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The International Monetary System and the New International Order

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Editorial Office:

The Dag Hammarskjöld Centre
Övre Slottsgatan 2
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Editorial Note

The South-North Conference on 'The International Monetary System and the New International Order', to which this issue of DEVELOPMENT DIALOGUE is devoted in its entirety, took place at the Arusha International Conference Centre in Tanzania from June 30th to July 3rd, 1980.

In bringing together people from Third World and industrialized countries, the Conference provided an occasion for a group of policy-makers and economists from all regions of the world to seek common ground in dealing with one of the major issues confronting the international community as it tries to build a just international order. The aim of the Conference sponsors (a coalition of extra-governmental 'third system' organizations) was to associate Third World criticism of present monetary arrangements and their main institution, the Washington-based International Monetary Fund (IMF), with industrial country concerns about inflation and growing monetary disorder, thus building a constituency, transcending the North-South frontier, committed to establishing a new monetary system in support of global development. An important aim was also to consider urgent transitional measures within the present institutional framework.

The 40 conference participants from 20 different countries included parliamentarians, planners, bankers, officials of international organizations, economic researchers and international communicators. Particularly significant was the fact that the Conference brought together ministers from Jamaica and Tanzania, two countries with recent experiences of tough negotiations with the IMF, experiences underlying the message to the Conference from Prime Minister Michael Manley of Jamaica and the statement made at the turn of the year by President Nyerere of Tanzania.

The proceedings of the Conference were chaired by Marc Nerfin, Ahmed Ben Salah, Jozef Pajestka, Amir H. Jamal, Robert Borosage and Hugh Small. Juan Somavia and Evelyn Herfkens acted as rapporteurs and Sven Hamrell and Justin Maeda as joint secretaries to the Conference.

The *Arusha Initiative*, which represents the general consensus of the Conference, reflects the main papers prepared for the Conference and the views advanced by the participants during the discussions. As is evident from the text of the document, the *Arusha Initiative* is based on the recognition of the fact that the monetary system agreed upon at Bretton Woods in 1944 has broken down and on the conviction that it is imperative that a new monetary system be negotiated by the entire community of nations. Hence the call for a United Nations Conference on International Money and Finance. Meanwhile, there is a need for IMF facilities to be enlarged and improved and IMF conditionality criteria to be reformed as well as for the establishment of a new mechanism of appeal and arbitration in cases of dispute between the Fund and its member countries. In addition, new mechanisms outside the IMF are urgently needed for massively increased and qualitatively improved resource transfers.

Three main papers by Ismaïl-Sabri Abdalla, Norman Girvan and Justinian F. Rweyemamu and a set of Background Notes on the IMF were prepared for the Arusha Conference. They were edited and integrated in one document by Michael Zammit Cutajar who also compiled the Background Notes on the IMF. Michael Moffitt made valuable comments to the authors and E. A. Brett provided useful material on the IMF.

The three papers are presented here separately and under the name of their authors. The content is, however, substantially the same as that submitted to the Conference though some revisions have been made in the light of the wide-ranging discussions. One of the participants, Luigi Spaventa, was moved to summarize the main points of his interventions for this issue of *DEVELOPMENT DIALOGUE*. The participants also had the benefit of case studies prepared on the experiences of Jamaica, Peru and Portugal in the 1970s. The Jamaica study is published here in a revised version.

The institutions sponsoring the South-North Conference were: the Dag Hammarskjöld Foundation, Uppsala, Sweden; the International Foundation for Development Alternatives (IFDA), Nyon, Switzerland; the Institute for Policy Studies, Washington D.C., U.S.A.; the Latin American Institute for Transnational Studies (ILET), Mexico City; and the Third World Forum (TWF), Cairo, Egypt. Collaborating institutions were the Jamaican National Planning Agency, Kingston, Jamaica, and the Institute of Development Studies at the University of Dar es Salaam, Tanzania.

The South-North Conference was the culmination of a project initiated by the sponsors early in 1979 and all of them have, at one time or another, contributed to the formation of the ideas contained in the papers presented to the Conference and in the *Arusha Initiative*. Of particular importance to the outcome of the Arusha Conference were the results of a first substantive meeting held at the Terra Nova Hotel, Kingston, Jamaica, in October 1979, at which experts from a number of countries exchanged their experience of dealing with IMF 'stabilization programmes' and the constraints which these impose on the development of Third World countries, affecting most harshly the poorest of their citizens. The consensus of that meeting was expressed in 'The Terra Nova Statement on the International Monetary System and the Third World', published in *DEVELOPMENT DIALOGUE* 1980:1.

It should be emphasized that the papers featured in this issue of *DEVELOPMENT DIALOGUE* served as a basis for the discussions at the South-North Conference and that, although they have been revised by their authors to reflect these, they do not, unlike the *Arusha Initiative*, constitute consensus documents. They are printed here as working documents, open to further discussion and not as 'definitive' papers. It is hoped that they will serve as contributions to the debate on the New International Development Strategy and the New Round of Global Negotiations and that media and third system groups will take up this important theme and generate pressure for governmental action.

**Message from the Prime Minister of Jamaica,
Hon. Michael Manley, to the South-North
Conference on the International Monetary
System and the New International Order**

I salute the delegates attending the South-North Conference on 'The International Monetary System and the New International Order'.

The Dag Hammarskjöld Foundation, the International Foundation for Development Alternatives, the Institute for Policy Studies, the Latin American Institute for Transnational Studies and the Third World Forum deserve our gratitude for sponsoring this very important event.

For our part, the Government of Jamaica is very pleased to have been associated with the organisation of the conference, through our National Planning Agency working in collaboration with the Institute of Development Studies at the University of Dar es Salaam.

Jamaica's experience of IMF stabilization programmes is very recent and very salutary. Three months ago we discontinued our negotiations for further IMF support because, after three years of experience in which we struggled relentlessly to persuade the IMF to soften its conditions, we were convinced that

IMF prescriptions are designed by and for developed capitalist economies and are inappropriate for developing economies of any kind;

the severe suffering imposed on a developing society through IMF conditionality is endured without any real prospect of a favourable economic outcome and without an adequate foundation of social-welfare provisions to mitigate the hardships experienced by the people;

the notion that with IMF approval international commercial banking institutions will supplement the funds made available by the IMF is a fallacy;

the punitive withholding of tranches of foreign exchange as a consequence of the failure to meet periodic IMF tests condemns the defaulting country to a worsening of the foreign-exchange situation which the IMF involvement itself is aimed at improving.

The South-North Conference on 'The International Monetary System and the New International Order' should

focus attention on the defects in the system and should be a catalyst in the process of change in the international order.

The fact that the distinguished assembly of delegates at the Conference has come not only from the disadvantaged South but also from the North should assist in the search for global consensus on the need for fundamental change.

I am confident that yours will be a very constructive conference and that it will play a significant role in advancing the struggle for the New International Order.

Michael Manley

No to IMF Meddling

Extract from President Nyerere's New Year Message 1980 to the Diplomats accredited to Tanzania

Your excellencies: Tanzania needs peace—in Africa and elsewhere. But the major economic problems which have pre-occupied us in recent months, and which darken the coming year, were not caused by the war against Amin's Uganda, nor the African struggle for freedom. These make things worse; they added to the strain on our resources and deflected our attention at an important time. But we were experiencing inflation before October 1978; our balance of payments was in serious deficit before that war; oil price increases have nothing to do with events in East or Southern Africa.

These externally caused problems are obvious, and so is our need for an injection of balance of payments support. What recently became equally obvious to me but nevertheless strange and repugnant was the attempt by the International Monetary Fund to exploit those difficulties in order to interfere with the management of our economy.

The IMF always lays down conditions for using any of its facilities. We therefore expected that there would be certain conditions imposed should we desire to use the IMF Extended Fund Facility. But we expected these conditions to be non-ideological, and related to ensuring that money lent to us is not wasted, pocketed by political leaders or bureaucrats used to build private villas at home or abroad, or deposited in private Swiss Bank accounts.

We also accepted that we could justly be asked how we were planning to deal with the problem in the medium or longer term. We could then have accepted or rejected such conditions, but we would not have felt it necessary to make a strong and public protest.

Tanzania is not prepared to devalue its currency just because this is a traditional free market solution to everything and regardless of the merits of our position. It is not prepared to surrender its right to restrict imports by measures designed to ensure that we import quinine rather than cosmetics, or buses rather than cars for the élite.

My Government is not prepared to give up our national endeavour to provide primary education for every child, basic medicines and some clean water for all our people. Cuts may

have to be made in our national expenditure, but we will decide whether they fall on public services or private expenditure. Nor are we prepared to deal with inflation and shortages by relying only on monetary policy regardless of its relative effect on the poorest and less poor.

Our price control machinery may not be the most effective in the world, but we will not abandon price control; we will only strive to make it more efficient. And above all, we shall continue with our endeavours to build a socialist society.

When an international institution refuses us access to the international credit at its disposal except on condition that we surrender to it our policy determination, then we make no application for that credit. The choice is theirs—and ours.

But such conditions do reinforce our conviction about the importance of the Third World demand for changes in the management structure of the IMF. It needs to be made really international, and really an instrument of all its members, rather than a device by which powerful economic forces in some rich countries increase their power over the poor nations of the world.

There was a time when a number of people were urging that all aid to the Third World countries should be channelled through international institutions. They honestly believed that such institutions would be politically and ideologically neutral. I do not know whether there are now people who honestly believe that the IMF is politically or ideologically neutral. It has an ideology of economic and social development which it is trying to impose on poor countries irrespective of their own clearly stated policies. And when we reject IMF conditions we hear the threatening whisper.

‘Without accepting our conditions you will not get our money, and you will get no other money’. Indeed we have already heard hints from some quarters that money or credit will not be made available to us until we have reached an understanding with the IMF.

When did the IMF become an International Ministry of Finance? When did nations agree to surrender to it their power of decision making?

Your Excellencies: It is this growing power of the IMF and the irresponsible and arrogant way in which it is being wielded against the Poor that has forced me to use my opportunity to make these unusual remarks in a New Year Speech to you. The problems of my country and other Third World countries are grave enough without the political interference of IMF officials. If they cannot help at the very least they should stop meddling.

I have made it repeatedly clear to my own countrymen, however, that whatever decisions are made by us, and by our friends, 1980 is going to be a very difficult year for Tanzania. I believe that when they understand the problem our people will respond to this economic challenge as they have responded to other challenges in the past.

I believe they will bear the further sacrifices, and further burdens, which present conditions impose upon us just as long as they are assured that we are doing our best to share the burdens equitably, and continuing to pursue our own policies.

