MONETARY AND FINANCIAL ASPECTS OF THE NEW INTERNATIONAL ECONOMIC ORDER

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I

The significance of economic development as a crucial international issue in the post-colonial era was recognized quite early. It figures prominently in all post world war discussions on economic issues. In fact, the focal point of attention during the past three decades has been the problems associated with development and growth of national economies. The results of a long period of debate, discussion and practical effort at national and international levels are, however, in many ways, disappointing.

There has been substantial economic growth and expansion. In many ways, it is unprecedented. However, there are two crucial tests on which this growth experience appears highly disappointing. Firstly, according to the latest estimates given in the World Development Report 1978, there are some 800 million individuals trapped in absolute poverty. These are people living at the very margin of existence — with inadequate food, shelter, education and health care. Secondly, despite impressive growth in the developing countries as a group, the disparity in per capita incomes between the developed and developing countries has been growing. The disparity has also been growing among the poorer and relatively better-off developing countries.

The average performance of developing countries has been impressive during the 25 years period 1950-75. According to the data compiled by the World Bank, income per person has increased by 3% a year, with the annual growth rate accelerating from about 2% in the 1950s to 3.6% in the 1960s. Most of those countries which are now regarded as developed, maintained a growth rate of less than 2% per annum over the 100 years of industrialization beginning in the mid-Nineteenth Century. These averages compared for entirely different periods are highly misleading. This average for the developing countries during the past 25 years has been largely influenced by the performance of countries which constitute special cases in many ways.

The main cases of high growth are those of some oil-producing countries (Libya, Iraq and Iran) or those which have special defence, trade and financial relations with the United States' market (Taiwan, Korea, Jamaica, Hong Kong, Israel). The export-led growth of these countries has been possible because of investment by multi-national corporations and because of acceptance of their exports in the developed countries which would not be possible if a larger number of countries were taking the same road. Comparison with the corresponding growth experience of developed countries since the 1850s is also not appropriate. An average of growth over the century would be lower than the high growth rates attained by various countries in the period of their respective take-off.

In any case, for the most populous countries, excluding China, growth rates have been low. For 28 countries, accounting for 49% of the population of 72 developing countries studied, the rate of growth in per capita incomes has been less than 2% per annum. At this rate, half a century would be required to obtain a doubling of per capita incomes — the minimum necessary to seek eradication of poverty. Even with certain bold assumptions for accelerating growth in low income developing countries, the World Bank projections show that 600 million people would remain trapped in absolute poverty.

The complexity and the immensity of the magnitude of the task is only now becoming apparent. This was not fully realized either by the developed or developing countries. The developed countries believed that they would be called upon only to provide technical assistance and concessional loans. Capital is the scarce factor. By providing capital, a process of rapid expansion could be initiated in the developing countries.

They did not bargain for fundamental changes in the world economic relations which are bound to take place with the economic rise of a large number of countries. This is why one sees the curious phenomenon of industrial nations providing concessional loans to a developing country, while taking strong measures to shut out exports from that country which could reduce its "aid" requirements. The developing countries themselves misconceived the process as simply involving capital formation financed by domestic and foreign savings resulting in growth through the magic of compound interest tables applying fixed capital-output ratios. Fundamental changes in society to receive and apply technology to production processes and the overall transformation of relations on a societal plane are only now beginning to be grasped. The naiveté of both views is becoming obvious.

There is an attempt to apportion responsibility for the results. The demand for New International Economic Order is at times presented as if changes in international economic relations are the only obstacle in the development process. An improvement there would be sufficient to change the entire picture. On the other hand, the emphasis on basic human needs strategy is followed by some developed countries with almost a fanatical religious zeal, signifying a belief that the only problem with development has been the maldistribution

of the gains in income and production. Changes in internal economic order are presented as substitutes for required changes in international economic order.

There are examples of countries which have achieved high rates of economic growth through their own effort and internal reform. Also there are examples of rapid development in countries which did not carry out sizeable programmes specifically designed to meet basic needs. There has not been a sufficient study and analysis of successful cases to identify common factors determining their progress. It must, however, be realized that many more basic changes are necessary in developing countries than have so far been undertaken for the full transition of these societies to a high level of development. However, for an orderly transition and smooth adjustment, it would be necessary that these should be in the context of a fundamental change in international relations.

International Economic System includes a set of relationships which determine trade and financial flows among nations. The basic elements which should be considered are the following:

(i) ownership and control of natural resources;

(ii) terms for sharing and using technology;

(iii) terms on which trade takes place between those who produce manufactured goods and those who export primary raw materials;

(iv) a monetary system including settlement for trade and financial transfers among countries.

