BRETTON WOODS II: AN AGENDA

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Four subjects are suggested as the core agenda of the world financial and monetary conference:

(a) debt reorganisation;

(b) reconstruction of the international monetary system;

(c) reform of development finance; and

(d) organisation of international financial institutions.

Debt Reorganisation

At the end of 1982, short-term debts of developing countries, i.e. with a maturity under 1 year, were estimated at US $ 160 billion, compared to 60 billion in 1978. 1/ These debts used to be almost automatically rolled over, prior to 1981. In the debt crisis of 1981-82 this practice stopped, and a number of developing countries experienced a sudden need to repay massive sums out of dwindling or non-existent exchange reserves. Many were compelled to request postponement of payments, and the accumulated short-term liabilities now hang as a sword over their heads and, in a sense, over the heads of their creditors as well. No solid financial structure in the future can be envisaged without a conversion of a large part of the short-term debt into long-term.

The other side of debt reorganisation concerns the rate of interest. At least US $ 300 billion of the debt of developing countries is contracted at floating interest rates. These rates, consisting of the base rate (LIBOR or US prime) and the margin to reflect country risk, are now running at 12 per cent on the average. As the export prices of developing countries have long since stopped increasing, the nominal 12 per cent rate equals the real rate for them. At this rate, the debt burden will be rising with almost mathematical certainty. Debtors will be compelled to borrow at 12 per cent interest just to pay interest; and debt will virtually automatically increase faster than real output, leading to a rising proportion of national income being absorbed by debt service abroad, until either debt principal is scaled back, or the rate of interest is reduced. In the case of bank loans, renegotiation of interest rates will involve the somewhat complex matter of renegotiating the rates of interest with the depositors.

For the next year or so a great many individual debt negotiations will be going on. Judging by recent experience, they will result mostly in temporary arrangements. It is in the interest of debtors as a group that eventually an organised multilateral settlement is negotiated. Judging by a number of proposals made by prominent financiers and economists in the western world, it is felt in the creditor countries as well that such an organised settlement would be in the collective interest of all parties. Consultative negotiations would have to start quite early, hopefully to be finalised in a formal multilateral agreement with appropriate institutional arrangements at Bretton Woods II.

Reconstruction of the International Monetary System

Three major matters are involved here: first, the size and allocation of future issues of Special Drawing Rights (SDRs), improvement in their marketability and their future role as an international reserve asset; secondly, future organisation of balance-of-payments support to meet disturbances of the size and severity experienced in recent years; and thirdly, modalities of international monetary cooperation aimed at reduction and stabilisation of interest rates, stabilisation of exchange rates and reduction in international speculative capital movements.

The future of SDRs is becoming a central issue for several reasons: because the US financial authorities are showing an increasing unwillingness to supply dollars to the outside world to meet its liquidity and reserve needs in view of the US domestic budgetary problem and the pressures on its balance of payments; because the authorities of other reserve currency countries, or potential reserve currency countries, the Federal Republic of Germany, Japan, Switzerland, the United Kingdom and Saudi Arabia, are unwilling to play individually or even collectively the role which the US Treasury had played for decades, that is being a *de facto* lender of last resort; because the confidence in the private international banking system continuing to supply liquidity and reserves on a wide geographical basis has been severely shaken after the collapse of bank lending to the newly industrialising countries in August 1982; and because nobody in power, and rightly, is prepared to take the risk of attempting to restore the gold standard. Issues of SDRs seem the only way out, barring world deflation. How much, to whom and how to make them become an international currency rather than a hybrid of credit and money they are now?

The experience since 1973, and particularly since August 1982, has shown that the present system of balance-of-payments support in a crisis, centered around the IMF as now organised, is one of too little and too late. The IMF was established to act momentarily in periods of balance-of-payments stress in order to prevent such stress from having the devastating effects on trade, employment and welfare, because the experience in the 1930s had shown that ad hoc deals among central banks to provide support were difficult to make in a hurry. We are now back at ad hoc deals, perhaps only worse: a large number of private banks are now involved, on top of central banks, BIS, IMF, export credit agencies, name it, each with its own objective and pulling in its direction. In the meantime, crisis and deflation spread. An overhaul is indicated.

The issue of international monetary cooperation is probably most difficult, conceptually and politically. Without it, exchange rate stabilisation is probably impossible; and without the latter, competitive depreciations and trade conflicts will increase sharply. In 1981, the estimated exports of funds through the exchanges from the US alone were some US $ 100 billion. At the end of 1982, the foreign assets of Swiss banks were estimated at Sw. fcs. 350 billion, or about US $ 175 billion: these assets in part represent holdings of US, other European, Arab, Latin American etc. nationals and companies which prefer Swiss intermediation and protection. 2/ A large proportion of these funds is in constant move across exchanges in response to interest rate and exchange rate changes, in addition to other factors. While the BIS seems optimistic that central bank intervention in exchange markets could be helpful, it is a major question whether any central bank has enough resources to cope with the flows of private liquid funds of the magnitudes now being encountered. The remedies are either controls over capital movements or reduction of international differences in interest rates. The developing countries do not have much of a choice but controls, particularly after the experience of Mexico and some others in recent years. The developed countries, whose financial markets have reached an unprecedented degree of integration, will resist controls. The only choice left is coordination of monetary policies in order to reduce international differences in interest rates. However, as interest rates are a result of much deeper forces than monetary policy in anything but the very short run, and as there is an enormous political pressure almost everywhere to reduce the world level of interest rates (in addition to reducing their fluctuations and their inter-country differences), what we are really talking about is international coordination of fiscal, expenditure and broad economic policies, probably to a degree never tried before.