The Arusha Initiative

A Call for a United Nations Conference on International Money and Finance*

1. The post-1945 international monetary system has broken down. The ensuing inflationary and speculative disorders inflict serious damage on the majority of peoples and countries. It is imperative to conceive and negotiate new monetary structures and procedures. The international community has given little attention up to now to this major component of a new international order. This ARUSHA INITIATIVE is a contribution to the development of the necessary debate and action.

Mutual interest in ending monetary disarray

2. There is today a common interest, shared alike by the countries of the OECD, Eastern Europe and the Third World, to articulate a new monetary system that would reflect the employment and development needs of people living in different material conditions, social systems and cultural environments. Inflation, protectionist tendencies, competitive deflationary policies, unstable exchange markets, unregulated Eurocurrency transactions, recurrent and growing balance of payments disequilibria, and the 'conditionality' of the International Monetary Fund are problems which affect us all, though in different ways. If there is an area in which interdependence has almost immediate effect, it is that of money and finance.

3. The present monetary disarray does no credit to human rationality and ingenuity. Inaction is increasingly costly and dangerous. Policy initiatives for a new monetary order and public debate on them are needed now. The necessary political decisions must be taken urgently by governments acting in a collective and democratic manner.

* This document represents the broad consensus of the participants, though none of them necessarily agrees with all points in the analysis or recommendations. It should also be noted that most participants attended in their personal capacities, i.e. without committing the organizations or governments to which they belong. Affiliations are mentioned for identification purposes only (see list of participants below). Communicators and one observer also contributed to the discussion.

The collapse of the Bretton Woods system

4. Money is power. This simple truth is valid for national and international relations. Those who wield power control money. Those who manage and control money wield power. An international monetary system is both a function and an instrument of prevailing power structures.

5. The monetary system devised at Bretton Woods in 1944 reflected the historical conditions of the time, particularly the domination of the United States of America within the capitalist world and the persistence of colonial empires. The Third World as we know it today did not exist then. Moreover, the Union of Soviet Socialist Republics and other socialist countries refrained or withdrew from participation in the system, which thus came to lack universality. The monetary results of such a structural situation were inevitable: the United States dollar became the *de facto* international currency and the policy prescriptions on international monetary and financial affairs were designed to provide a stable basis for economic relations within the capitalist world. The International Monetary Fund is the institutional expression of these aims and conditions.

6. The world has been dramatically transformed since the Bretton Woods conference, while the formal monetary framework and the values it expresses remain unchanged. Third World countries have insistently questioned the adequacy and legitimacy of monetary rules and mechanisms in whose design the majority of them did not participate. Moreover, there was an inherent contradiction in the system itself: between the role of the US dollar as the main source of international liquidity and its function as a stable international store of value. The prolonged payments deficits of the USA led to the suspension by that country, in 1971, of the convertibility of the dollar into gold and to the termination of the system of fixed exchange parities. These evolutions reflected a crisis in the capitalist system. More specifically, they represented the erosion of the conceptual foundations on which the Bretton Woods system was built and the consequent loss of legitimacy on the part of the IMF. For all

practical purposes, the monetary system agreed upon at Bretton Woods collapsed. It had proven unacceptable to the South, inefficient for the North, and anachronistic for all.

The inadequacies and inequities of IMF prescriptions

7. The package of 'stabilization' measures prescribed by the IMF for countries with balance of payments deficits required these to accept a credit squeeze to reduce the money supply, reduced public spending particularly on welfare services, reduced real wages, liberalized price controls, the encouragement of private foreign investment, and the substitution of devaluation for tariffs and direct controls over trade.

8. The IMF claims to have a 'scientific' basis for these policies and to be an objective and neutral institution charged with the 'technical' function of 'helping' countries to overcome their financial difficulties. Available evidence, including internal Fund documentation, points the other way. This contradiction is particularly clear when the Fund addresses Third World countries' balance of payments problems. What does the record show?

(a) *The IMF is not 'scientific'* because its analytical approach and policy prescriptions ignore the structural and inevitable nature of payments disequilibria that result from the development process. Its instruments were never designed to cope adequately with the development-deficit problems of Third World countries, or with 'shock' deficits arising out of sudden and unforeseen adverse turns in their import costs or export incomes. These phenomena are now qualitatively and quantitatively different from when the IMF was set up. To continue considering them as temporary situations, susceptible to correction through monetary mechanisms, highlights the analytical irrelevance of the Fund's policy approaches. The resulting performance tests which the Fund imposes upon deficit countries lack scientific basis. Yet, failure to comply with these tests, and the consequent penalties, disrupt economic life and politically discredit governments in Third World countries.

(b) *The IMF is not objective* in the application of its own criteria. Double standards have been applied to similar situations. Examples show that certain countries, because of their geopolitical situation, international weight or political orientation, receive more lenient treatment than others, whose development strategies do not gain the sympathy of the Fund and who are thus subjected to extremely harsh conditions. The attitudes of the International Monetary Fund have ranged from the passive acceptance of the unilateral abrogation of US-dollar convertibility to the Draconian prescriptions applied to certain small Third World countries.

(c) *The IMF is not neutral* because it systematically bases its prescriptions on market ideology, giving the preponderant role to local private enterprise and transnational investment. It envisages the state in a restrained and subsidiary role, promoting the free play of national and international market forces. The principle of state participation and intervention, involving a significant presence of public enterprises, is anathema to it. Alternative development patterns that reduce or control the space for private market logic are labelled as inefficient in economic terms and considered inadequate in political terms.

9. The IMF has proved to be a basically political institution. It tends to reproduce colonial relationships by constraining national efforts which promote basic structural transformations in favour of the majorities. Its orientation is fundamentally incompatible with an equitable conception of structural change, self-reliance and endogenous development. The IMF medicine systematically favours the more conservative sectors of society and traditional centres of power. Worse still, when these sectors constitute real national power alternatives, the Fund prescriptions and its manner of dispensing them become an unabashed form of external political intervention in their favour. The Fund's policies, conceived to achieve 'stabilization', have in fact contributed to destabilization and to the limitation of democratic processes.

10. At the centre of all these issues lie the questions of national responsibilities, consciousness and discipline. Structural change generates imbalances and new policies may produce understandable mistakes as part of the development process. Under such conditions, self-discipline and coherent economic management, including efficient planning and tight administrative controls, become particularly crucial for the survival of policies of change. Moreover, democratic communication and consultation between the government and the people are essential to counter destabilizing forces. Such basic questions as how to reconcile social consensus with basic accumulation and how to harmonize revolutionary expectations with actual possibilities, or productive efficiency with popular participation, need to be adequately resolved in both technical and political terms.

11. For all these reasons, we wish to highlight our solidarity with Jamaica, Tanzania and other countries in similar situations. Their chosen development paths and their confrontation with the Fund deserve international backing. It is morally and politically unacceptable that their efforts at independent and equitable development be blocked by the IMF. The demands made by these countries and the priorities they wish to pursue have the full legitimacy of their popular representation, national sovereignty and right to self-determination. We call upon progressive forces, groups and institutions, in both industrialized and Third World countries, to express in practical terms their support for the right to determine autonomously national development objectives. This should constitute a rallying point around which to generate a massive international movement of public opinion in favour of Jamaica and Tanzania. What happens to them now will constitute a warning signal for others in the future. These, and other countries attempting social transformations, are in the front line of an international power struggle to assert autonomy and independence.

The impact of monetary disorder and the impotence of the IMF

12. The current monetary disorder is neither inevitable nor accidental. It is truly man-made and can consequently be re-

dressed by political decisiveness and action. Creeping inflation was a characteristic of the international economy during the 1950s and 1960s. In the 1970s, this situation worsened as a result of a series of successive and interrelated events: the continuous balance of payments deficits of the USA, the devaluation of the US dollar, strong price increases in certain commodities, and the capacity of large transnational enterprises to increase prices above current costs and inflation levels. The compounded effect of these and related phenomena was to push inflation into double digit figures. Western governments overreacted by applying deflationary measures which—under present conditions of monopoly and concentration of big business—have stimulated leading firms to increase prices in order to compensate for fallen sales and to maintain and improve their cash flow. Such policies have actually aggravated rather than reduced recessionary tendencies in industrialized countries, without really affecting the pricing and profits of large firms. The real burden has been borne by workers and weaker social groups through unemployment and the reduction of real wage levels.

13. Such a situation serves those very institutions—the transnational enterprises and banks—which have dominated monetary reform efforts since the demise of the Bretton Woods system. Only they have the information and the capacity to profit from instability in currency markets. Ironically, even the transnational banks are now seeking to establish a private ‘safety-net’ to protect themselves from possible collapse. Yet, where is the safety-net for the peoples who bear the burdens of the current disorder?

14. Instead of relieving these burdens, the IMF has perversely combined a policy of deflation for the weak and inaction for the strong. The Fund has allowed the principal deficit country, the United States of America, to escape blame for much of the current inflation by taking no action in response to its chronic deficits and its unilateral abrogation of the Bretton Woods obligations in 1971. The Fund has not sought to regulate the creation of international money, fuelled by the US deficits,

which takes place through the transnational commercial banks and the Eurocurrency markets. It has done nothing to bring about adjustment by the chronic surplus countries, which contribute as much as deficit countries to payments imbalances.

15. The severity of the Fund's treatment of most deficit countries must indeed be contrasted with the complete freedom of action of those industrialized countries which have been in surplus for most of the last three decades. Thus, while the deficit countries are forced to open up their markets to imports in exchange for the relatively limited credit flows whose provision is dependent on agreement with the IMF, surplus countries are free to solve their own short-term problems by exporting deflation and unemployment, and even to adopt protectionist measures against Third World exports.

A United Nations Conference on International Money and Finance

16. The experience of world development has demonstrated with increasing force that it is impossible to implement a genuine international development strategy without fundamental restructuring of the international monetary system. It is imperative that a new monetary system be constructed with the agreement of the international community. If this is not done, the current non-system will continue to evolve through the *ad hoc* arrangements made in their own interests by a few industrialized countries and the transnational corporations and banks, under the constant threat of an international financial catastrophe.

17. We therefore call for a *United Nations Conference on International Money and Finance*. This will provide a universal, democratic and legitimate forum for the negotiation of a new monetary system—one, moreover, which can be open to public scrutiny. We also urge that the drafting of a charter for a new system should start now and we call upon the extragovernmental community ('third system') to take the lead in this endeavour, so as to show the way to governments.

Characteristics of a new international monetary system

18. A new international monetary order must serve two fundamental objectives. First, it must be capable of achieving monetary stability, restoring acceptable levels of employment and sustainable growth, and checking the present strong inflationary and stagflationary policies and tendencies in the world economy. Second, it must be supportive of a process of global development, especially for the countries of the Third World, which contain the majority of the world's poor.

