SAVA CENTAR

The fight against inflation

This year's Annual Meetings of the Boards of Governors of the World Bank and the International Monetary Fund—the thirty-fourth—were held in Belgrade from October 2 to 5. The participants were faced with a difficult international economic situation as they met to discuss and chart the future direction of the world economy. This article reports on the main themes of the Fund Meeting.

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The fight against worldwide inflation was the main theme of the Finance Ministers and central bank Governors from 138 member countries that participated in the 1979 Annual Meeting of the Fund's Board of Governors in Belgrade last October. Unlike the agenda for the 1978 Meeting, which contained a number of single issues, such as quota increases and SDR allocations, requiring specific decisions and action, the 1979 Meeting was devoted principally to a wide-ranging discussion of the world's economic problems. Other major themes discussed at the Meeting were as follows:

- A growing number of poor developing countries were approaching a critical economic situation in their external payments.
- The Fund's role in the international monetary system should be enlarged and strengthened, particularly in respect to its surveillance over the exchange rate policies of its members, and improvements made in certain of the Fund's financing facilities.
- A substitution account, if properly designed, could be a useful step in the evolution of the international monetary system.
- A unified call from the developing countries to move toward a new international economic order, together with the preparation by these countries of an Outline for a Program of Action on International Monetary Reform.

As in previous years, the plenary sessions of the Annual Meeting were preceded by meetings of two Committees—the Interim Committee of the Fund's Board of Governors on the International Monetary System, and the Development Committee (or, to give the full title, the Joint Ministerial Committee of the Boards of Governors of the World Bank and the Fund on the Transfer of Real Resources to Developing Countries). There was also a number of other meetings of various groups of countries—the Group of Ten industrial countries, the Group of 24 (representing some nonaligned nations), and, at the invitation of the Yugoslav authorities, the Finance Ministers of the Group of 77 (nonaligned countries). Nearly 6,000 participants attended the meetings.

Economic background

In his opening remarks to the Conference, the Fund's Managing Director, Mr. J. de Larosière, described the international economic situation as "gloomy," citing the main problems as a marked slowing in the rate of growth in industrial countries, a worldwide acceleration of inflation, and a sudden shift in the pattern of external balances on current account.

These developments were occurring at the time of an emerging recession in the United States and an average increase of 60 per cent in oil prices during the first half of 1979. Outside the United States, most economies in the industrial world were also slowing down but were expected to continue to maintain a positive growth rate in the following year. The overall rate of economic growth in the industrial world was likely to fall, in real terms, below 3 per cent in 1979 and to slow down even further in 1980. Even though it might turn out, as was hoped, that an international recession could be avoided, it was clear that the world economy was in for stormy weather, with the slower rate of expansion coming at a time when many countries were al-

Readers may wish to see the October 15 issue of the IMF Survey *for detailed coverage of the Annual Meeting and related events in Belgrade, including the meetings of the Interim and Development Committees, the Group of Ten, and the Group of 24. Full texts or excerpts of major speeches and documents are also included.*

ready suffering from substantial slack in their economies and high levels of unemployment.

Despite the widespread slowdown in the growth of the world economy, rates of inflation were accelerating in almost every country. Indeed, it was particularly disturbing that after several years of pursuing anti-inflationary policies, with some initial moderate success, the world was now back to a level of inflation comparable with that experienced in the period 1974–75. The gravity of the situation was to dominate the discussions throughout the meetings.

At the time of the Belgrade Meetings, consumer prices in the major industrial countries were rising at an annual rate of nearly 13 per cent, almost double the rate for 1978. Inflation rates in other areas of the world were even higher, with projections for 1979 pointing to a rise of 14 per cent in the major oil exporting countries, 19 per cent in the more developed primary producing countries, and 30 per cent in the non-oil less developed countries. More alarming, there was growing evidence that inflationary expectations, nourished by almost a decade of continuous inflation, were becoming deeply rooted in many countries, making a solution to the problem more intractable.

