

RESTRICTED

CEPAL/WAS/R. 28
September 1981

ORIGINAL: ENGLISH

C E P A L

Economic Commission for Latin America
Washington Office

THE 1981 MEETING OF THE IMF/WORLD BANK GROUP
IN THE CONTEXT OF THE WORLD ECONOMY

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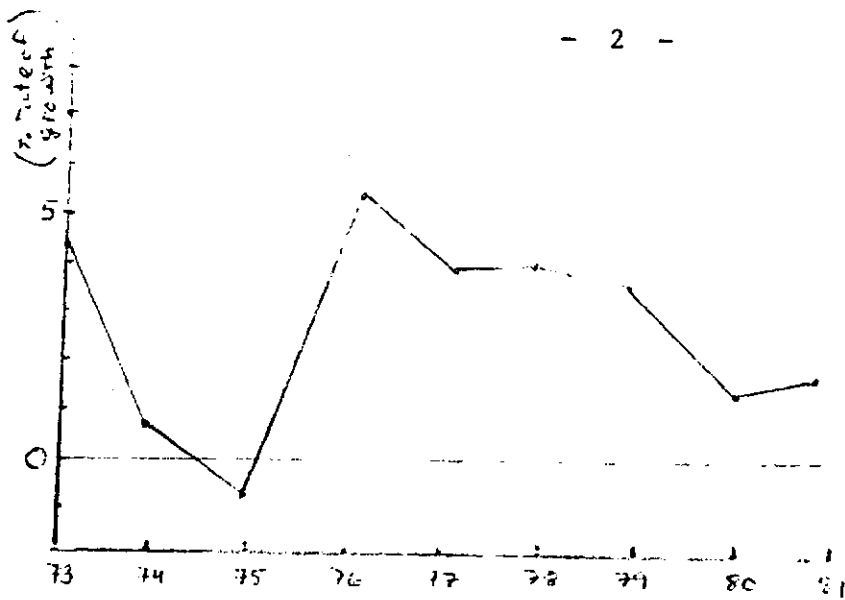
The purpose of this essay is to briefly sketch the economic environment that probably will surround the upcoming Joint Annual Meetings of the World Bank and IMF during the week of September 28. As background for this report, one might want to refer to papers which the Washington Office of CEPAL prepared on last year's meeting of the two organizations.^{1/}

In many respects, this year's meetings should be rather low key in comparison to the 1980 Conference. There are several reasons for this.

First and foremost is the fact that in 1981 the world economy is at an uncertain crossroad: the shock of the second major adjustment of oil prices in 1979/1980 is now behind us and the system has shown signs of adjustment, although no one knows how fast and complete that adjustment process will be. The aftermath of the second oil shock was undoubtedly less devastating for the industrialized countries --which clearly control the tone of the Meetings-- than the first one; as seen in figures 1 & 2, economic growth and inflation have been much less adversely affected in 1980 and 1981. Also, the current accounts of the balance of payments of the industrialized countries have not returned

1/ R. Devlin, Issues That Will Be Probably Raised at the 1980 International Monetary Fund Annual Meeting, CEPAL/WAS/R.18, September 1980; R. Devlin, Issues That Will Possibly Be Raised at the 1980 World Bank Annual Meeting, CEPAL/WAS/R.19, September 1980 and R. Devlin, Update on the World Bank/IMF Joint Annual Meeting, CEPAL/WAS/R.20, October 1980.