19. The main attributes of a new monetary system must be:

(a) *Democratic management and control*. While it may be inevitable that significant influence will be wielded by economically powerful countries, the interests of the majority of the world must be clearly reflected.

(b) *Universality*. As trade and payments have become increasingly internationalized, global interdependence demands that all countries should participate in the institutional arrangements for international monetary management.

(c) *The establishment of an international currency unit*, as the international means of exchange and primary reserve asset. The world cannot continue to afford a situation where one country imposes its own currency to play this role, and uncontrolled international money creation and transnational speculative movements are allowed to occur.

(d) A certain degree of *automaticity in transfers of resources* through reserve asset creation by the international community.

20. A new *international monetary authority* would need to be established to manage the monetary system. Universal and democratic, it would be capable of accommodating the needs of different development patterns and economic and social systems. Such an authority would have to control the supply of international money and be capable of redistributing national payment surpluses and existing exchange reserves. To prevent manipulation, firm rules and adequate mechanisms governing

the creation and distribution of the international currency would be required. The existence of an international currency unit must serve to reintroduce in the international payments system the principle of asset settlement, the abandonment of which in the late 1960s was both a symptom of past contradictions and a cause of further disorder. Observance of this principle would imply convertibility of national currencies into the international currency unit. However, provision would have to be made by international agreement for the limitation and suspension of convertibility to meet special circumstances, such as those of some Third World countries and socialist countries.

Urgent transitional measures

21. As the process of building a new international monetary order will undoubtedly be long and difficult, there are a number of urgent steps which must be taken in the meantime to deal with the immediate problems, while supporting the transition to a fundamentally new system. Most of these short-term steps have to be taken within the framework of the IMF.

22. First, the IMF should be equipped and prepared to finance those deficits which are the natural consequence of serious and disciplined efforts at development and structural change. The conditionality of such financing must reflect the sovereign right of states to choose their own social and economic models and development paths. In particular, there must be no penalization of countries which opt for strategies which emphasize national planning, systems of administrative budgeting (of foreign exchange, imports, investment and credit), the reform of traditional institutions, and an active role for the public sector. Rather, assistance needs to be provided to help these countries to overcome the difficulties and obstacles which such a development model necessarily encounters, and to help improve the efficiency of their planning, economic management and allocation of resources. In this context, the use of quarterly performance tests, based on a small number of narrowly defined monetary variables, is highly inappropriate to the conditions of a Third World country.

23. Secondly, Third World countries' access to the higher credit tranches of the IMF must be guided by an unambiguous recognition that a large part of the deficits they now experience is attributable to factors for which they are in no way responsible. These include high international inflation, weak and fluctuating export prices, low demand for their exports, deterioration of their terms of trade and high interest rates: all symptoms of the present international monetary disorder and more generally of an unjust international system. Financing such deficits by the IMF must be much more flexible and automatic; it must not be guided by present conditionality criteria.

24. To this end, the Compensatory Financing Facility should be expanded and a new low-conditionality facility established to deal with external shock deficits (like the former Oil Facility). Access to these facilities should be related to the size of externally caused deficits, not tied to quotas. Repayment should be related to recovery of the balance of payments from export deterioration or external shocks, instead of being tied to arbitrary time periods.

25. Next, further decisions need to be taken to make the Special Drawing Rights the principal reserve asset in international payments and to ensure that the role of national currencies in international settlements is effectively reduced. For that purpose, the SDR should be made more attractive. The allocation of SDRs and proceeds from sales of IMF gold should be made according to criteria separate from the IMF quota structure and should be based on relative need, economic vulnerability and development deficits.

26. Finally, there is an urgent need for the establishment of a mechanism of appeal and international arbitration, independent of the Fund, to deal with cases of dispute between the Fund and member countries applying for the use of Fund resources. The enormous power wielded by the staff and management of the Fund in negotiations with these countries provides the justifica-

tion for a mechanism which would ensure the equitable resolution of such disputes.

27. Besides the above mentioned measures, the financing of Third World development deficits and acute needs calls for a massively increased and qualitatively improved resource transfer that goes beyond the capacity of the IMF. The industrialized countries, both East and West, must recognize their obligations in this respect. The principle of international redistributive taxation must be pushed toward acceptance, since an international tax (for example, on oil consumption in industrialized countries) could be used to mobilize funds for resource transfers.

28. Third World countries must develop strategies of collective self-reliance in the financial and monetary fields, backed by specific mechanisms. Initiatives should be strengthened to channel resources from capital-surplus oil-producing Third World countries directly to other Third World countries in need of resources. The OPEC Special Fund should be augmented and expanded into a genuine development bank. The establishment of regional monetary systems within the Third World should be actively pursued.

The thrust of the Arusha Initiative

29. Success in building a new international monetary system in the 1980s requires that the issues on the monetary agenda be demystified and exposed to public debate and scrutiny. Those who hold power derived from money must be made publicly accountable for the consequences of its exercise. We hope that this ARUSHA INITIATIVE will help people to launch debates in their different national contexts, putting pressure on their governments to engage in serious study and preparation for intergovernmental negotiations on a new monetary system under the auspices of the United Nations.

30. We therefore call upon the people of the industrialized countries, and their organizations, including unions, parties and churches, to be aware of the costs of the present monetary

non-system to themselves as well as to the Third World. They must recognize their interest in a stable system which would help them to fight inflation and would lead the way out of the present era of unemployment and recession. We urge the governments of East and West to pursue together their common interest in a universal and democratic monetary system. We appeal for tangible manifestations of international support for the people of Third World countries, and their governments, seeking to preserve their sovereignty and dignity through self-discipline in the face of external financial threats. We entreat the Third World to reduce its dependence on western-dominated financial institutions and to express its solidarity through institutions of its own making for monetary and financial co-operation. Finally, we invoke the community of nations to respond promptly to our call for a United Nations Conference on International Money and Finance and to make this one of its major commitments for the decade ahead.

The South-North Conference on The International Monetary System and the New International Order, Arusha, Tanzania, June 30th – July 3rd, 1980

Participants

Ismail-Sabri Abdalla, Chairman, Third World Forum, (Egypt); *Carlos Amat*, Research Economist, (Peru); *Ahmed Ben Salah*, Co-chairman, IFDA, (Tunisia); *A. Benachenhou*, Secretary-General, Association of Third World Economists, (Algeria); *Robert L. Borosage*, Director, Institute for Policy Studies, (USA); *José Maria Brandão de Brito*, Research Economist, (Portugal); *E A Brett*, Lecturer, University of Sussex, (UK); *Norman Girvan*, Chief Technical Director, National Planning Agency, (Jamaica); *Reginald Herbold Green*, Professor, Institute of Development Studies, University of Sussex, (USA); *Toma Gudac*, Senior Adviser, Federal Secretariat for Finance, (Yugoslavia); *Sven Hamrell*, Executive Director, Dag Hammarskjöld Foundation, (Sweden); *Evelyn Herfkens*, Chairperson, Evert Vermeer Foundation, (the Netherlands); *Stuart Holland*, Member of Parliament, (UK); *Kamal Hossain*, Director, Centre for Research on the New International Economic Order, Nuffield College, (Bangladesh); *Amir H. Jamal*, Minister for Finance, (Tanzania); *Ibrahim Kaduma*, Minister for Trade, (Tanzania); *Lennart Klackenborg*, Adviser on International Affairs, Swedish Social Democratic Party, (Sweden);

Samuel Lichtensztejn, Fellow, Latin American Institute for Transnational Studies (ILET), (Uruguay); *Justin Maeda*, Director, Institute of Development Studies, University of Dar es Salaam, (Tanzania); *K. Malima*, Minister for Planning and Economic Affairs, (Tanzania); *Simon Mbilinyi*, Personal Assistant to the President (Economic Affairs), (Tanzania); *Michael Moffitt*, Fellow, Institute for Policy Studies, (USA); *M. Narasimham*, Executive Director for India, Bangladesh and Sri Lanka, IBRD, (India); *Marc Nerfin*, President, International Foundation for Development Alternatives, (Switzerland); *Olle Nordberg*, Associate Director, Dag Hammarskjöld Foundation, (Sweden); *Amon J. Nsekela*, High Commissioner to the Court of St James, (Tanzania); *C. M. Nyirabu*, Governor, Bank of Tanzania, (Tanzania); *Jozef Pajestka*, Chairman, Polish Economic Association, (Poland); *Oscar Pino Santos*, President, Association of Third World Economists, (Cuba); *Wolfgang Roth*, Member of Parliament, (FR Germany); *Delphin Rwegasira*, Director of Economic Research and Policy, Bank of Tanzania, (Tanzania); *Hugh Small*, Minister for Finance and Planning, (Jamaica); *Juan Somavia*, Executive Director, Latin American Institute for Transnational Studies (ILET), (Chile); *Luigi Spaventa*, Member of Parliament, (Italy); *Michael Zammit Cutajar*, International Foundation for Development Alternatives, (Malta). *Communicators*: Paul Fabra, Le Monde and Europa, (France); *Mohamed Mashmoushi*, Deputy Editor-in-Chief, As-Safir Daily, (Lebanon); *Chakravarthi Raghavan*, Inter Press Service Third World News Agency, (India). *Observer*: *Dudley Seers*, Professor, Institute of Development Studies, University of Sussex, (UK).

A number of people who had accepted to participate in the South-North Conference, but who were unable to do so, have since then associated themselves with the *Arusha Initiative* in their personal capacities and without necessarily endorsing all points in the document, namely: *Moinuddin Baqai*, Leader, IBRD Core Planning Team, Kuwait Ministry of Planning, (Pakistan); *Uwe Holtz*, Member of Parliament, (FR Germany); *Ernesto Augusto de Melo Antunes*, President, Constitutional Commission, (Portugal); *Philip R Newall*, Associate for Economic Justice Issues, United Presbyterian Church, (USA); *Jan Pronk*, Deputy Secretary-General, UNCTAD, (the Netherlands); *Justinian F. Rweyemamu*, Office of the Director-General for Development and International Economic Cooperation, (Tanzania); and *Clive Thomas*, Professor, University of Guyana, (Guyana).

Solidarity with Jamaica

Resolution adopted by the South-North Conference on The International Monetary System and the New International Order, Arusha, Tanzania, June 30th – July 3rd 1980

The South-North Conference on 'The International Monetary System and the New International Order' considered the situation created by the termination of the International Monetary Fund programme with Jamaica owing to the attitude adopted by the IMF. This revealed clear political motivation and calculation within the power structure of that organization. The IMF prescriptions for Jamaica would have involved punishing the people of Jamaica for the consequences of world inflation, and increases in oil prices and in interest rates.