On the external side, a dramatic shift in the pattern of payments imbalances among countries and groups of countries was in process, in large part as a result of the sharp increase in the prices for oil and other primary commodities. The combined current account surplus of the major oil exporting countries was projected to rise to $50 billion in 1979 and to a still higher figure in 1980. This was a startling reversal of the previous trend, which had brought the surplus for these countries down from $68 billion in 1974 to $6 billion in 1978. The sharply expanded surplus of the oil exporting countries was, of course, to be reflected in a corresponding deterioration in the current account position of the oil importing countries—a deterioration in 1979 compared with 1978 projected at $30 billion for industrial countries, $3 billion for the more developed primary producing countries, and $12 billion for the non-oil less developed countries. The situation of this latter group of countries was cause for particular concern, as the cost of imported energy and manufactured goods soared and these countries tried to cope at the same time with desperate poverty and mounting inflation at home and sharply deteriorating terms of trade and a crushing burden of indebtedness abroad. Together with rising interest rates on their external borrowing, stagnation in their export markets, and an inadequate and faltering flow of official development assistance (ODA), the outlook of the growing number of countries in this group was bleak indeed.

These serious world economic problems were reflected in foreign exchange markets. Although exchange markets had become calmer and more orderly since the package of measures announced by the U.S. Government on November 1, 1978, the situation was still one of considerable uncertainty. The gathering of the world's financial leaders at the Annual Meetings had been preceded by a realignment of currencies in the European Monetary System, and the ensuing nervousness in these markets seemed to be reflected in the gyrating price of gold on the world's bullion markets.

The discussions

The Interim Committee, meeting as it traditionally does on the day before the plenary session, discussed two substantive items—the world economic outlook and the question of whether it was desirable to create a substitution account.

In his report to the plenary session on the work of the Interim Committee, the Chairman of the Committee, the Honorable Filippo Maria Pandolfi, said that a major concern of the Committee had been the fact that inflation had intensified throughout the industrial world and now posed a grave threat to the stability of the economic and financial system. Although signs of recession in the United States had become stronger and some slowing of economic expansion in other industrial countries was in prospect, the degree of the expected international slowdown would be limited by a continuation of a positive growth rate in Europe and Japan. The Committee, said Mr. Pandolfi, had reiterated its view that the main task of economic policy was to contain inflationary pressures and to reduce inflationary expectations. The Committee had endorsed policies to be pursued by national governments to reduce inflation and had repeated the view, expressed at its previous meeting in May—but with less emphasis then—that in many countries progress in reducing inflation was an essential precondition for the resumption of vigorous economic growth. One of the immediate problems was to prevent the recent increases in the price of oil and other primary commodities from adding to inflationary expectations and from being incorporated into the underlying rates of increase of wages and prices.

This theme of the need for an effective policy on energy was also taken up in the discussions in the plenary sessions. Many Governors stressed the need for realistic pricing policies for energy and the priority that should be given to the conservation of energy, as well as the urgent need to search for new sources of oil and for new forms of energy. It was noted by some Governors that those countries that had seemed to be most successful in coping with the oil crisis in 1974–75 had been those that had made a timely adjustment to the new economic environment.

Turning to the external payments position, the Committee noted that with U.S. payments moving into a better balance—there was the prospect of a U.S. surplus next year and reduction in the surpluses of the Federal Republic of Germany and Japan—a significant improvement in the pattern of payments imbalances among industrial countries was in prospect. This improvement was attributable in part to the offsetting changes in demand conditions in the three countries, and to the effects of the past exchange rate changes. The development was welcomed by the Committee as important evidence of a better working of the international adjustment process.

Position of the developing countries

The Interim Committee noted with concern that the worsening of the external position of the non-oil developing countries was occurring at a time of growing internal strains; inflation was intensifying and growth had remained modest in relation to population growth and development needs.

While the Committee underlined the need for a larger flow of external resources

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to developing countries, it was observed that in many countries there was also a need to improve domestic financial policies. Industrial countries, in designing their policies, were asked to pay particular attention to the economic needs of the developing countries, and several policies were singled out for particular mention, such as a reduction in protectionist measures, the opening of import markets to exports of manufactures and commodities from developing countries, making capital markets accessible to developing countries, and, a matter particularly stressed by many Governors in the plenary sessions of the Meetings, an enlargement of the flow of ODA.

The Development Committee, in its deliberations, also paid great attention to the deteriorating position of the developing countries, noting that many low-income countries were critically dependent for their external capital requirements on the availability of concessional capital flows—that is, ODA. Reporting to the plenary sessions, the Chairman of the Development Committee, the Honorable Cesar E. A. Virata, said that the Committee had noted with concern the continuing decline in ODA flows from the industrial countries expressed as a percentage of gross national product (GNP) and regretted that only a very modest growth was projected over the next few years. The Committee called not only for an increase in the volume of assistance—which at 0.32 per cent of GNP was well under the internationally agreed target of 0.7 per cent—but also for an improvement in quality, such as quick disbursing assistance, the untying of aid, and a greater concentration of assistance in countries most in need.