The essential ingredients are resources, finance and technology. In theory, the system is based on free market conditions and competitive determination of price. However, in practice, both technology and finance are managed under monopolistic conditions. Power derived from technological advance is reflected in control of finance. Natural resources as distributed among nations, provide a much larger base for the developed nations, mainly because large new continents were occupied by migration of the population from Europe. Further control of natural resources is acquired in the developing countries through an extension of technology and finance.

The ability of OPEC in 1974 to raise oil prices provided a major opening in this tight system. It encouraged the view that a change is possible and provided dramatic evidence that the price relationship between raw materials and manufactured goods can be altered. The industrial nations sought to present the energy price as adversely affecting all the non-oil-exporting countries. The developing countries remained united and formulated demands for more fundamental changes in the system. At the Sixth Special Session of the United Nations General Assembly, Resolution No. 3202 adopted a programme of action on the establishment of a New International Economic Order. This, together with the Charter of Rights and Duties of States, has become the main reference document embodying the list of changes considered necessary by the developing countries and partly accepted by the developed countries. At the

Seventh Special Session, there was some progress towards getting a certain convergence of views on some of the issues. Actual negotiations shifted to Paris where North-South Dialogue continued in a smaller group of 27 for one year and ended with virtually no tangible progress. The year 1977 saw the failure of the Paris Conference. This was followed by protracted, but until recently, fruitless, discussions on the Common Fund for Integrated Commodity Programme, and some progress on the debt problem of the poorest countries which has yet to be translated into action by larger countries. There was a decline in transfer of resources to developing countries in 1977 in real terms. Multilateral Trade Negotiations have increasingly been confined to bargaining among the developed countries. Protectionist tendencies have grown in the developed countries specifically affecting the trade prospects of the developing countries. The new protocol of Multi-Fibre Arrangement, covering the period through 1981, permits the imposition of more severe restrictions on clothing and textiles. Under this, the European Common Market has reduced 1978 quotas for three countries beneath actual 1976 levels. Australia, Canada, France, the U.K. and U.S.A. and Sweden have imposed new quotas and so-called "orderly marketing arrangements" on the developing countries' export of footwear. The European Community and the United States have introduced special protective measures regarding steel which pose serious difficulties for those developing countries which are now emerging as exporters. The United Kingdom has imposed quotas on television sets from two developing countries and similar action is threatened by the United States.

There is a stalemate on proposals regarding transfer of technology and adjustment in world industrial production.

On the question of monetary and financial arrangements, despite the persistence of crisis in exchange relations in the world, there is no serious discussion on monetary reform directed towards creating a new monetary system.

There is a long agenda, and substantive progress on various issues may not be anything but painfully slow. Frustrated by this slow progress in North-South Dialogue, the developing countries have moved to fostering greater co-operation among themselves. Economic confederation among developing countries (ECDC) is the new approach. It has pitfalls of its own, but indicates one avenue of progress in an otherwise entirely disappointing picture.

II

In continuing the pressure for change, the developing countries need to determine priorities. Instead of pressing for a number of items simultaneously, it may be possible to make progress in selected areas. Monetary reform and seeking to create a new monetary system or order appears an obvious priority. It is one of the key elements in establishing new international economic order. It provides possibilities of bringing to light common areas of interest. It is not a field where the division is straight on the basis of North and South. The surplus and deficit countries cut across the traditional division among developed and developing countries.

The most significant point about the present monetary system in the world is the absence of elements which are necessary for calling it a system. Exchange rates are determined neither by fixed parity relations determined by longer-term relative economic strength, nor by fluctuating pattern determined by open market conditions. Speculation is as important as basic economic considerations. Creation of foreign exchange reserves and the level of liquidity is dependent upon the size of the U.S. balance of payments deficit. There is no way to check a rise in world inflation fueled by an indiscriminate creation of international money. One national currency constitutes international money and the internal economic policies of one country can decide to plunge the entire world in a deep recession or powerful inflation. There is no assurance that the real value of foreign exchange reserves can be maintained. In fact, there is reasonable expectation that such value would keep declining.

The developing countries suffer under these conditions because they are entirely helpless. As one U.S. expert put it, laws in a society are designed to protect the weak. Absence of laws in international economic relations restricting the freedom of "strong" currencies (in the sense of those being able to retain independence of action), must hurt the interest of weak or dependent currencies.

It is important from the point of view of the developing countries to take up the question of reordering international monetary system with fundamental reforms. Minor changes being examined at the annual IMF meetings only tend to give acceptability to the present vacuum, making it workable in the short run through improvisation. This may suit some of the developed countries, as it may enable them to avoid basic changes which would inevitably affect their dominant position. However, a number of developed industrial nations and much of the intellectual opinion in advanced countries would be willing to join this pressure for creating a new monetary order.