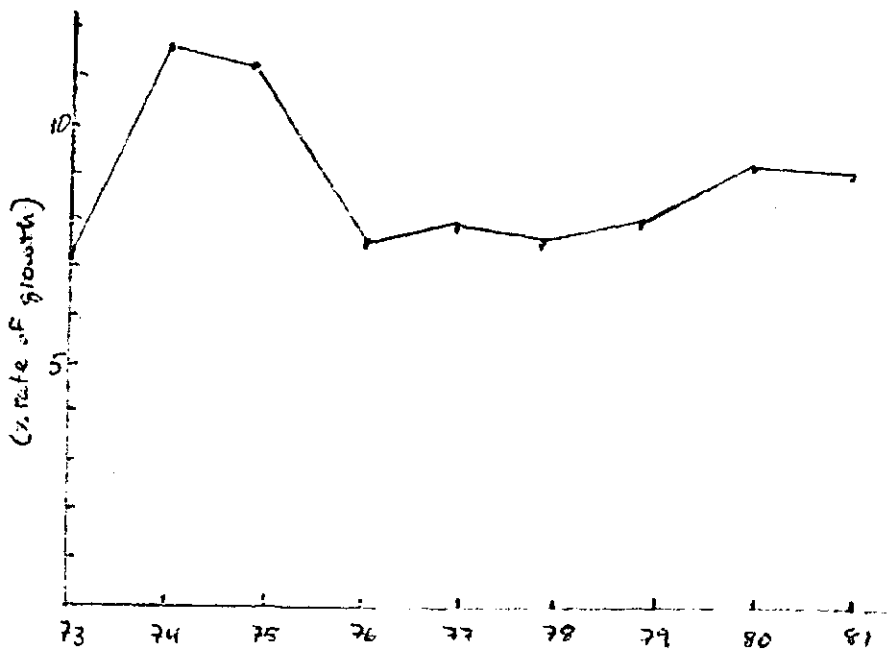
FIGURE 1



REAL GNP GROWTH RATES FOR THE INDUSTRIALIZED COUNTRIES

Source: data from IMF World Economic Outlook, June 1981

FIGURE 2



GROWTH RATE IN GNP DEFLATORS FOR THE INDUSTRIALIZED COUNTRIES

Source: data from IMF World Economic Outlook, June 1981

to surplus as quickly as in the first shock (see table 1), which means that these countries are assuming a larger share of the deficits, a healthy development because they are in the best position to finance them. Moreover, the larger industrialized countries have shown an uncanny ability to control or reduce deficits, making only the negative balances of the smaller industrialized countries seemingly intractable.

Other bright factors from the standpoint of the industrialized countries is that OPEC has apparently lost, at least for now, its ability to sustain price increases for petroleum. Meanwhile, although the deficits of the non-oil developing countries are as large in real terms as in 1975, and still growing in nominal terms (see table 2), there has been in 1981 much less difficulty than expected in financing them.^{1/} Finally, the impetus of NEIO and the proposals of the Brandt Commission seem to have lost momentum in Northern circles, and maybe in the South as well. In sum, there seems to be a feeling of complacency surrounding this year's Meeting, as compared to the excitement and sense of urgency that underpinned the tone of the Conference last year.

^{1/} An important barometer is Brazil. Last year there was great concern about Brazil's ability to finance its deficits and debt service. Since the country is the largest LDC debtor, there was great concern about its external payments prospects. But now Brazil has agreed to deflate its economy, and is paying very high interest margins for new loans; this keeps the bankers happy and likewise helps to reduce the tension surrounding LDC current account deficits more generally. Another probable factor behind the apparent correlation between concern about the health of Brazilian finances and LDC deficits in general, is that this may be the only developing country where foreign debt is large enough to actually threaten the stability of the international banking system should a default occur.

TABLE 1

INDUSTRIALIZED COUNTRIES: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

(Billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Canada	-	-1.6	-4.7	-4.0	-4.0	-4.1	-4.5	-1.6	-3
U.S.	9.9	7.6	21.2	7.5	-11.3	-11.1	2.8	8.4	13
Japan	0.1	-4.5	-0.4	3.9	11.1	18.0	-8.0	-9.5	- 1/2
France	-0.1	-4.9	1.0	-4.9	-1.6	5.2	2.9	-5.9	-7
Germany	7.1	13.0	7.7	7.7	8.5	13.5	0.9	-8.5	-6 1/2
Italy	-2.2	-7.4	-0.2	-2.5	3.1	7.8	6.4	-9.5	-9
U.K.	-1.2	-7.2	-3.0	-0.5	1.6	4.6	1.0	10.1	12
Other	5.8	-7.4	-4.7	-9.3	-12.8	-3.8	-12.2	-27.5	-28 1/2
<u>All countries</u>	<u>19.3</u>	<u>-12.4</u>	<u>17.1</u>	<u>-2.1</u>	<u>-5.5</u>	<u>30.1</u>	<u>-10.7</u>	<u>-44.0</u>	<u>-29.5</u>

Source: IMF World Economic Outlook, June 1981

TABLE 2

NON OIL-DEVELOPING COUNTRIES: CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

(Billions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
	-11.5	-37.1	-46.5	-33.0	-28.6	-37.5	-57.6	-82.1	-97.5

Source: IMF World Economic Outlook, June 1981.