The issues of SDRs, new IMF and a feasible degree of coordination of monetary etc. policies will inevitably absorb much energy and intellectual effort before and at Bretton Woods II.

Reform of Development Finance

The Brandt Commission Secretariat had identified, in 1979, 3/ six gaps in the financing structure, mostly in development finance:-

(a) long-term programme lending;

(b) lending for energy and minerals;

(c) export credit;

(d) assistance for cooperation among developing countries, such as support of payments arrangements, regional and subregional reserve schemes, and ECDC joint ventures;

(e) commodity stabilisation finance; and

(f) finance for debt reorganisation.

Progress has been made in programme lending and energy finance, but it is small in relation to needs and the gaps have largely remained. The Common Fund for commodities is still in the process of signature and ratification.

Currently under way is work on the feasibility of a Bank for Developing Countries (South Bank), handled by the Group of 77. If established, the Bank may take upon itself the task of filling some of the gaps, particularly as they affect ECDC finance, export credit, and perhaps commodity stabilisation. Much will depend on the amount of resources the Bank would be able to mobilise. It is safe to assume, however, that the unfilled needs left over for consideration at Bretton Woods II, i.e. in a world-wide rather than south-south context, will be large, particularly in programme lending, energy finance, and debt reorganisation.

The removal of restricitive clauses and precedents which have dominated the past policies of multilateral development finance institutions would also be for consideration at Bretton Woods II; included here are: inability to finance local currency expenditures to the degree needed, difficulties or inability of issuing guarantees, and arbitrary ceilings on certain classes of assets, such as programme loans.

Many students of development finance have noted the institutional gap in the Bretton Woods structure, gap between the long-term project loans of the World Bank (and subsequently the regional banks) and the short-term balance-of-payments lending of the IMF: the architects of Bretton Woods I had almost forgotton, or did not fully believe in, long-term balance-of-payments (programme) lending. The Bank Charter provides for non-project lending only as an exception, and this has been a problem ever since. Bretton Woods II would provide the opportunity to close this gap: the needs for long-term programme loans and the conditions on which to meet them will be central issues in development finance.

Organisation of International Financial Institutions

The growing exposure of international financial institutions to a variety of development problems of increasing complexity and rising numbers of developing country nationals on their staff have made a difference to their operations, attitudes and image. The control has remained firmly in major developed country hands, however, and this has been decisive for the scope of operations and lending policies. Furthermore, the institutions have retained virtually without change their theory of economic policy, the view, the "mind-set", which have been their hallmark since the beginning, setting them apart from the views held by large numbers of developing country membership and bringing them into frequent country conflicts, particularly concerning conditionality.

It is the persistence of this adversary relationship and the existence of unfilled gaps in the financing structure which have led, from 1950 onwards, to numerous proposals for the creation of a new world-wide financial institution or new facilities in the existing institution, or both. The last of these was a call by the Brandt Commission for consideration by the international community of a World Development Fund, specifically designed to fill the gaps the Fund and the Bank have been unable to meet, and to do it on the basis of partnership of lenders and borrowers which would be a novel feature in international economic relations.

This entire set of issues - conditionality, reform of existing institutions, management structure, modification of control commands, creation of a new institution or facilities, in short the possible ways in which the "mind-set" can be transformed into a many-minded approach and replaced by participatory management while retaining the capacity to act and mobilise funds - will inevitably be at the centre of political considerations at Bretton Woods II. If these issues can be satisfactorily settled, much of the North-South dispute will have been resolved.

Another organisational issue of major importance is the place and role of socialist countries of Eastern Europe and some elsewhere in the system of international financial institutions. Yergin has shown that the formal beginning of the cold war in 1946 coincided with George Kennan's appeal not to make a special effort to persuade the U.S.S.R. to ratify the Bretton Woods Agreement.4/ Another opportunity for everybody concerned would arise at Bretton Woods II: if universality of financial institutions can be agreed, it may in many different ways contribute to the end of cold war and thus to reduction of spending on armaments. This would be the ultimate success of Bretton Woods II.

Preparations

Powerful forces are now at work likely to lead to a decision to hold the world financial and monetary conference in 1984: the call by the Non-Aligned Summit in March 1983, the view of the US Secretary of the Treasury of December 1982, and the call by the President of France in May 1983, supported by the other social-democratic governments of Europe (Austria, Finland, Greece, Spain and Sweden). The perspectives of these different powers are different, however, and so are the objectives. There is no chance of success of Bretton Woods II without a broad, precise, methodical and virtually fulltime technical preparation on the part of each of the major country groups and then of all groups together. The history of preparatory work for Bretton Woods I, described by Sir Roy Harrod, 5/ shows the magnitude of the job even when only a few dominant powers and even fewer dominant personalities were involved. The present situation and relations of forces are much more complex, called for even greater sustained efforts.

Footnotes

1. Federal Reserve Bank of New York, November 1982, as reported in the Wall Street Journal, 5 November 1982 and Journal de Geneve, 6 November 1982.

2. Report of the Swiss National Bank quoted in Bank for International Settlements Press Review of 30th December 1982.

3. See The Brandt Commission Papers, Independent Bureau for International Development Issues, Geneva, 1981, pp. 608-634.

4. Daniel Yergin, Shattered Peace: The Origins of the Cold War and the National Security State, Boston, 1977.

5. R.F. Harrod, The Life of John Maynard Keynes, New York, 1951.