

# CEPAL Review

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## S U M A R I O

Basic needs or comprehensive development <i>Sidney Dell</i>	7
Between reality and utopia. The dialectics of the Social sciences in Latin America <i>Jorge Graciarena</i>	35
External finance and commercial banks. Their role in Latin America's capacity to import between 1951 and 1975 <i>Robert Devlin</i>	63
Informal-formal sector interrelationships <i>Victor Tokman</i>	99
Transnational corporations and export-oriented primary commodities <i>Benny Widyono</i>	135
Prices and gains in the world coffee trade <i>Alberto Orlandi</i>	161
Wage disparities in the urban labour market <i>Paulo R. Souza</i>	199
The International Monetary Fund in a new international financial constellation: An interpretational commentary <i>David H. Pollock and Carlos Massad</i>	225
Some CEPAL publications	231
Other publications	247

## *Notes and Comments*

### **The International Monetary Fund in a new international financial constellation: An interpretational commentary\***

David H. Pollock and Carlos Massad

1. A 'new' IMF appears to be just now in process of emerging. If so, it will probably possess at least four central characteristics, namely: (a) it will be endowed with a significantly larger volume of loanable resources than before; (b) it will dispense those resources as part of a deliberate global policy primarily in order to find a way of recycling OPEC surpluses more efficiently than before; (c) it will undertake those new lending functions with a greater degree of 'conditionality' than before; and finally, (d) it will be granted a greater degree of 'surveillance' authority in so doing. These judgements stem from the following lines of reasoning.

2. From the time of the 'oil shock' in late 1973 to the end of 1976, the OPEC countries ran an enormous cumulative

current-account surplus of some 145 billion dollars. One half of this was represented, in counterpart, by the cumulative current-account deficit of the NOPEC developing countries. Indeed, their deficit was so large that the total outstanding external debt of these developing countries rose by more than 50 per cent in 3 years, reaching the very large total of around 160 billion dollars by December 1976.<sup>1</sup> Viewed in aggregative terms, therefore, it is clear that the international monetary system is now faced with a new and very important problem: namely, how to match the *overall* OPEC surplus with the *particular* deficits of individual NOPEC countries, developed and developing alike.

3. Some solutions to this new problem have of course already been forthcoming. But not in a manner very satisfactory to developing countries. This is basically because OPEC countries have been depositing their surpluses primarily in private banks located in the United States and Euro-markets, which, in consequence, became 'spontaneously' involved in the matching (recycling) process. This short note is not the place

\*This 'commentary' reflects the main points of an internal discussion held in CEPAL, Santiago, in late 1977, during which Mr. David H. Pollock (Director of the CEPAL Washington Office) expressed his views concerning a possible new IMF role in the emerging international financial and monetary constellation, and the potential significance of that role from the Latin American angle. After the discussion Mr. Pollock, in close collaboration with Mr. Carlos Massad, Co-ordinator of UNDP/CEPAL Joint Project RLA/77/021, synthesized the ideas that had been expressed. Although they do not necessarily reflect the views of CEPAL, they are being reproduced in the Review in order to bring this important issue, which is still unfolding, to the attention of a wider audience (Editor's Note).

<sup>1</sup> Latin America accounted for approximately one-half of this total by the end of 1976, the countries mainly concerned being Brazil and Mexico (\$4 billion dollars combined) and Peru, Argentina and Colombia (26 billion dollars combined). By end-1977, the total debt of NOPEC developing countries reached around 180 billion dollars.

to assess the costs and benefits of how the private banks have handled the global recycling process since 1974. What should be stressed, however, is that, although private banks have handled most of the required matching-of-funds, they have done so on an essentially day-by-day and *ad hoc* basis. No conscious policy framework has been brought into play, either by donor or recipient governments, or by the private banks, and certainly not by the international community considered as a whole. To repeat, this note was not intended to analyse how well or how poorly the private banks have carried out the post-1973 recycling process. What it does wish to stress, however, is that, in the absence of any international policy framework, the time would inevitably come when private banks could not, or would not, continue handling so much of the global recycling. Clearly, private banks cannot indefinitely carry on their books the ever-growing debt of all the developed countries with weaker balance-of-payments positions, plus that of the developing countries as well. And whatever they can do in this regard, they cannot maintain their future lending volume *pari passu* with OPEC's huge current account surpluses, which have averaged around 45 billion dollars per year since 1974 and are generally expected to average nearly 40 billion dollars per annum for many years to come. Thus it is our opinion that a watershed was reached during 1977, when private international commercial banks were estimated to have held roughly one-half of the total outstanding debt of all NOPEC developing countries, compared to only one-tenth of a much smaller debt volume back in 1970. If we are correct in such a watershed thesis, then debtor NOPEC countries will have

to turn increasingly to intergovernmental channels like IBRD and especially IMF to help finance their foreign exchange gaps. To these ends the IMF will presumably have to follow a two-pronged approach, consisting in undertaking more loans, and of a riskier nature, on the one hand, and imposing stricter lending prerequisites ('conditionality') related to foreign borrowing, on the other. In other words, IMF will have to deliberately increase its lending volume and at the same time it will presumably have to urge borrowing NOPEC governments to modify the 'inadequate' policies that were contributing to their prior balance-of-payments deficits and hence their external debt. In even blunter language, to the same extent that IMF expands its future loans to NOPEC developing countries with weaker balance-of-payments prospects, IMF's conditionality will tend to be more stringent than that imposed by private banks since the 'oil-shock'.