A second possible reason for the calm tone of the Meetings is the Reagan Administration. It is highly suspicious of multilateralism, which clearly has dampened the feasibility of proposals for new multilateral initiatives (and funding) to tackle world problems. The Administration would probably stymie any attempts to expand the role of the Bank and maybe even the Fund. With the dollar strong in international foreign exchange markets, the U.S. does not even have to seriously consider debate over a Substitution Account in the IMF.^{1/} In sum, both the Bank and Fund may consider it appropriate to maintain a low profile in the current hostile environment for international organizations.

A third factor for the quiet tone of the upcoming Meetings is that the World Bank --easily the most imaginative and visionary of the Bretton Woods Twins-- is in a state of transition. McNamara has retired and the new President, Ted Clausen, just began his new work in July, thus he is still adjusting himself to an enormous institution with over 5000 talented people. It will take Clausen awhile to become comfortable enough to begin to put his mark on the Bank.

It is in this context that one can better understand the environment surrounding the upcoming Meetings. The issues that are likely to receive attention are sketched in the following pages.

THE IMF

The Seventh Review of Quotas has been completed, increasing the basic resources of the Fund by 50%, and now there is preparation for an Eighth

^{1/} Ironically, with the dollar so strong, this would be an ideal time to proceed with the Substitution Account.

Review. Meanwhile, the IMF just completed a 9 billion SDR borrowing arrangement with Saudi Arabia for 1981 and 1982, making the Fund's financial picture rather bright for the immediate future. It also has established a special loan window for shortfalls in food production, thus helping the Fund in its efforts to gain a better public image, especially in the Third World.

The main issues likely to be raised about the Fund fall into 4 basic categories.

1. Greater LDC Voting Power - The LDCs want a greater voice in the decision-making of the IMF via increased voting power. This is an issue that has been on stage for several years now. However, there seemingly is little chance that progress will be made in this area as the industrialized countries have shown themselves to be unwilling to dilute their power without some big incentive, e.g. the influx of massive resources that Saudi Arabia used as part of its leverage to gain more voice in the Fund. Perhaps a more effective strategy is that suggested by Jeker; i.e. LDCs should work for maximum representation in Fund staff positions and maximum efficiency in the appointment of skilled individuals to these positions. ^{1/}
In other words, the campaign for more influence would come from inside at the functional level, rather than at the more problematical level of formal voting rights.

^{1/} Rolf Jeker "Voting Rights of Less Developed Countries in the IMF", Journal of World Trade Law Vol. 12, No.3, May/June 1978. pp. 218-227.

2. SDR Allocation. There will be discussion of a new allocation of SDRs. However, the "link" to development assistance still appears to be a problematical issue.
3. Soft Loan Windows. As the World Bank's excellent new World Development Report makes all too clear, the low income developing countries have fared very badly in the decade of the seventies. Thus, there may be a special effort to provide assistance to those countries. In the case of the Fund this would mean subsidies on the cost of balance of payments assistance, something the Fund has been doing via the receipts from its gold sales, but which needs to be done on a larger scale and on a more permanent basis.
4. Conditionality. Conditionality has long been a source of friction between the IMF and developing countries. Under Laroisiere, the Fund has attempted to become more sensitive on this issue, raising standby assistance to 450% of the new quotas, and deciding that it would extend adjustment programs over a 3 year period, with due consideration being explicitly given to the social and political objectives of the governments. Many --including myself-- feel that the Fund has a long way to advance before it has an effective and ideologically plural design for stabilization policy. Nevertheless, there has been progress, as witnessed by the new Jamaican stabilization program, which among other things, desisted in the need for devaluation, normally de rigueur in an IMF program. Ironically, as

1/ IBRD, World Development Report, 1981, Washington D.C., 1981.

the Fund attempts to improve its image in the Third World,^{1/} it finds itself being subject to criticism in the industrialized countries to the effect that it has become too "soft". One source of criticism has been international commercial banks in the U.S., which have often viewed the Fund as their point man in efforts to deflate economies so that foreign exchange can be squeezed out for service of the debt. Thus, in the meetings, the Fund may encounter criticism from both the North and South on the subject of conditionality.

THE WORLD BANK

Nothing new is expected to develop vis-a-vis the World Bank; most issues will represent a continuation of the same debate that has developed over the past few years.