OPEC countries have a fundamental stake in the system. It would be desirable for them to seek changes in the system instead of only seeking to correct the ill effects by periodically reviewing the price of oil. Why should inflation and erosion of purchasing power be accepted as a normal phenomenon which is sought to be matched by a change in oil price? This is unavoidable so long as the system is not functioning. But with a more stable system, much of the drama requiring focus on price change can be avoided.

In 1944, the international monetary system created at Bretton Woods was decided essentially by arguments between U.K. and U.S.A. through the famous argument between Keynes and White. The U.S.A. expected to continue to be a surplus country and the U.K. a major deficit country. Rules were decided between them. It was decided that the currency of the surplus country would be used as international currency to avoid inflation. It was also decided that the burden of corrective policy would be mainly on the deficit country. On stable exchange rates, there was a fundamental agreement.

In August 1971, the basic element of the system, i.e., convertibility of the dollar into gold, was suspended. Since then, the currency of the country with the largest balance of payments is the unit of account and world currency. The fluctuating exchange rates can be used for quite some time as a substitute for domestic policy action. The dollar is a reserve currency without accepting the costs and limitations on policy required from a reserve currency. This situation cannot go on for a long period. It would be better for the world community to think out the new monetary order instead of stumbling into one through improvisation. It may be desirable to begin where the deliberations on the subject were overtaken by events. The Committee of 20 set up to deal with the question of Reform of International Monetary System in 1972, forwarded the First Outline of Reform in 1973 to the Board of Governors.

It contained a general agreement that there is need for a reformed world monetary order, based on co-operation and consultation within the framework of a strengthened International Monetary Fund that will encourage the growth of world trade and employment, promote economic development, and help to avoid both inflation and deflation.

The main features of the system included:

(i) that the exchange rate should be based on stable and adjustable exchange rates, while floating exchange rates could be used only in special situations;

(ii) co-operation in dealing with large capital flows which create inequilibrium in exchange markets;

(iii) the introduction of some degree of convertibility for the settlement of imbalances;

(iv) management of the world-wide creation of foreign exchange reserves with the Special Drawing Rights (SDR) becoming the principal reserve asset, and the role of gold and of reserve currencies being reduced;

(v) the promotion of the flow of real resources to developing countries.

It is obvious that we have moved considerably away from this line. The steps taken towards demonetization of gold perhaps cannot be reversed. The convertibility question cannot therefore be taken up at this stage, though it cannot be ruled out in the long run if there is not an adequate progress towards creating a better alternative system. It would be important to focus on organizing a system in which reliance is not placed on a national currency for creation of international reserves. A number of proposals have been advanced which adopt different routes for reaching essentially the same goal. One obvious line is to begin with the existing institutions. Progressively the International Monetary Fund will have to be converted into a central banking institution for the world. Just as national monetary authorities have the responsibility of nationally regulating domestic money supply and maintaining its value, an international monetary authority would be required to do the same. The present Special Drawing Rights — which is popularly, though now erroneously, termed as paper

gold — could be converted into a world currency. For a transitional period the dollar and S.D.R. could co-exist as international currencies. However, the surplus countries have a right to insist that at least future surpluses, if not the past accumulated surpluses, should be expressed in a more stable unit of account. The S.D.R. represents not the gold value but an average value of a currency basket. It would not thus decline because of weakness of one currency. Some currencies will decline and others will go up. The average would show some stability. But even this arrangement does not provide a protection against inflation if it is taking place at the same rate throughout the world.

The S.D.R. supply can also be regulated. It does not depend upon the balance of payments of any one country.

This would be backed by the collective credit-worthiness of all countries of the world and would be much more acceptable. The rate of interest paid on it would be useful for both surplus and deficit countries. But institutional progress from the present system which is similar to primitive money-lending, would represent an advance for all parties. The deficit countries would be required to carry out an adjustment process within a reasonable period and would be allowed to accumulate deficits during this period. For key currencies, the adjustment period could be longer, to avoid adverse impact on world trade and growths in world economy.