The Conference viewed with concern that several other Third World countries—which like Jamaica are striving courageously to restructure their economies to satisfy the needs of their peoples as agreed to by other sectors of the United Nations system—are either on the verge of a breakdown in relation with the IMF or forced to change progressive policies to fit the immutable, unattainable and doubtful technical criteria of the IMF and its entrenched power structure, and their politically motivated multiple standards of treatment.

The Conference welcomed the remarkable efforts of the people of Jamaica and its political leadership in the field of development and the participants expressed their warm solidarity with them in their struggle.

The participants believe that a high-level task force nominated by the Secretary-General of the United Nations, including experts from the Third World, should meet with experts from the IMF and the Jamaican Government to review the situation of Jamaica so as to enable a settlement of the dispute.

The participants also appeal to governments and financial institutions in the Third World and in the industrialized countries to take urgent measures *now* to assist Jamaica in its efforts to further development and maintain a genuine democratic framework. The participants also appeal to the peoples of the South and the North, and especially trade unions, church groups and other people's institutions, to persuade their governments and institutions to show in words and deeds solidarity with the people of Jamaica and countries in a similar plight.

The Inadequacy and Loss of Legitimacy of the International Monetary Fund

By Ismail-Sabri Abdalla

1 The Splendid Isolation of the IMF

Money is one of the vital elements in any international power structure. Hence, any serious study or statement on change in the world order must deal with the issue of restructuring the international monetary system.¹

Thus, when on May 1st, 1974, an overwhelming majority of United Nations member states solemnly proclaimed their 'determination to work urgently for the establishment of a new international economic order', they stated as one of the principles underlying such an order that a reformed international monetary system should promote the development of Third World countries and an adequate flow of real resources to them. In the 'Programme of Action for the Establishment of a New International Economic Order', adopted on the same day, the United Nations General Assembly put squarely on the agenda for action a series of objectives for international monetary reform and some immediate measures to that end. Even a year later, when the fire of the Assembly's famous sixth special session had been dimmed by the moderation of the seventh, the consensus of the Assembly gave a prominent place to recommendations on monetary issues. And the subsequent Paris Conference on International Economic Cooperation (CIEC), which met between December 1975 and June 1977, devoted one of its four commissions to issues of money and finance.

The International Monetary Fund (IMF) was present at all these events and General Assembly recommendations were addressed directly to it. At the CIEC, the IMF was able to take part in the debates as an observer. Yet, six years after the concept of a 'new international economic order' was first elaborated, the term has still to find a place in the discourse of the IMF. It has not filtered into the annual reports of the Executive Directors of this institution. Holding itself aloof from the universal United Nations system, the IMF acts as if the intergovernmental decisions emanating from that system have no bearing whatsoever on its actions—or even on its language.*

* A comparison of the annual reports over the last six years of the IMF and its sister institution, the International Bank for Reconstruction and Development, is very revealing in this respect—not to mention the contrast between the public policy statements of Bank President Robert McNamara and those of contemporary IMF Managing Directors.

So, while the United Nations General Assembly and its Conference on Trade and Development (UNCTAD) have continued to adopt declaratory resolutions and call for studies on international monetary issues, these have been kept off their effective negotiating agenda by the insistence of the most powerful members of the IMF, the big industrialized countries. Thus protected, the IMF lives in its own world. It sits in judgment on its own effectiveness and provides the framework for such reforms as ensue from its findings. Its staff impose restrictive 'stabilization programmes' on many Third World countries in defiance even of the declared development assistance objectives of the major donors themselves (satisfaction of basic needs, direct attack on poverty, growth with redistribution, etc.). Nor does world inflation seem seriously to preoccupy the IMF Executive Directors and staff. For them, the motto seems to be 'Business as usual'.

Such a haughty attitude on the part of the international monetary institution might have been understandable—even though not altogether acceptable—if it had been able to demonstrate a capacity for the sound management of the international monetary system. However, the facts show the contrary. Not only has the underpinning of the system been destroyed by the abandonment of the basic principles on which the IMF was founded, but—more dramatically—today's monetary and financial systems escape the Fund's, or anyone else's, management. Anarchy is not too strong a word to describe the situation.

The structural surpluses of a few countries contrast with the persistent deficits of many others. Among the industrialized capitalist countries, the Federal Republic of Germany, Japan and Switzerland have been consistently in overall surplus. For the remainder, deficits and foreign indebtedness are a regular feature. In the Third World, structural 'development deficits' are a fact of life for all countries except the five so-called 'oil-exporting capital-surplus countries': Kuwait, Libya, Qatar, Saudi Arabia, United Arab Emirates. Linked to these imbalances is world inflation which spares no country and continues unabated, pushing up prime interest rates in major money markets to a recent record 20 per cent. Meanwhile, the huge pool of transnational liquidity in the Eurocurrency market defies official control.

Looming over all this is the chronic deficit of the United States of America. Trade deficits of the order of US\$ 30–35 billion in recent years left central banks of other countries holding some US\$ 200

billion in their reserves in 1979. Meanwhile, the stock of Eurodollars has risen to 700 billion or so. As these liquid liabilities built up, US reserves shrunk to as little as US\$ 12 billion in 1972. They have since 'recovered' to around US\$ 15 billion, but at that level still represent only 7.5 per cent of official US liabilities. Such a ratio would probably be considered intolerable by the IMF if it were that of a small country, but the USA gets away with it. It does so because of what General de Gaulle called its 'exorbitant privilege', as the source of the reserve currency, to run deficits (e.g. in order to finance foreign military adventures) in the knowledge that the consequent outflow of dollar liabilities would be held outside the USA and not presented for payment. This has so far enabled the United States of America to avoid having to make serious deflationary adjustments to its economy, while exporting inflation to the rest of the world. The diminishing willingness of the USA's main trading partners and political allies to acquiesce in this situation has been the cause of a still unresolved economic power struggle between these countries and the USA.

This degradation of the international monetary setting is depriving international trade and finance of any currency fulfilling the classical functions of money: universally accepted means of payment, standard of prices and store of value. The best the IMF has been able to do to face the threat of uncontrolled inflation and a potential financial crash is to reconsider the establishment of a 'substitution account' to reduce the dollar overhang. On the eve of another special session of the UN General Assembly devoted to development issues, the IMF has nothing that looks like a comprehensive and coherent plan for reforming the international monetary system.

An observer of this scene is struck by an obvious contradiction. Every country—strong or weak—has a stake in a better, more stable and more effective international monetary system. This is, *par excellence*, an area of 'mutual interest' between North and South, such as many people of goodwill have been seeking since 1973. Yet, in this very area, the international community has been unable to make a start towards restructuring the existing order. Needless to say, behind the esoteric language of the monetary priesthood—always ready to explain why something cannot be done—there are political forces at work which have forestalled a productive dialogue. The supposed aridity and complexity of monetary issues are only pretexts. Many equally complex issues are dealt with in United Nations fora (e.g. the Conference on the Law of the Sea). The reality is that—as was stated

at the outset—money is power, and the prevailing power structure is bound to resist significant change to one of its main sources of support.

The intention behind the Arusha Conference was to provide an occasion for people from South and North who are committed to a new international order to get behind the smokescreen, to demystify international money, and to lay bare the political issues underlying the present monetary disorder. The monetary agenda must be brought out from behind closed doors, and exposed to public debate and scrutiny. It must be open to the participation of the 'third system'—people, their organizations, and the agents of change who listen to them and attempt to reflect their views.²

For this purpose, what better means do we have at our disposal at present than the mechanism of a United Nations conference? Money is no less important than, say, food, population or environment—all of which have benefited from the convening of UN conferences and from the attendant public debate. The convening of a United Nations Conference on International Money and Finance—a 'Bretton Woods II'—with the participation of all interested parties should become an objective for all those, in the South as well as in the North, who are suffering from the ravages of inflation and who are worried by the precariousness of present monetary arrangements. Such a conference would end the splendid isolation of the IMF; it would blow wide open the pretence that monetary issues are technical and not political, and break the decision-making monopoly in this area hitherto enjoyed by the leaders of the big western industrialized countries.

2 The Origins and Legal Base of the International Monetary System

An analysis of the present monetary disorder calls for a quick look at the history of the international monetary system, before examining the character of the system agreed upon at Bretton Woods in 1944. The Bretton Woods system did not emerge from a vacuum. Underlying it were the economic and legal foundations required for any international monetary system, as well as the actual evolution of

monetary history up to the outbreak of war in 1939 and the recent memories of severe economic depression. Such a historical approach should help to achieve a better understanding of the nature and defects of the IMF system and, in particular, its congenital inability to deal with monetary issues linked to development.

The rise of capitalism and the gold standard

The right to issue currency has at all times been an attribute of sovereignty. Even when money was made exclusively of metals, the effigy and name of the prince on the coin made the difference between currency and the metal as an ordinary commodity. The emergence of nation states in Europe led to the disappearance of all currencies issued by sub-national authorities (feudal lords or private banks).^{*} The seal of the state, used directly at the royal mint or through conferring on one bank the monopoly of issuing currency, was the only instrument to oblige all parties to transactions to accept the national currency in payment of debts. Clearly, a national monetary system was the indispensable corollary of the unification of the national market; this is why even the most fervent advocates of a liberal economy acknowledged the need for state intervention in the process of creating money. Such intervention was seen as a guarantee against shortages or excesses of money supply, thereby assuring the stability of the currency, which was considered at that time to be essential for the efficient operation of the market mechanism.

The growth of western capitalism in the nineteenth century led to a dramatic growth in international transactions. Before that era, foreign trade had been limited to a few luxury goods imported from overseas. Payments were settled one by one in gold or silver, according to the market price of these precious metals at the time settlement took place. The multi-

plication of international transactions, even between neighbouring countries, at a time when there was exclusive use of a single national currency within the borders of each state made it impractical and expensive to settle every transaction in this way.

Such a problem had been solved within national economies by the generalized use of bank notes convertible into gold on demand and at a fixed rate called the 'par value' of the currency unit. This solution was possible because the state imposed the acceptance of bank notes in all transactions and concomitantly guaranteed their convertibility into gold. For international transactions, there was no super-state or world government to fulfil the same function. Yet, a solution had to be found which, without infringing national sovereignty in an age which was particularly jealous of it, would free international trade from the constraints of barter and from the inconvenience of settling all international payments in gold and silver.

'Free trade' was one of the major articles of faith of the new socio-economic system of capitalism. To achieve this, it was not considered sufficient to reduce customs barriers and remove quantitative and qualitative trade restrictions. The active pursuit of 'free trade' called for a supportive system of international payments. This system had to be both 'neutral', so that it would not affect the 'free interplay of market forces', and 'automatic', in order to escape manipulation by any national government. The monetary system that emerged in response to this demand and spread rather rapidly came to be called the gold standard.