1. The Energy Affiliate. McNamara's imaginative proposal seems to be in serious trouble, largely on account of opposition from the Reagan Administration. The EEC, the Scandanavian countries and the South support the Affiliate. In the recent UN Conference on New and Renewable Sources of Energy, held in Nairobi, it was expressed in many circles that the Affiliate is a necessary vehicle for the promotion of new forms of energy development. But the U.S. has been very hostile to the concept for several reasons.

^{1/} The image problem is a real one; as long as countries view the IMF as a "mortician" rather than a "physician", they will avoid it until all other options are closed. For the IMF to be effective, it must be in consultation with countries at an early stage of a problem, so that the costs of adjustment can be minimized. This will happen only when countries feel that the institution is working for their objectives and not against them. This issue is explored in greater detail in R. Devlin, The IMF: Physician or Mortician?, CEPAL/WAS/R.24, August 1981.

The first is ideological; it simply distrusts international organizations and feels that they promote socialism. In a recently prepared report on the World Bank's energy lending ^{1/}, it argues that the Bank is biased towards the public sector. It also feels that the Bank substitutes private investment in energy, and in the Administration's mind the private sector can more efficiently develop hydrocarbon resources. In effect, the Administration's view is "hands off"; let the private sector develop energy.

The second reason for the Administration's attitude is financial. It is attempting to cut budgetary outlays and perceives the Energy Affiliate as a potential source of new pressure on fiscal expenditure.

The third reason is that in the U.S. there is a growing sense of complacency with respect to energy prices. Many feel that OPEC has permanently lost its grip on oil prices because high prices are stimulating a greater supply of petroleum; there is rapid development of energy substitutes; and conservation measures are now an integral and effective part of the national economic consciousness.

Since the U.S. is the Bank's biggest member, the Affiliate seems to be in serious jeopardy. The IBRD may therefore have to plan its loans for energy within the confines of its existing and future regular capital authorizations.

1/ U.S. Treasury, An Examination of the World Bank Energy Lending Program, July 1981.

2. The Poorest of the Poor. There should be much discussion of the plight of the lowest income developing countries. The Meetings will immediately follow a U.N. Conference on the Least Developed Countries and the World Bank's World Development Report 1981 (p.3) brings into stark focus the plight of these members: during the decade of the seventies their economies grew in per capita terms an average of only 0.8% per annum, compared to 3.1% for the middle income developing countries; in Africa, per capita incomes actually underwent a decline. The prospects are particularly dismal for Africa as the low case scenario of the Bank projects an average 1.0% per annum decline in GNP per capita in the 80s, while the high case provides for practically no growth. The low and high cases for the middle income countries are average growth rates of 2.1% and 3.4% per annum, respectively. The Report (p.56) also shows the inherent discrimination in aid flows to the lowest income countries: In 1979 low income countries (excluding China) --whose share of the developing countries population was 55%-- received only 37% of ODA given by OECD and OPEC Countries". Most of the discrimination has its roots in bilateral aid flows: 65% of bilateral aid in 1979 was channeled to middle income developing countries. In addition, as the Bank points out, there is a severe bias in bilateral aid flows to middle income countries: Israel and Egypt absorbed 2.5 billion dollars in aid (largely from the U.S.)

which is \$58 per person and 7.2% of GNP; meanwhile, OPEC channelled the bulk of its aid to Jordan and Syria, and French aid was granted mostly to its overseas territories. Thus, aside from a much needed increase of aid flows, there should be discussion

of a more equitable distribution of existing aid flows. Of course, the replenishment of IDA is an integral part of this debate.

3. The Private Sector and Co-financing. The U.S. will undoubtedly express its feeling that the Bank should begin to better attend to the private sector. It is already known that the U.S. Treasury is doing a study on the bank to determine whether its lending has fostered socialism in the developing world. To the Reagan group, the public sector is synonymous with inefficiency, and the World Bank of course does most of its business with governments.

As an integral part of this general concept, there may be more active debate over co-financing with the private banks. In effect, the World Bank would attempt to do more parallel lending with the private banks. One argument voiced for co-financing, is that it will allow the World Bank to better husband its resources and thereby forestall requirements for more financial support.

4. Other issues. There will likely be discussion of the need for more structural adjustment lending, and possibility of changing the capital leveraging ratio of the Bank from its present restrictive level of 1:1. Clausen has already expressed the opinion that a change in this ratio might be appropriate in light of the future demands on the banks resources.