III

In this new monetary order, one question has proved highly vexing. This is the question of a "link" between the creation of an international reserve and the transfer of real resources to the developing countries. In many ways, the particular formulation of the question has given rise to apprehensions and rigid positions. At present, the reserve creation is done by countries with reserve currency status. A balance of payments deficit for the United States is necessary to provide dollars in the hands of monetary agencies in other countries, otherwise their reserves would not grow and therefore world trade would not grow, just as volume of transactions cannot grow in individual countries if the money supply is not changing. It implies that the world, in order to meet its requirements of international money, must provide loans to U.S.A. In the long run, this is not good for U.S.A. as it weakens the dollar. It also leads to a maldistribution of credit in the world. The U.S. money market must in turn lend to other countries in need of funds. Such lending cannot be for long periods and therefore when lent for a medium period to developing countries creates an unhealthy situation. The question therefore comes back to the point that the new monetary order would not be fully functional unless it also provides for meeting the developmental finance needs of the developing countries. There is an unavoidable link between the money market and the capital market. This link has to be recognised. If the new liquidity is created by an international institution but provided to developed countries in bulk, it would not change the existing system. It would allow the deficit countries to continue with the deficits and to finance them. For them the need is to force some corrective action. New money should be used to increase their exports and improve their balance of payments.

However, if it is agreed that new money should only be used to avoid recession and to use the idle industrial capacity in the world, it should initially be given to countries whose efforts to maintain demand for capital goods are essential to induce a higher level of activity in the industrial nations. This could help the balance of payments of deficit developed countries.

It appears necessary for the developing countries to move from an aid relationship to an institutional development approach. Setting up targets of 0.7% of G.N.P. would not help. Since the target was set up, actual performance has come down from 0.6% to 0.3%. One should not criticise the developed countries. Governments are responsible to their electorates and must act in their interest. Foreign assistance developed out of a particular phase in the foreign policy of the United States. Others were persuaded to join either with a feeling of sharing the cost of what was essential for the defence of the western global policy, or for commercial considerations. There is a growing element of genuine desire to help developing countries among smaller European countries but this cannot be enough to change the picture. Even the quantitative aspect is altered by qualitative restrictions. The high cost of aid-tying is obvious and well-known. However, holding back aid in a naked attempt to force developing countries to accept dictated policies is becoming obvious. Selection of countries for providing aid is in many cases an extension of national interest. For instance, in 1976 Israel received $643 million as net flow of official Development Assistance from OECD countries and multi-lateral agencies. This represented an increase from $186 million in 1973. With the large repayment due on post aid, this must have involved a large increase in aid to a country which would not qualify for aid on accepted criteria. Similarly, Reunion Island (a dependency) got $308 million which was more than any other country got in Africa with the exception of Egypt. A certain part of the aid budget should be charged to foreign policy and defence. Another element should be regarded as subsidy to inefficient suppliers from the aid-giving countries. The real content of aid is definitely much less than nominal. It is clearly a case where the burden on tax-payers is more than the benefit to the receivers. Bilateral assistance where a variety of considerations subtract from the real quantum of aid in an unpredictable manner can hardly be regared as an efficient mechanism for helping a steady process of world economic development. More of this might help — though there are not firm quantified grounds to be sure of it — but at the risk of increasing the real cost.

The World Bank and regional banks have been able to provide concessional loans by borrowing on commercial terms. The record of developing countries is excellent, as there has been no problem of repayment. The cost has been low as the world community only provided guarantees. There has been a use of private funds. Interest rates have been low and the repayment period is reasonable. This trend should be encouraged. More institutions should develop. From the point of view of lenders, loans expressed in their own currency are safer and interest rates are attractive. With the surplus available within developing countries, such institutional lending should grow on the basis of mutuality of interest. There would still remain the problem that some poorer developing countries cannot rely entirely on non-concessional loans. The need for concessional lending in their case can be reduced by rescheduling their past

concessional loans. Also it would be necessary to move towards the concept that a programme for meeting basic human needs which has to be conceived widely to include development related to meeting such needs, should be financed through international grants as well as elements of international taxation.

IV

To sum up, creation of a monetary system in place of a chaotic situation is a necessary step in the interest of developed industrial nations, OPEC and the poorer developing countries.

The reform should be by expanding the use of Special Drawing Rights as a truly international unit of account as well as a currency for settling accounts.

This should be combined with an attempt to provide development finance to the developing countries. This would diversify the assets from the point of the surplus countries. The deficit industrial countries would gain because the money would be spent on buying capital goods. It would not be put into banks. Production would increase as well as exports. Their balance of payments would decline.

The developing countries will not have to depend on aid arrangements of a bilateral nature, the real benefit from which was affected in the past by high cost purchases based on tied aid, political pressures and distribution of aid to countries where it was not really related to development.

There should be an increased flow of funds through international institutions on commercial lines.

In these institutions, greater voice should be given to developing countries along with surplus OPEC countries.

Finally, for poorer developing countries, there may be a need to finance basic human needs through international taxation and international grants.