Under the gold standard, national currencies were linked to gold at a fixed parity, i.e. each national currency unit was defined as equal to the value of a certain weight of pure gold.

^{*} Bank notes started as a private banking practice. When their use became common, states insisted upon their monetary prerogative. They made the right to issue bank notes a privilege granted usually to a single bank in return for some benefits to the national treasury, plus of course the state's right to regulate emissions.

From this common denominator, the value of any currency in units of any other was easily deduced. Thus, rates of exchange were not supposed to undergo major variations in the normal course of affairs. International payments were settled through banks. Only deficits or surpluses of the balance of payments of any country gave rise to actual movements of gold. According to the quantity theory of money, these gold movements were supposed to trigger an automatic adjustment process. A continuous balance of payments surplus in one country for a two- or three-year period would increase a country's gold stock and hence its money supply, thus provoking a general price increase. The latter would be reflected in rising imports and falling exports until the surplus disappeared. In the case of a persistent deficit, the money supply would diminish, causing the reverse phenomenon.

Whatever the analytical value of these adjustment mechanisms, the gold standard prevailed through the second half of the nineteenth century and up to the outbreak of war in 1914. During this period, the use of national bank notes outside the borders of the country of origin did not raise any problems, since all bank notes were immediately convertible into gold, at the par value. Consequently, national currencies could be used in the settlement of international payments. The exchange markets were there to convert one currency into any other at a very low cost. It is hard to imagine the considerable growth of international trade and finance in that era of liberalism taking place without the simplicity and rigour of the gold standard system, although it did not always work smoothly.

Every now and then, wars, revolutions or major political upheavals forced one or more governments to suspend convertibility into gold. In order to cover extraordinary public

expenditures resulting from such events, governments usually resorted to borrowing from their central banks. A central bank could satisfy the government's demands by printing more bank notes, provided it was relieved from the obligation of converting them into gold on the bearer's demand. Such situations were viewed as unhealthy and temporary, however, and the return to convertibility was the best evidence of the restoration of political stability.

In order to avoid any misguided nostalgia for the apparent lack of complexity of that bygone age, it must be recalled that the stock of gold available to Europe from its colonies was more than enough to cover the growing needs of international transactions, and that all today's 'developing' countries were then colonies or semi-colonies. The gold standard system outlined above applied exclusively to the major European powers and the USA. Noone paid much attention to the balance of payments between a colony and its metropolitan power. The predominant pattern of these balances was characterized by trade surpluses for the colonies, which were used to pay back the returns on capital invested in them.

What should be retained here is the fact that, in the absence of any supra-national authority, states recognized as international currency a commodity (gold) whose total available quantity escaped the control of any one of them, and whose supply variations from year to year were negligible in comparison with existing stocks. If it is out of the question today that the international community should return to the gold standard, although the idea is still raised from time to time in influential quarters, this lesson must be learned from the working of that system: *Any truly international currency should fulfil two basic conditions: to be beyond the control of any single state or group of states and to have some mechanism of is-*

suance which limits both shortages and excesses of supply.

The gold exchange standard and the rise of reserve currencies

After war broke out in 1914, almost all countries participating in international trade suspended the convertibility of their currencies into gold. Recourse to inflation to finance the war effort was inevitable. During the four years of warfare and the immediate postwar period, what had previously been considered as a health hazard, from which a given national economy could quickly recover, became an epidemic. States used their sovereign power to impose paper money, still nominally defined in terms of gold, as a means of domestic payments. Yet, they could not prevent the depreciation of the paper units against gold. The burden of war was not evenly distributed, nor were the resources available to different parties to the conflict. Consequently, rates of inflation were not identical and exchange rates witnessed great variations out of all proportion to pre-war fluctuations.

The defeated countries became the scene of an unprecedented phenomenon, of which the most striking manifestation was the tragedy of the German mark. But the victors also came out of the war with complex monetary problems. Economists and policy-makers in the latter countries thought that the old medicine could be applied and the gold standard restored, as had been done a century before in the aftermath of the French Revolution and the Napoleonic Wars. In doing so, they underestimated their losses in production capacities, failed to recognize the impossibility of extracting reparations from the vanquished in amounts sufficient for reconstruction, and overlooked the repercussions of the disruption

of international trade flows during the war years. Moreover, they gave scarcely a thought to the implications for the world order of the Soviet Union's delinking. Thus, all attempts at restoring the gold standard in the early 'twenties were ephemeral in nature. By the end of the decade, the first international financial crash took place, signalling the beginning of the severest recession in the history of capitalism, which came to be known as the 'Great Depression'.

Faced with armies of unemployed, countless bankruptcies, sharp decreases in production and a downturn in prices, all countries tried to make full use of all possible defence mechanisms. Interventionism overcame liberalism. The state was called upon to save the national economy. In the monetary field, state authority enforced by law the general acceptance of paper money; bank notes were no longer convertible into gold. This generalization of paper money could not but hurt international trade. In those times of distress, however, international cooperation was overshadowed by national interests, as perceived by policy-makers and entrepreneurs. The doctrine of 'free trade' was sacrificed, not only by higher customs tariffs, but also by the introduction of discriminatory quantitative restrictions on imports. Every imperial power sought to control the foreign trade of its dependencies and to dominate their markets through systems of 'imperial preference'.

In such a situation, the gold standard was not only hard to re-establish, but was in fact undesirable. Free trade called for automaticities of exchange. Protectionism, on the contrary, was conducive to the use of monetary manipulations, as one of the weapons of what has been rightly called 'economic war'. It was in these conditions that the system of the gold exchange standard was born.

The above-mentioned circumstances gave rise gradually and almost spontaneously to a new international monetary system, later baptized by economists as the 'gold exchange standard'. Instead of relating their national currencies directly to gold (by the definition of their par values and by assuring their convertibility on demand), many countries were only able to assure that their currencies would be convertible (at fixed rates and in any amount) into other currencies, which were convertible into gold. *Prima facie*, this could be seen to mean simply establishing indirect convertibility in place of direct convertibility, but in fact the new system introduced far-reaching changes in the world monetary setting.*

First and foremost, it established the concept of a 'reserve currency'. Before the 1914–18 war, the term 'reserve' used to refer to the stock of gold held by the central bank or the monetary authority to cover the bank notes it issued. The amount of this gold backing was not to drop below a certain percentage, fixed by law, of the total notes in circulation. Originally, this cover was meant to assure the bearer of bank notes that these could be converted into gold at any time and in any quantity, and to enable the central bank to meet this obligation on demand. Later, the ratio of reserve to notes in circulation also came to play the role of a regulator of money supply (as a guarantee against inflationary creation of money) and provided for the settlement of external deficits. In the post-war period, the notion of reserve was enlarged to include the

very limited number of national currencies (notably the pound sterling, the French franc and the US dollar) that were convertible into gold, or susceptible of being restored to convertibility. Thus, the emergence of the gold exchange standard conferred on these national currencies (i.e. on the liabilities, or debts, of the reserve currency countries) the unprecedented privilege of being international means of payment.

Secondly, countries using the gold exchange standard began to accumulate reserves of foreign exchange to make up for their diminishing gold reserves. Of course, rather than stocking piles of reserve currency notes, they would buy interest-yielding claims on the reserve currency country (generally Treasury Bills). This meant, in effect, that countries holding a reserve currency were lending resources to the country issuing it. Thus, the gold exchange standard led to the use of debts (of reserve currency countries) in place of a commodity (gold) as a basis for reserve building. In this way, a new demand on reserve currencies was created. This sometimes helped to keep the exchange rates of those privileged currencies unduly high and provided the monetary authorities issuing them with additional flexibility.

Thirdly, the gold exchange standard turned out to be inflation generating—so it is no wonder that some economists criticized it from its inception. Not only did it facilitate inflation in the reserve currency country itself, but since a sizeable part of the excess money supply in that country was absorbed by other countries holding its currency, because of fixed parities and automatic convertibility, the reserve country could export inflation to all countries utilizing its currency. In principle, the threat of externally-imposed inflation could be considered lessened in the case of a

* The seeds of the gold exchange standard were, in fact, present in the pre-1914 gold standard to the extent that many countries invested part of their reserves in London, where the safety of the Bank of England was then proverbial. This confidence in sterling, reflecting Britain's influence in the world order, made of it a 'proto reserve currency'.

country whose reserves were judiciously composed of a 'basket' of convertible currencies instead of a single one. Such a situation was to remain a theoretical hypothesis because other economic ties (e.g. imperial trade preferences and, more broadly, the structure of foreign trade of countries orbiting around the major colonial powers), added to political influences (including military presence in many cases), soon divided the world into a few monetary zones. All colonies and most countries belonged either *de jure* or *de facto* to such a zone (notably the sterling and franc zones). Exchange rates within each zone were fixed in relation to the imperial currency and intra-zone trade was favoured to the detriment of trade among different zones.

Forced devaluation and lending—the 'paper standard'

The Great Depression brought about the suspension of convertibility of sterling and the French franc in 1931. Recovery took place gradually and at the price of devaluation of all convertible currencies. Countries of each zone had no choice but to align themselves and keep the previous rates of exchange between their own currencies and the respective reserve currencies. In other words, they were forced to devalue their currencies in terms of gold—and in some cases in terms of other reserve currencies—regardless of the effects of devaluation on their national economies.

At the outbreak of war in 1939, inconvertibility of reserve currencies into gold became the rule. The gold exchange standard ended in a 'paper reserve currencies standard'. Thus, for example, the 'sterling standard' became a familiar expression; in fact, the sterling standard was the most widespread—a reflection of

the dimensions of the British Empire and the prominent role of London as the principal international financial market. The bonds of the sterling standard allowed Britain to oblige countries of the sterling zone to contribute financially to the cost of warfare. Whenever they had to buy goods or services, the British authorities were able to pay in UK Treasury Bills remitted to local monetary authorities, which issued against them the corresponding amounts of local bank notes needed to effect payments. By the end of the hostilities, the sterling zone countries found themselves in an inflationary situation, holding large sterling balances which London hastened to 'freeze' until a process of gradual 'defreezing' was devised. The crisis of frozen sterling balances and the reduction of their value in dollars consequent to the unilateral decision to devalue the pound sterling in 1949, as well as the time (on average ten years) that it took to liquidate them, is not without similarity to the crisis of today's dollar balances.

