of excessive domestic or foreign debt as a way out of short-term difficulties. If aid was provided more readily to countries with external debt or balance of payments problems, it was possible that the efforts of other poor countries to implement sensible policies would be undermined.

In his concluding remarks at the Annual Meeting, Mr. Witteveen stressed the primary significance of the general consensus reached on the need for greater emphasis on the adjustment of imbalances, as distinct from financing alone. Despite the concern of the primary producing countries that import expansion of the industrial countries would proceed more slowly if cautious policies prevailed, he sensed that they had concurred that it would be in their own interest if the industrial countries were “to conquer inflation.” As a result of the discussions during the week in Manila, the Fund would need to intensify its work on problems of international liquidity, and high priority would be given to the Seventh General Review of Quotas, in which many Governors had suggested that there should be substantial increases.

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