In sum, at this point in time there is no big new issue on the horizon for the World Bank. The debate should focus on subjects which have been raised in past meetings. The only clearly new dimension might be the ideological struggle over public vs private allocation of resources.

THE FACTOR OF THE U.S. ECONOMY

Viewed in a more general way, the tone of the Meetings also may be influenced by recent developments in the U.S. economy. One possible reason for the apparent lull in the debate over the world economy is a "wait-and-see" attitude on the economic policies of the U.S., the biggest and most influential economy among IBRD-IMF members. Reagan's policies of supply side economics are confusing to many, yet since conventional policy has not been very effective, the government seems to be receiving the benefit of the doubt in many circles.

At least by conventional Keynesian standards, the Administration's policies seem unusual, and biased towards economic stagnation rather than the spurt in growth that has been promised by advocates of supply side economics.

The government's success in simultaneously bringing about tax and spending cuts is not to be underestimated; it was a brilliant maneuver that surprised many by the ease with which it was effected. But conventional wisdom would suggest that, all things being equal, the tax and expenditure reductions of roughly equal magnitude will be deflationary by a factor of one. Unless there are further budget cuts, however, the objective of a balanced budget by the mid-1980s will be difficult to realize because of an ambitious defense program, and an expected slowdown in economic growth, which will further reduce tax revenue and raise expenditure via the so-called automatic fiscal stabilizers. Thus the projected deficit of \$42 billion dollars in 1982 could very well reach as high as 60-70 billion dollars. An increased deficit would mean that the weight of the anti-inflationary program will continue to be borne by monetary policy, which would tend to keep interest rates very high. High interest rates would of course work against the recovery that the Administration promises to be just around the corner.

The Administration does not view economics in a conventional way, however, and therefore does not see economic stagnation as the outcome of its policies.

First, it would be argued that the tax cuts will provide much needed incentive for investment. The tax cuts were in fact embarrassingly skewed towards upper income brackets, which have higher propensities to save. Normally, one might question whether low growth, excess capacity and high interest rates might not inhibit investment. But the Administration seems to believe that a dollar saved automatically equates with a dollar of productive investment.

Second, while the fiscal deficit could reach the record level of 1975, the Administration views the economy as being larger now and even in the worst circumstances (60-70 billion dollars) the deficit will equal only 2% of GNP, not large enough to inhibit a fall in interest rates. But this overlooks the fact that in 1975 monetary policy was accommodating deficits, while today it is very restrictive, which could make government finance disruptive in capital markets and help to sustain higher real rates even in the face of economic slack. Also, longer term inflationary- expectations among investors have not abated as much as the short term rates of inflation, thus giving further impetus to high real rates of interest.^{1/} The Administration appears to recognize this danger, and now is contemplating further budget cuts. However, the cuts must further attack social programs, which could meet resistance in Congress.

^{1/} Investors are very concerned about prospects of large fiscal deficits and their inflationary consequences. Growing defense expenditures in the face of already programmed multi-year tax cuts will induce deficits. The estimates of these deficits continue to rise. While 60 billion dollars is now the most often cited figure, some have mentioned 100 billion dollars as a possibility. The increasing debate over deficits adversely affects inflationary expectations even in the face of some recent slackening of consumer price increases.

The center piece of the economic program is tight monetary policy. The consequent high interest rates have Europeans very concerned, because they must keep their domestic interest rates very high in order to stem capital outflow and weakening exchange rates.^{1/} They will undoubtedly continue to express this concern in the Meetings.

The Europeans are, of course, very nervous about the social consequence of slower growth. Unemployment is a sensitive issue there, and it is not surprising that politicians on the left seem to be undergoing a revitalization of their prospects for gaining power in government. The Reagan Administration does not suffer from this problem, as the policies being introduced by it are new and a U.S. public, desperate for change of any sort, has assumed a wait-and-see attitude on the current economic program. Reagan's seemingly contradictory objectives of simultaneously increasing growth and lowering inflation may run into trouble; the result may be stagnation with less than dramatic gains on the inflationary front, much like England. However, should the program fail, or involve very high social costs in the attainment of reduced inflation, the political consequences would probably not begin to appear until after 1982. Thus the Europeans and the U.S. are today facing different domestic political climates and this may be a source of lively debate in the Meetings.

^{1/} The weakening exchange rates have caused a "third oil shock" for Europe, as the local currency price of dollar denominated oil has undergone a sharp increase.