To conclude this brief analysis, one may draw the following lessons from the inter-war experience of the gold exchange standard:

- *The privileges it conferred upon the reserve currency countries were bound to give their governments a measure of freedom to disregard the demands of monetary discipline, while making countries holding reserve currencies more and more dependent on the policies adopted by the authorities in the issuing countries.*
- *Moreover, the stability of such an unbalanced power structure could only be assured if one of the reserve currency countries was able to exercise hegemony over the other members of the monetary system.*

3 Bretton Woods and the Dollar Standard

The imprint of the Great Depression

In July 1944, the representatives of 44 'United and Associated Nations' gathered at Bretton Woods in New Hampshire, USA, for the International Monetary and Financial Conference. Their task was to rebuild an international monetary order which had been scattered by economic depression and war. In doing so, they should have been able to draw upon the lessons of recent monetary history. From the pre-1914 gold standard, they could have learned that a truly international currency must be beyond the control of any single state or group of states and must have some mechanism of issuance which limits both shortages and excesses of supply. From the interwar gold exchange standard, they could have learned that its stability could only be assured at the cost of accepting the hegemony of the main reserve centre, as well as the freedom of the latter to disregard monetary discipline. However, the knowledgeable negotiators, including the authors of the proposals submitted for discussion, appear to have been more preoccupied with the need to protect the world economy against the possibility of another Great Depression.

The interwar Depression—part of a secular cycle of the type analysed by Kondratief—had profoundly marked people and policy-makers everywhere. The struggle for economic survival which had followed it, acquiring multiple forms, had led to the fragmentation of international commerce. Freed from constraints previously imposed by the gold standard, the governments of the major trading states had resorted to the use of monetary weapons—devaluations and monetary zones—in pursuit of commercial war. More broadly, the Bretton Woods delegates were

mindful of the socio-economic consequences of the Depression and the extent to which they had paved the way for Nazism and the horrors and sufferings of war.

Thus it was that the restoration of economic growth, as the basis for a peaceful world community, was the main aim at Bretton Woods. And the prevailing conviction—then as later in Havana, where the General Agreement on Tariffs and Trade (GATT) was born—was that a return to free trade was essential if economic growth was to be sustained. Consequently, and aside from divergent views on how best to secure it, the objective of eliminating monetary manipulation as a tool of economic competition in world markets met with unanimity.

Article 1 of the Bretton Woods Agreement, reflecting these concerns, states the purposes of the IMF as follows:

- (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- (iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

- (v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
- (vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.*

The fundamental choice

Regarding the means to attain these purposes, there was a kind of consensus on two points. First, there could not be any return to the rigid rules of the gold standard. Many factors told against such an attempt. Among them were the disillusionments stemming from the attempts at restoration of the 1920s, the uneven distribution of monetary gold among different countries, the policies followed in some countries to break away from the Depression and the central role therein of a flexible money supply, and the 'Keynesian revolution' which legitimized deficit financing as a means of combating serious unemployment. It would also have been against the interests of international capi-

tal, which profited from a steady rate of inflation.**

The second point of consensus was that nobody was in favour of the complete demonetization of gold. The fundamental choice that faced Bretton Woods negotiators was between two alternatives:

1. The establishment of an international currency conceived by Keynes as 'international bank-money.... fixed (but not unalterably) in terms of gold and accepted as the equivalent of gold' by all nations who would become members of an 'International Clearing Union' that would issue and manage the new currency. The purpose of the proposed institution in Keynes's view was to supplant gold as a governing factor, but not to dispense with it.³
2. The codification and universalization of the more familiar gold exchange standard in such a manner as to avoid the reemergence of monetary zones.

Not only out of fear of innovation, but as the result of the desire of the USA to assert itself as the leading financial power, the conference opted for the gold exchange standard. The dollar being the only currency convertible into

* These purposes have remained unchanged to this day. When Special Drawing Rights (SDRs) were created in 1969, the amended Articles included a new objective, that of 'making the special drawing right the principal reserve asset in the international monetary system'. However, this objective was not included in the general purposes of the IMF; it is stated as part of the additional articles dealing with SDRs.

** Capitalism at the mid-century was characterized by the emergence of close links between big business and banks. Prices were no longer a given factor to which all producers had to adapt; they became one of the variables that big corporations could influence and control. Competition be-

came largely 'imperfect' or 'monopolistic', to use the terminology of Robinson and Chamberlain. One instrument of maintaining high prices was an easy money supply. Moreover, a 'reasonable' rate of inflation was also necessary to offset in part the increases in nominal wages that the growing strength of trade unionism was able to obtain. Thus, 'moderate inflation' was a *sine qua non* for the operation of monopolistic capitalism, exactly as monetary stability was necessary for the development of the small-scale capitalism of the nineteenth century. For more details, see Abdalla, Ismaïl-Sabri, *Monnaie et structure économique: Essai sur le rôle des conditions de structure dans la détermination de la valeur de la monnaie* (Ph. D. thesis, Paris, 1951).

gold, what the conference in fact accepted was a 'dollar exchange standard', exactly like the 'sterling exchange standard' under which the British Empire and other countries in its orbit had lived in the 1930s.

Thus, when the war ended, the US dollar had dethroned its only possible competitor, the pound sterling. At the time, the USA owned 80 per cent of monetary gold (not counting that of the USSR and East European countries) and accounted for more than 20 per cent of world exports. The need for dollars was felt equally by Europe and Japan, which were starting their post-war reconstruction, and by Third World countries seeking to develop their economies. This 'dollar shortage' helped to maintain the demand for the US currency at a constantly high level. All these factors made it possible for Washington to impose on the market the dollar price for the precious metal that had been decided upon in 1934, i.e. US\$ 35 per ounce.*

Under these conditions, the entire 'Free World' found itself within the dollar zone, with all the unavoidable consequences, the most important of which was the accumulation of dollar holdings outside the USA. Since it was considered the equivalent of gold, the US currency actually became the international universally accepted currency. Consequently, it was natural for countries to accept settlement of claims in dollars. Gradually, the dollar took over another attribute of gold: it served as a reserve for national currencies. Since, as a means of international settlement, the US currency had to be available in sufficient quantity in order not to inhibit the growth of world

trade and finance, the deficit in the US balance of payments became the principal source of international liquidity. Being a reserve currency that was favourably looked upon by central banks, its circulation was allowed to swell for years, without provoking inflation of alarming proportions within the USA itself. Benefiting from such an exceptional situation, Washington was able to pursue an expansive policy without any major disturbances until the mid-1960s.

The basic rules

The consequences of this dollar outflow will be discussed later. Let us recall here the basic rules of the Bretton Woods system, because they will show how today's IMF practices are contrary to those rules and, moreover, how irrelevant the rules were to the needs of Third World countries.

1. In spite of what has been said about the practical role of the US dollar, the system was related to gold, whose price for monetary transactions was fixed. Each member state had to define the par value of its national currency in terms of a certain weight of the precious metal. Subscriptions to the IMF (quotas) were to be paid up to 25 per cent in gold.**
2. Member states committed themselves to maintain the rates of exchange resulting from the 'gold content' of each currency, as defined upon its participation in the system. Changes in par values were only to be used 'to correct a fundamental disequilibrium'; they were to be 'proposed' to the IMF by the member con-

* In consequence, gold—unlike other commodities—enjoyed price stability for 35 years. From another point of view, the purchasing power of the dollar within the USA declined significantly without any effect on its par value.

** More specifically, Article III.3 of the Agreement required that 'each member shall pay in gold, as a minimum the smaller of: (i) 25 per cent of its quota; or (ii) 10 per cent of its net official holdings of gold and United States dollars....'

cerned. Failure to obtain the IMF's approval of a par value change could result in exclusion from the Fund.

3. General convertibility of the currencies of member states, into each other and at par value, was considered essential for trade liberalization and monetary stability.

4. Acting as a kind of central bank, the IMF was supposed to help national central banks in dealing with temporary deficits in balances of payments. A member country was entitled to funds for this purpose up to a limit related to its quota; beyond this limit, the country concerned was supposed to take appropriate

measures to reduce its deficit and establish equilibrium or surplus, mainly by increasing its exports (becoming more competitive). Conditions attached to such drawings became stiffer as the amount passed through successive 'tranches'.*

5. When the conventional measures of credit and fiscal policies failed, the IMF might agree to a devaluation, in order to make imports more expensive and exports more competitive, without creating imbalances in international trade that could lead to a series of competitive devaluations of other currencies.

4 The Congenital Inability of the IMF to Deal with Development Problems

The original sin of the IMF

The Bretton Woods Conference was essentially a conference about the monetary and financial problems of the industrialized capitalist countries. Although the latter were in a numerical minority, their views and interests—particularly those of the United Kingdom and, above all, the USA—were predominant. The USSR was present but chose not to join the IMF; the few of its Eastern European allies which did join later withdrew. The major Third World presence was that of the Latin American countries (which were all there except Argentina). Africa and Asia were represented by only seven countries apart from China, all of which were in one way or another under British or US control or influence.** The remainder of Africa, Asia and the

Caribbean was represented by proxy, i.e. by the colonial powers.

It is easy to imagine how Third World delegates at Bretton Woods, despite some attempts to put development issues on the table, were overwhelmed by the weight of the big powers. Even more relevant in this respect is the fact that national liberation movements struggling to acquire political freedom were not yet fully conscious of the need for Third World solidarity, nor of the tough demands of development. Thus, it is by no means an exaggeration to state that the spirit of the Group of 77, born some 20 years later, was completely absent from Bretton Woods; indeed, the G.77, as such, only penetrated the IMF precincts in 1979.† In the declared purposes of the IMF, no mention was made of the particular problems of Third World countries. In the

* See Background Notes on the IMF, paragraphs 55–57.

** For details about representation at Bretton Woods and IMF membership, see Background Notes on the IMF, paragraphs 3–4 and 6–10.

† See Background Notes on the IMF, paragraph 41.

official name of the institution which has come to be called the 'World Bank' (e.g. IBRD), the word 'reconstruction' precedes 'development'. The priorities at Bretton Woods were obvious.

In fact, the IMF was not conceived to deal with the specific financial problems of Third World countries. In that sense, to be for a moment theological, it was born with an 'original sin' which continues to afflict it. The Fund's financial mechanisms were designed to cope with a typical problem of industrialized economies: to provide short-term breathing space to enable countries to work their way out of payments deficits and thus avoid unwarranted devaluations, which would threaten the system of relatively stable exchange parities. The coercive powers of the IMF were aimed at safeguarding exchange stability and ensuring promptness in the correction of payments imbalances, which were considered to be transient phenomena. As the industrialized countries were, on the whole, capital exporters, there was no need to envisage mechanisms for medium- and long-term financing. Banks, the international capital market and, if necessary, interstate agreements were available for meeting financial needs of that nature.

Joining the IMF after acquiring independence, most Third World countries acceded to an agreement which they had not negotiated—a kind of contract of acquiescence, to use the language of lawyers. The efforts that they have been making, in the past ten years or so, to make the best of it have up to now borne little fruit. On the other hand, their demands are often inadequately formulated and rarely do they include operational proposals. We are witnessing a kind of dialogue of the deaf: those belonging to the G.77 ask the IMF to participate in development financing, while the latter

invariably replies that its vocation is only to provide short-term support.