The role of the Fund

On the question of the role of the Fund in the international monetary system, the Interim Committee again stressed the importance of an active exercise by the Fund of its surveillance procedures as a means of supporting the adjustment process. Addressing the plenary session, the Governor for the United States, the Honorable G. William Miller, in particular, urged a bolder use of the surveillance procedures, suggesting that one way to proceed would be for the Fund to assess the performance of industrial countries against an agreed global strategy for growth, adjustment, and price stability. Another way suggested by the Governor was that any nation with an exceptionally large payments imbalance—deficit or surplus—would submit for Fund review an analysis showing how it proposed to deal with that imbalance. The view that surveillance by the Fund should be applied symmetrically—over deficit and surplus countries, large and small, developed and developing—was a view expressed by many speakers at the plenary sessions.

One theme that was to run through all the meetings held in Belgrade was the extensive degree of economic interdependence among countries. It was recognized that the world economy was now so closely knit that no country could hope to set its policies—whether monetary, fiscal, trade, exchange rates, external payments, or adjustment—without taking into account the international context and the actions and reactions of other countries. The Fund was thus seen to be at the center of the web of national economies, playing a vital role as an international consultative and coordinating agency.

Discussion of the Fund's financing facilities concentrated mainly on the extended Fund facility and the supplementary financing facility. The extended Fund facility had been established in 1974 to help countries finance programs of structural adjustment extending for longer periods and requiring finance for amounts larger in relation to quotas than had been available under credit tranche policies. In Belgrade this year, both the Development Committee and the Interim Committee endorsed a proposal to extend the repurchase period of this facility from eight to ten years. In regard to the supplementary financing facility, which had become operational earlier in the year for countries with financing needs that were large in relation to their quotas, both Committees requested the Executive Board of the Fund to give additional thought to developing ways and means of lowering the interest costs of the facility.

During the discussions in the plenary sessions, a number of Governors from developing countries called for a review of all the Fund's financing facilities, with a view to enlarging the amount of finance available to members and to easing the conditionality applied to the use of the Fund's resources. In particular, one suggestion endorsed by a number of Governors called for the enlargement, by 50 per cent, of the first credit tranche—namely, those drawings made on the Fund that involve the lowest conditionality.

Toward a substitution account

On the question of a substitution account, the Interim Committee considered an Executive Board report on the matter and concluded that such an account, if properly designed, could contribute to an improvement in the international monetary system and could be a step toward making the special drawing right (SDR) the principal reserve asset in the system. The Committee asked the Executive Board to continue to give priority to designing a plan for a substitution account in the light of the views expressed by members of the Committee.

The concept of a substitution account was first considered by the Committee of Twenty between 1972 and 1974 as part of its endeavor to introduce a thorough reform of the international monetary system. As envisaged in those days, such an account would have brought about a fundamental change in the settlement of payments imbalances and in the supply of international liquidity. There was not then, and there is not now, sufficient agreement on such a fundamental reform of the system.

The substitution account at present under consideration differs in many important aspects from the earlier version and is much more modest in scope. The account is now seen mainly as a device that in the course of time would help to make SDRs the principal reserve asset of the international monetary system. A further consideration—and one that is held to more strongly by some than by others—is the view that there are problems, both actual and potential, with a system based on a single national asset, such as the U.S. dollar. On the other hand, there is also a belief—shared by potential reserve currency countries and others—that an enlarged role for other currencies through diversification could also be disruptive. A substitution account is thus regarded as an alternative to both a single reserve currency system and a multicurrency system. Such an account, administered by the Fund, would accept dollar deposits from members of the Fund and certain other official holders in exchange for an equivalent amount of SDR-denominated claims.

Although the Fund's Executive Board was invited to prepare a plan for such an account by the Interim Committee, it was evident from the speeches made by many Governors that the design of the account would have to be carefully thought out and meet the requirements of all countries at various stages of development. However, a number of general features were agreed upon. The account would be in principle permanent, participation in it would be voluntary, and it would be up to each member to decide on the size of the deposit to be made. At the same time, it was recognized that for the account to serve any useful purpose, participation would have to be widespread and the scale of substitution would have to be substantial over time.