4. If all this should come to pass—as we believe is likely—it would presume an ever-growing fiscal involvement on the part of the developed countries in the international recycling process; i.e., the treasuries of the developed countries would in effect be taking up some of the slack resulting from the decline in net new private bank lending. Furthermore, as governments in developed countries face up to the prospect of ever-growing contributions to IBRD and IMF, there will undoubtedly be increasing demands for closer scrutiny by the congresses and tax-payers in those same developed countries. The final stage in this entire sequence could be growing recriminations and strains between nations of the north and south, unless things were done differently from in the past.

5. Thus, the sequence of events traced above might be summarized as follows:

- (i) continuous OPEC current account surpluses for many years to come, generating continuous deficits and thereby an ever-growing debt on the part of NOPEC countries.
- (ii) with private banks handling most of the transitional recycling task,
- (iii) until eventually the private banks reach a limit of their new net lending.
- (iv) in consequence placing more pressure on IBRD and especially on IMF to take up the slack,
- (v) but with the private banks, taxpayers and legislatures in developed countries insisting on growing 'conditionality' in this emerging stage of global recycling, and
- (vi) as a final element in this sequence, the endowment of IMF with greater disciplinary authority ('hard surveillance'), at least in so far as developing countries are concerned.

6. As already mentioned, this sequence of events, under way since 1974, has been essentially *ad hoc* and extemporaneous in nature. Clearly, therefore, a global policy – to transfer more real resources to developing countries in the long run, and to ensure a smoother distribution of global liquidity to both developed and developing countries in the short run – must eventually emerge. Otherwise a cloud will continue hanging over the international monetary system; a cloud involving a new and different sequence of events, such as defaults on debt payments by one or more developing countries, leading to a loss of confidence in the private banking system of the western world and thence

to a slow-down of the rate of growth in both developed and developing countries, and ending with the economic and political trauma that would result in the latter eventuality. For we cannot reiterate too often what we consider to be the central reality facing the international monetary system today: namely, that very large OPEC surpluses will continue being generated for many years to come. This being so, something will have to change. Otherwise the world's major banking and trading systems, the rates of growth in many developed and developing countries, and finally the degree of political stability in those countries whose growth slows down, could all be very seriously affected. This may sound unduly dramatic. Yet, given the ever-growing degree of interdependence that characterizes global trade and payments, it does not seem to us too far-fetched. Hence our stress on the need for a *deliberate policy* that will augment long-term real resource transfers from developed to developing countries on the one hand, while simultaneously facilitating shorter-term liquidity transfers between OPEC and NOPEC countries on the other. If such a policy were to evolve, presumably IMF would play an important if not the central role therein.

7. This last is a very interesting conclusion from an institutional point of view, since, only half a decade ago, the Bretton Woods concepts were in disarray and the authority and prestige of IMF seemed to have significantly dwindled. Floating currencies had deprived IMF of its long-standing role as manager of the international exchange rate system. Sudden and large exchange restrictions had been imposed by a few major developed countries without prior IMF consultations. Huge private capital flows were occurring outside the IMF frame-

work. IMF lending resources had become depleted and its lending volume had stagnated proportionately. Today, in contrast, all this seems on the verge of reversal. Private banks in developed countries may want to institutionalize their loans to developing countries, and if so IMF would undoubtedly be their preferred institution for doing so: indeed probably their only one. The OPEC governments must recycle their vast liquid assets, and they will wish to do so with both safety and profit. One way would be for them to recycle some portion of their liquidity through IMF, given its guarantees against exchange-rate as well as other economic and political risks.<sup>2</sup> Governments in developed countries will want a more effective global balance-of-payments 'surveillance' system, since they realize the need for ensuring a more effective approach to the international adjustment process. Thus we see the convergence of recent statements by the previous Chairman of the United States Federal Reserve System, by private transnational banks, and by most governments of the G-10 developed countries, all stressing their support for IMF. And thus we see the attention being given by Mr. Witteveen to finding new ways of revitalizing and enlarging the Fund.