Structural deficits

The real problem lies in the fact that the deficit in the balance of payments of nearly all Third World countries is of a structural nature, continuing from year to year without provoking any spontaneous adjustment mechanism. The persistence of the deficit is intimately linked to the development effort. A country stagnating in its underdevelopment may have a surplus in its external balance. Such was the case in Egypt, for instance, from 1900 to 1938, when with the exception of the years of sudden drops in cotton prices a surplus was regularly recorded in the foreign trade balance. The surplus went to pay for the profits and interest on foreign capital. The average economic growth rate during this long period, however, was of the order of 1.7 per cent per annum, corresponding to the annual population increment. This was the very image of a stagnating colonial economy: exporting raw materials (raw cotton accounting for more than 80 per cent of the total) and importing manufactured products, primarily consumer goods. By 1945, Egypt had accumulated reserves in London to the tune of £500 million sterling.

With the active pursuit of economic growth, however, new and essential items are added to the traditional list of imports, namely machinery and intermediate products. It goes without saying that sound economic management in the face of such a need implies a reduction in consumer goods imports and an increase in exports. But there is a limit beyond which one cannot avoid importing, since basic products of the highest priority are involved. Demographic pressure, even if the birth rate is under control, tends to increase the demand for those

products. As for traditional exports, they can rarely be expanded in the medium term. On the other hand, development projects aimed at the production of import substitutes or exportable goods cannot modify the situation except after a period of several years, and then only gradually. Consequently, a chronic deficit is inevitable. This should certainly not be used as an excuse for poor economic or monetary management. Inadequate allocation of resources, inappropriate choice of technology, and indulgence in luxurious consumption by the privileged classes worsen the deficit and hinder development, and should never be tolerated. But to try to 'correct' the development deficit is to halt the development effort itself.

Thus, a new analytical concept has emerged, that of the 'efficiency' of external deficits, which could be measured by the impact they may have on the acceleration of development. According to this notion, an appropriate instrument for dealing with development deficits would be a mechanism for consolidating them in the form of medium-term loans.

This analysis of the structural deficit does not, of course, exclude occasional cases of a temporary character. More important yet is the deficit due to external or exogenous causes, e.g. several years of drought, sudden and considerable price changes of some raw materials, etc.

Wrong medicine

Meanwhile, the IMF persists in its desire to apply to the Third World remedies conceived for other diseases. As stated above, the means of intervention at the disposal of this institution were devised to deal with situations that arise in industrialized countries and are based on the expected response of those economies.

These situations can be reduced to two: either an occasional deficit or a deeper disequilibrium.*

A deficit in the balance of payments of an industrialized country normally implies the existence of stocks of unsold goods and services, or of idle production capacities. An occasional deficit is considered a simple 'mal-adjustment'. In other words, the country concerned, in its desire to boost growth, would have allowed the money supply to increase to such a degree that the resulting inflation made its export prices less competitive, while more imports were attracted by the domestic market. According to Keynesian economics and the prevailing practice, the remedy would consist of the adoption of some deflationary measures: higher rates of interest, more taxes and less government expenditure. The IMF could extend credit to such a country in the legitimate expectation that deflation would make its export prices more competitive and the above-mentioned stocks or idle capacities would enable the economy to respond almost immediately.

If the disequilibrium is deeper, those measures would not be sufficient. Hence the need to devalue the national currency. Devaluation makes imports more expensive and exports more competitive. Given the already high standard of living, a decrease in imports would hardly hurt the population seriously. And in any case, in western democracies, labour is well organized; people in low income groups can express their grievances through their political representatives and thus fight against the threat of having to bear alone the entire burden of these adjustments. The increase in

* The treatment of surpluses has never been seriously undertaken by the IMF medicine men, except by recycling the surpluses through increased quotas and borrowing.

exports would take place without any new investment, because of the size of installed production capacities and the availability of stocks. Returns from this growth of exports and output would, in turn, ease the modest damage incurred by people with low incomes.

Deficits in Third World countries, on the contrary, are of a structural character. Hence the inanity of persisting with treatment for 'maladjustment'. The demand for devaluation, under the pretext that the rate of exchange for the national currency is not realistic, is a typical example of the medicine prescribed by the IMF. The effects expected from devaluation in the industrialized countries are rarely in evidence in Third World economies, where most exports and imports lack flexibility in the medium-term. In the case of imports, devaluation raises the prices of equipment and intermediate products; this in turn is reflected in final production costs, thereby putting a brake on exports instead of stimulating them. In cases where a country imports a substantial proportion of its foodstuffs, devaluation raises the prices of these items. On the other side of the balance, the decrease in export prices scarcely brings on an export boom, since most Third World countries lack significant exportable surpluses. The mechanisms of price transfers in intra-firm transactions of TNCs and their subsidiaries may also offset to a certain extent the expected positive effects of devaluation.

Another example of the wrong medicine is the IMF demand for internal suspension of all subsidies. In Third World countries, trade union movements are still weak and only rally a small part of the labour force. Consequently, wages do not keep pace with abrupt price rises. What happens in such cases is that the misery of the less organized and most deprived masses increases, with all that this means in

terms of social and political unrest. All these risks, and so much disdain for the essential needs of people, are borne in the name of liberal orthodoxy, the favourable effects of which on economic growth are at least doubtful.

The IMF seems to believe, for example, that 'world prices' are the pure products of perfect competition, while it has been demonstrated since the 1930s that the prevailing type of market is monopolistic competition, that is to say a market where major producers are in a position to manipulate prices. In today's world, where TNCs are by far the most important actors in international trade, many so-called world market prices are simply those imposed by concerned TNCs and their ramifications. In general, TNCs tend to minimize, if not completely eliminate, the price wars which were so frequent under nineteenth-century capitalism. Factual evidence is the steady increase in the prices controlled by TNCs, even in times of recession, when they prefer to reduce output rather than decrease prices. Those prices may be more or less in tune with wages in industrialized countries, but they are too often unrelated to the low wages prevailing in most Third World countries.

A further example is provided by the IMF obsession with cutting public expenditure. This is based on the assumption that private expenditure is always good (the free enterprise paradigm), while public expenditure is bad because it exposes the magnitude of state interventionism. But the IMF overlooks the fact that in many cases—even in industrialized countries—public expenditure is indispensable for the meaningful promotion of private expenditure. The state sector is usually involved in infrastructures, major development projects, basic industries, etc.

5 How the System Worked, 1945–70

Predictable negative results

The IMF got off to a very quiet start. The US economy was at the apex of its strength and was able to allocate sufficient bilateral aid to make the resources of the Bretton Woods institutions marginal. The Marshall Plan, from 1948 to 1952, provided Western Europe with about US \$17 billion and recipients of this aid were not allowed access to IMF resources. Moreover, the Korean War boosted commodity prices and hence the exports of commodity producing countries. Up to fiscal 1952, drawings on the IMF amounted to a mere US \$0.85 billion, going largely to peripheral northern countries.

During the early years, the Fund authorities were able to concentrate on institution building. One of their far-sighted measures was the establishment of a training institute where officials from Third World central banks could be initiated into the mysteries of money. However, around the Fund, the scenery was changing....

In fact, in the light of the experience of the sterling zone in the interwar years, it is hard to understand how the Bretton Woods negotiators and the Fund staff could have expected different results from the generalization of the dollar exchange standard. Most of what has happened since could have been predicted then. The choice made at Bretton Woods was, in the final analysis, the expression of power relations between the USA and its allies; it contributed greatly to the consolidation of US hegemony and a dominance–dependence relationship between the USA and the other countries which joined the IMF system.

Since the US dollar was held outside the USA as a universally accepted means of payment and reserve asset, Washington was in a

position to increase its money supply without giving rise to significant inflationary pressures at home. At the same time, other industrialized countries were applying the Keynesian medicine and increasing money supply whenever signs of recession appeared. In their case, however, the ensuing inflation could not be pursued for a long period; as their economies started to ‘overheat’, deflationary measures had to be imposed. The USA retained its privileged position in this respect for almost 20 years.

Until 1967, the USA was almost always in surplus in its trade balance while being in overall deficit because of overseas expenditures by the US government and the outflow in the capital balance. From the monetary point of view, this deficit supplied world trade with the necessary liquidity for its growth. But the economic and political consequences were questionable, to say the least. The outflow of funds from the USA was due to ‘imperial’ expenditures abroad, public long-term lending to ‘friendly’ countries, and overseas investment. In fact, the dollar outflow financed enormous direct and portfolio investment abroad on the part of US transnational corporations, which has enabled them to acquire large sections of the productive capacity of Western Europe and the Third World. Military expenditure abroad and bilateral loans reinforced the US military might, as well as its political influence. From an economic viewpoint, they also boosted US exports and contributed to a large extent to the maintenance of the US trade surplus.

Dollars received by a country found their way primarily to central banks, which would buy them against national currency thus increasing domestic money supply. The French

government rightly qualified this process as the export of US inflation to other countries. The accumulation of dollar claims in the foreign reserves of other countries also meant that these countries were in fact lending to the USA. At the extreme, this system could produce the following aberrant result: A US corporation could buy a local firm in dollars, which would then be bought by the central bank and converted into US Treasury Bills, i.e. credit to the US government. The central bank would be unable to convert these claims into imports of merchandise or services, because the amount of dollars it held exceeded the needs of the country. The takeover of the local firm by the US corporation would thus have been financed by credit from the national central bank!

The US economy since the mid-sixties has been suffering from West European and Japanese competition in the world market. Instead of addressing the real cause of this situation and adopting appropriate internal policies to correct it, the US authorities relied on the privileged position of the dollar and permitted an increasing deficit in the trade balance. Given the amount of claims in dollars in the hands of non-Americans, the USA became the most indebted country in the world. The 'dollar exchange standard' would have permitted that situation to worsen, were it not that at last internal inflation began to preoccupy the US administration.

Finally, the holding of dollars by private transnational banks outside the USA allowed them to multiply the outstanding amount of dollar claims according to the well-known rule that 'loans make deposits'. The Eurodollars thus created by these banks added greatly to the total amount of claims in dollars held outside the USA (the 'dollar overhang'), accelerated world inflation and, through speculative

use, magnified fluctuations in the rates of exchange within the dollar zone.

Such piling up of dollar claims could not possibly go on without affecting the convertibility of the US dollar into gold. There was no panic pushing all holders of dollars to ask for gold, but some industrialized countries did so, either with discretion (FRG) or with panache (de Gaulle's France). Finally, the inevitable occurred; in 1971, the US administration suspended convertibility and the international monetary standard became the paper dollar.