A host of other features remain to be settled. These include the extent to which the account is to be market oriented and the role to be played by nonofficial holders, the interest rates to be paid on the SDR claims and the relationship of these claims to the SDR itself, the liquidity of the claims, and, perhaps of greatest importance, how the costs and benefits of the account can be shared equitably by the depositors or holders, on the one hand, and by the United States, on the other. No timetable for working out these technical details has been indicated, but the Executive Board has been asked to submit a progress report at the next meeting of the Interim Committee in Hamburg on April 25, 1980.

Program for reform

As part of a general program to achieve a new international economic order, the Ministers of the Group of 77 meeting in Arusha, Tanzania, in February 1979 put forward a number of proposals for reform. The Group of 24 assessed and elaborated on these proposals within the context of a reform of the international monetary and financial system, and formulated an action program. This program, after endorsement by the Finance Ministers of the Group of 77 meeting in Belgrade, was submitted to the Interim Committee and the Development Committee, as well as to the Chairman of the Annual Meetings of the Boards of Governors. The Group of 24 was established as an offspring of the Group of 77 in the early 1970s for the purpose of coordinating and unifying the position of the developing countries on international monetary and financial matters.

The program prepared by the Group of 24 takes as its starting point that the international community has failed to achieve its goals in the fields of money, trade, and transfer of real resources to developing countries and calls for movement toward a fundamental reform of the international monetary system under four main headings, as follows:

Transfer of real resources. An acceleration in the flow of concessional aid to developing countries through the establishment of programs and binding commitments for the annual growth of official development assistance; the early establishment of a link between SDR allocations and additional development assistance; a substantial increase in program lending by the multilateral financial institutions; a planned alleviation of the debt service burden of some developing countries; and a strengthening of the resources of the International Development Association and the World Bank.

Increase in total resources. An increase in the present agreed SDR allocations, regular annual allocations of SDRs for the future, an early strengthening of the Fund's resources, and a revision of the criteria for determining the quotas of Fund members.

Balance of payments support. The establishment of a new medium-term balance of payments facility to provide longer-term financing on terms of minimum conditionality, together with a review of the resources available, repayment periods, and conditionality under existing Fund facilities, particularly in respect of the compensatory financing facility. Support of the developing countries for the proposed substitution account was to be considered in the light of further studies, and implementation of such an account would be within the framework of a balanced package of measures for immediate action.

Trade. The establishment in the World Bank of a long-term facility to finance purchases of capital goods, along with a subsidy account to ensure the broadest access by low-income developing countries. Full and strict adherence to the standstill provisions on trade barriers pledged by developed countries for imports from developing countries and the continuation of existing policies, as well as the development of new ones, to encourage structural changes in trade patterns, especially where the long-term competitive advantage favors the developing countries. In addition, the full implementation of the commitments already undertaken by developed countries to provide for the removal of protectionist barriers against the exports of developing countries.

In their communiqués issued after their meetings, both the Interim Committee and the Development Committee stated that the Outline for a Program of Action on International Monetary Reform would be "kept in view." Subsequently, a number of Governors from the developing countries speaking in the plenary sessions urged its speedy implementation.

Inflation the priority

At the opening session, the Managing Director, Mr. de Larosière, had described the economic situation as "gloomy," and this sentiment had been echoed and elaborated on in ensuing speeches by Governors from all parts of the world. Although there were clearly differences of emphasis to be placed on the range of problems confronting national policymakers, one consensus that emerged during the course of the discussions was that the fight against inflation should be given number one priority. In his closing remarks, the Managing Director reminded Governors that in his opening speech he suggested the broad lines of policies that might be followed. He emphasized that he firmly believed that these policies could turn the situation around and get things moving in the right direction. The Meeting thus closed with the feeling that it had reached a sense of purpose. As the Chairman, the Right Honorable R. D. Muldoon, Prime Minister of New Zealand, put it,"we have, together, sent a clear and positive message that we still feel that we can change the course of events by our own efforts, and that our dedication to making those efforts with the greater strength of cooperation and togetherness is stronger than ever before." F&D

The report in this issue of Finance & Development *on the Fund's Annual Meeting attempts to present only the main issues discussed at the Meeting. It does not cover all the points made by Governors in their speeches at the Meeting. A more complete record is contained in* Summary Proceedings, *to be published in English by the Fund in January 1980.* Summary Proceedings *is available free on request from:*

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