8. What can IMF do in response to these new challenges? One answer seems clear: it can expand its volume of loanable resources. How to do this? A number of different approaches might be considered. *One* entails increases in quotas. As mentioned earlier, it is expected that a 33 per cent quota expansion will

<sup>2</sup>Of course, there are other outlets, such as direct investment or private portfolio placements, which OPEC countries will wish to use for both economic and political reasons.

be ratified shortly, entailing an increase of some SDR 10 billion. Still another quota increase is now in process of negotiation, though its timing may be quite distant.<sup>3</sup> A *second* approach would be for the G-10 industrial countries to lend further amounts of hard currencies to IMF through the General Agreement to Borrow (GAB), as was recently done in the case of the United Kingdom Standby of 3.9 billion dollars. Here, however, there is a basic shortcoming—from the developing countries' point of view—in that the GAB is an exclusive lending facility available only within the developed G-10 countries. A *third* approach could be for a new issuance of SDR's. However, only SDR 12 billion have been issued to date (none since 1972) and the possibility of more than a modest new SDR issuance currently seems slight. Hence the great emphasis that was recently placed on another alternative, namely, creation of the new 'Witteveen' facility.

9. Yet useful as this new 'super-tranche' facility will be, too much should not be expected from it. For one thing it is considerably smaller than had originally been anticipated. Only a year ago, for instance, expectations concerning its size had ranged as high as 15 billion dollars or even 20 billion. Now it is expected at best to total not over 10 billion. Secondly, it will involve a structure of charges that is expected to be almost

<sup>3</sup>The amount of the next quota increase is still problematic. The developing countries are currently talking in terms of a 100 per cent increase, whereas some developed countries are understood as wanting one of only 25 per cent. The current expectation is of an eventual increase of around 50 per cent, which would imply a total IMF quota of some SDR 60 billion in the future. As mentioned, however, the timing of this will probably be some years away.

purely commercial. Thirdly, it will operate separately from although parallel to the normal IMF tranche arrangements. To put all this another way, the Witteveen Facility places IMF in the role of an agent trying to recycle surplus liquidity from OPEC to non-OPEC countries. None the less, the new Facility will enable IMF to impose its own forms of conditionality upon this recycling process. And last but by no means least, an important indirect effect of this new Facility will be to insert Arab countries with large balance-of-payments surpluses directly into the western monetary system. An interesting political issue emerges in consequence. The key Arab donor for the new Witteveen Facility is Saudi Arabia, and its support will undoubtedly be linked to an insistence upon very conservative measures by those developing countries drawing upon IMF. In short, the new Facility could make IMF become, even more than before, a global 'policeman' acting on behalf of private banks, developed countries, and the key Arab OPEC donor countries. The central emphasis, in short, will be on caution and conservatism.

10. To conclude, IMF seems to be entering upon a new stage of global resurgence. *Its volume of resources will undoubtedly be considerably augmented*, mainly through new quota increases plus the creation of the new super-tranche facility. But *it will increase its conditionality prerequisites*, in order to safeguard the new resources entrusted to it, and also to reduce the balance-of-payments deficits that are assumed to arise because of 'inadequate' policies applied by NOPEC countries. To such ends, *it will be given stronger surveillance authority*. Here we draw some final (and even more conjectural) interpretative conclusions about the signifi-

cance of a 'new' IMF. Future IMF surveillance authority will undoubtedly be demonstrated by an insistence on greater 'internal discipline' within developing deficit countries: i.e., by the placing of stress on more conservative domestic monetary, fiscal and investment policies. But a very important related question is this: will IMF also use its enhanced surveillance authority to urge or compel *developed countries with a surplus* to adjust via appreciated exchange rates, larger imports, an expansion of capital outflows, or all three? Or will it concentrate its surveillance efforts primarily if not solely on *developing countries with a deficit*, as was so often the case during the 1950s and 1960s? In a nutshell, will IMF become more symmetrical than before in its distribution of the costs and benefits deriving from global trade and payments? This is a very important question for many Latin American countries. Their continued economic growth will require continued capital flows. Such flows will, in part, come *directly* from IMF. But they will also come from other suppliers (such as private banks, IBRD, OECD and OPEC governments), each of which in turn will be influenced *indirectly* by IMF judgements on the 'adequacy' of national policies within individual Latin American countries. All this suggests that stronger surveillance by IMF could, if not carefully handled, lead to a revival of the old charges of 'interference in internal affairs' which were heard so often during the 1950s and 1960s and which abated in the 1970s.

11. One last thought. A basic conclusion here is that private United States and Euro-banks will tend to lend progressively more to those NOPEC developing countries that have accepted

strong IMF conditionality prerequisites. This would, as stated above, be especially important to Latin American countries that rely so extensively on funds from private banks. Yet a certain contradiction is present in such logic: to get money at commercial rates from private banks, developing countries will have to be in such balance-of-payments straits as to accept strong surveillance. It would therefore appear to be desirable for the Latin American (and other developing) countries relying on private money to think of new alternatives. One might be the CEPAL 'refinancing facility'. Another might be to contemplate the idea of a new and better-balanced

'country evaluation' process, which could include the views not only of one agency but rather of several, together with those of the government concerned and a group of high-level independent consultants. In any event, there appears to be a clear need, from Latin America's point of view, to search for some new institutional process that would involve greater flexibility in IMF lending and borrowing powers on the one hand, with the ability to undertake co-financing with commercial banks on the other. In this search, it will be incumbent upon Latin American countries to lead the way, since they will have so much to gain or lose in the process.