"APERTURA"

The subject of "apertura" may be highlighted in discussions. The World Bank's World Development Report 1981 makes a very strong pitch for policies that pursue open economies with respect to trade and finance. It points to the fact that countries that had outward-looking policies were most successful in coping with the difficult economic environment of the 1970s.

I think few would take issue with the argument that policies directed at greater participation in trade can improve the allocation of resources and growth; under proper circumstances competition is healthy for the individual spirit as well as the national spirit. Also, aside from theoretical merits, in the difficult economic environment that we have today, concern about export performance has its own internal logic. However, in my view the Bank's suggestions for policy may be insufficiently qualified with regard to the short and medium term problems that will be encountered with such a strategy.

First, it seems to underestimate the difficulty of exporting in a world environment of low economic growth. Assuming that South-South trade can grow only gradually due to institutional obstacles, what would happen if all countries pursued the aggressive export policies of South Korea? Over the long run there might be prospects for a better allocation of resources in developing countries through trade, but in the short and medium term obstacles such as protectionism in the North --brought on by a wave of new LDC exports-- might stymie the process. In other words, the slow growth in the North could induce very high adjustment costs if all LDCs shift to more open economies. This could be alleviated through structural adjustment loans, but there is no

prospect that the World Bank will have resources sufficient to attend to more than but a handful of countries. This leaves countries reliant on commercial banks. But will the banks be a reliable source of finance in the 1980s? Will the banks lend to middle and lower income developing countries as they have to the upper income countries that now are their principal clients? Are there any special costs or risks associated with reliance on the banks for credit? These are all questions which need to be answered in greater detail.

Second, there is one possible serious adjustment cost which is hidden in the "economistic" approach of the analysis on outward looking policies. Is it any coincidence that at least 6 of the 8 countries that the Bank cites (p.75) as having had successful adjustment by outward looking policies are also noted for having harsh authoritarian governments? Is it any coincidence that 11 of the 13 countries cited (p.75) for inward looking policies are democratic governments, governments moving toward democracy, or "soft" authoritarian regimes where there is a considerable degree of political participation? In fact, competing in international markets and maintaining the confidence of international bankers often require policies that repress real wages and labor organization. Trade may increase employment under certain circumstances but suppression of wages and the perrogatives of labor may also be socially very disruptive and full of unforeseen costs.^{1/} Whether outward looking policies in developing countries require authoritarian regimes, is an empirical question, but I think that the causal correlation is so strong that it shouldn't be hidden in the economic analysis. The possibility of this social cost should be made explicit for those countries that might be contemplating such a strategy. This is

^{1/} Some of the potential socio-economic effects of outward looking policies can be found in Hector Assael "La Internacionalización de la Economías Latinoamericanas: Algunas Reservas" Revista de la Cepal, No.7, April 1979, pp. 43-58.

especially true for developing countries with democratic traditions.

Finally, after examining the results of outward and inward looking policies, the bank concludes that in the 80s countries "should move toward policies that provide equal encouragement to export and domestic production...." But this presupposes that balance is a realistic objective, when in practice countries might have to pass through alternating cycles of import substitution and export promotion. Thus the bank seems to underestimate a potential mutual dependence between import substitution and export promotion.^{1/}

In sum, the Bank's analysis is very good and to the point, although it might be overselling the benefits of outward looking policies and not giving adequate attention to the costs and socio-economic obstacles to such a strategy.

INTERDEPENDENCE

The common theme of both the IMF's World Economic Outlook and the IBRD's World Development Report is interdependence. However, while the defense policies of the industrialized countries seem to increasingly respect this principle, there is evidence that cooperation on the economic front is far from optimal. The U.S. seems suspicious of multilateralism and the very international organizations that could help bring about adjustments in energy dependence, finance and trade. There seems to be a drift backwards towards the bilateralism of the 50s, when a strong U.S. dollar and foreign private investment were the favored palliatives to world economic problems. Moreover, the tone here could be interpreted as "what is good for the U.S., is good for the world." Only time will tell whether this step backwards in time will work, but the conflict

^{1/} It mentions Brazil as a case where import substitution played an important role in the export of manufactures. But it is unclear whether the Bank views this as a special case, or a feasible strategy that other countries could pursue.

between the apparent need for interdependent policy formation and the increasing stress on bilateral solutions to problems, could introduce an interesting element of debate in the Meetings.