The crisis of the 1960s and SDRs

For about 20 years, the US dollar was synonymous with gold. The only difference between holding an ounce of the precious metal and a claim to 35 'greenbacks' seemed to be the rate of interest earned on the latter. Since the amount of monetary gold available grew very slowly, and the limited resources of the IMF were not intended to ensure adequate world liquidity, the dollar deficit was the main lubricant of world trade and finance and the main provider of monetary reserves (see Table 1, page 44).

When the US deficits—and their inflationary consequences for that country's main trading partners—became intolerable, the latter were confronted with a contradiction (subsequently known in economists' jargon as 'the Triffin Dilemma'): if they or the US took action to stem the dollar outflow, there would be a critical shortage of international liquidity, from which all would suffer.

Nevertheless, holders of big dollar reserves started to switch to gold (notably EEC countries—which numbered six at the time—Switzerland and Canada). As the US gold in Fort Knox dropped from US \$24.4 billion in 1948 to US \$15.4 billion in 1964, the

IMF could not be of much help to the USA, in view of the size of the latter's deficits in relation to its quota. The USA's reaction was to press for general increases in IMF quotas (including its own, of course).^{*} Quotas were increased by successive amounts of 50 per cent, 25 per cent and 25 per cent between 1959 and 1970. Moreover, the combination of the USA's payments problems with those of chronically weak European economies (UK and Italy) led the 'Group of 10' industrialized countries to set up a US \$6 billion mutual credit arrangement in 1962—the 'General Arrangements to Borrow'.^{**}

The liquidity dilemma, meanwhile, had not been overlooked. From 1959 on, other scholars and some statesmen joined Triffin in arguing for some form of international reserve asset, free from the problems besetting the dollar. The debate eventually reached the G.10, where the USA was initially 'unconvinced' of the need for any measure which would dethrone its dollar. However, faced with the alternatives put forward by France—a return to the gold standard or some form of 'currency reserve unit' (CRU)—Washington agreed to enter into negotiations on the latter. The gold standard would, of course, have 'bust' Fort Knox!

The negotiations were initially confined to the G.10, where a number of schemes were proposed. Once the G.10 members had accepted the Third World view that a new reserve asset should be distributed to all IMF members, negotiations moved to the IMF. In 1966 and 1967, IMF staff elaborated alternative blueprints for discussion by policy-ma-

kers. The first tended towards the establishment of an organization affiliated to the IMF, to be called the 'International Reserve Fund' or 'Union' (not without resemblance to Keynes's 'International Clearing Union'), which would have been empowered to issue international reserve units. The second was less ambitious, providing for a 'reserve facility based on drawing rights in the Fund'.

It was the more modest scheme which prevailed. Agreement on the establishment of Special Drawing Rights was reached in 1967 and ratified in 1969. SDRs were available from a separate account within the IMF and allocated to members participating in that account, in proportion to their quotas. They could be exchanged against currencies in transactions among countries participating in the scheme (as virtually all IMF members eventually did) and between members and the IMF itself. Being a reserve asset alone, they were not available for use in international commerce and banking.

While the SDR scheme may be seen as a step in the right direction, its inadequacies in relation to the need for a truly stable international currency are evident. In the first place, while it was originally defined in terms of gold with the same value as the US dollar, the SDR lost its gold link as a result of the dollar losing its convertibility. Since 1974, its value has been nothing more than the weighted average of the values of 16 national currencies.[†] Since none of those currencies has its stability assured, the only virtue of the SDR from this point of view is that the fall in its purchasing power is smoother than that of the weaker

^{*} See Background Notes on the IMF, paragraph 14.

^{**} See Background Notes on the IMF, paragraph 35. The GAB was channelled through and managed by the IMF.

[†] The 16 currencies are those of the countries with the largest exports of goods and services. The weight of the US dollar in this basket is 33 per cent. The current value of the SDR is about US \$1.3.

currencies, such as the US dollar. One may note here that the yield on SDRs has been deliberately kept less attractive than that on dollar claims, even if the relative stability of the value of SDRs in comparison with that of the dollar is taken into consideration; because if encouragement of the use of SDRs as reserve currency were at stake, allowance would have been made for a higher rate of interest.

Secondly, the quantity of SDRs issued has been very small in relation to international

liquidity needs, particularly if these are to be met other than by the emission of more and more dollars. The first issue amounted to SDR 9.3 billion; when it was completed in 1972, this represented some 6 per cent of world reserves (see Table 1, below). The second issue of SDR 12 billion, to be completed in 1981, will just about restore that proportion, which had dropped since 1972 because of the explosion of exchange reserves.

Thirdly, the distribution of SDRs was not

Table 1 Size, sources and distribution of world monetary reserves 1913–78 (in billions of US \$ or SDRs)

	End of:	1913	1937	1949	1959	1969	1972	1975	1978
<i>Sources</i>									
I	World gold in billions of SDRs at 35 SDRs per ounce throughout	4.1	25.3	34.4	39.9	40.8	41.2	41.1	40.1
II	Credits in billions of SDRs	0.7	2.4	11.1	17.0	37.9	105.3	152.7	239.3
	A. Foreign exchange	0.7	2.4	11.0	16.1	32.0	95.9	136.9	220.8
	B. SDR allocations and IMF credits			0.2	0.9	5.9	9.4	15.8	18.5
	1. SDR allocations			n.a.	n.a.	n.a.	9.3	9.3	9.3
	2. IMF credits	n.a.	n.a.	0.2	0.9	5.9	0.1	6.5	9.2
III	Impact of gold–\$ fluctuations			–0.3	0.1	0.2	44.2	149.6	291.5
	A. On gold valuation			–0.3	0.1	0.2	35.2	123.6	219.0
	1. Gold+SDR rate			–0.3	0.1	0.2	29.2	99.6	158.8
	2. SDR–\$ rate			n.a.	n.a.	n.a.	6.0	24.0	60.2
	B. On credit valuation (SDR–\$ rate only)			n.a.	n.a.	n.a.	9.0	26.0	72.5
	<i>Total reserves, in billions of \$</i>	4.8	27.7	45.2	57.0	78.9	190.7	343.4	576.9
<i>Distribution</i>									
	Total reserves in billions of SDRs	4.8	27.7	45.2	57.0	78.7	146.6	193.8	279.4
I	United States of America	1.3	12.8	26.0	21.5	17.0	12.1	13.6	15.0
II	Other countries	3.5	14.9	19.5	35.5	61.7	134.4	180.2	264.4
	A. OPEC members			1.2	2.5	4.1	10.0	48.3	46.2
	B. Other countries			18.3	32.9	57.6	124.4	131.9	218.2
	1. Other industrialized			11.0	26.3	45.6	104.7	105.9	165.4
	2. Other Third World			7.3	6.6	12.0	19.7	26.0	52.8

n.a. = not applicable

Source: R. Triffin, 'The Future of the International Monetary System', paper delivered on October 31st, 1979 at a conference of the Global Interdependence Center, Philadelphia, Annex, Table 1.

related to development needs. The famous 'link' between reserve creation and development finance, canvassed by UNCTAD and the Group of 77 since 1965, was ignored. It was made clear from the outset that this new form of liquidity was not intended to permit Third World members to relax monetary discipline.

Distribution of SDRs according to quotas meant, of course, that the lion's share went to the industrialized countries, starting with the USA. Third World countries obtained about 25 per cent of the first issue; they will receive about 35 per cent of the second.

6 The Dismantling of the Bretton Woods System, 1971–76

Direct blows to the foundations

No human system is immutable. While all systems change and some of their original rules can be modified, they may nevertheless survive if their foundations remain solid. The pre-1914 gold standard—to take a clear example—overcame occasional upheavals because governments and the world of finance agreed to abide by its basic rules. In the case of the Bretton Woods system, increases in IMF quotas, changes in their distribution, the General Arrangements to Borrow and the IMF-approved revaluations and devaluations of major trading currencies (e.g. the Deutschmark and sterling) all came under what might be considered to be the normal evolution of the system. The series of measures adopted, one after the other, since the USA finally abandoned convertibility in 1971 have gone much further, however.

It should be remembered that, in order to fulfil the purposes enumerated in the first article of the Bretton Woods Agreement,* the IMF was supposed to guarantee two basic and closely related principles:

1. The stable parities of the currencies of member states.
2. The gold base of the system as a whole.

At the risk of repetition, let us recall that among the main concerns of the Bretton Woods negotiators were the avoidance of competitive rate manipulation and the maintenance of stable exchange rates among the main trading currencies, so as to promote international commerce and payments. Currency devaluation was envisaged as a last resort, to be approved by the IMF only in cases of fundamental disequilibrium and to be avoided if possible by the use of IMF credits.

Thus, while adjustment in parities was not excluded, stability was the objective and, through these fixed relationships to gold, stability was also to be the rule in rates of exchange among different national currencies. The abandonment of fixed parities and of gold as the common denominator can thus be seen as direct blows aimed at the very foundations of the Bretton Woods system. Subjected to this stress, the whole edifice fell apart. Rather than standing up in defence of its principles, with the same orthodoxy that it shows when dealing with Third World countries, the IMF gave way to the demands of its most powerful member and acquiesced in its own disorientation.

* See page 34 f.

The generalization of 'managed floating'

In August 1971, the US administration of President Nixon announced a unilateral decision to suspend the convertibility of gold.* This could have been the opportunity for the IMF to convene a negotiating conference aimed at the creation of a new international currency. Instead, all it did was convert its accounts into SDRs.

In December of the same year, the 'Smithsonian Conference' of the Group of 10 decided on a general realignment of parities which introduced a new form of devaluation. Without reference to gold, the US dollar had to be valued in terms of other currencies. So what the realignment actually meant was a devaluation of the dollar ranging from 7.5 per cent in relation to the weakest currency of the participants (The Italian lira) up to 16.9 per cent in the case of the strongest currency (the Japanese yen). Detached from any standard, the dollar was again devalued just over a year later (February 1973). It became obvious that the system of fixed rates could no longer be maintained. In March 1973, the G.10 plus a few other industrialized countries introduced the practice of floating rates modified by central bank intervention. Needless to say, all these decisions were taken without the participation of the Third World.

Floating rates were in flagrant violation of the provisions of IMF Article IV concerning par values and exchange stability, but this violation did not raise any formal protest from the Fund. Instead, IMF bodies were given the task of legitimizing 'managed floating' of exchange rates through the amendment of the Articles of Agreement.

* The Managing Director of the IMF was informed of this decision just before the President announced it publicly on television.

The demonetization of gold

Increasingly, from the early 1960s, the maintenance of the price of gold in terms of dollars became unsustainable. In a world where the general level of prices had been moving up for about two decades, how could the price of the most precious of metals remain fixed? Gold convertibility, which was one of the major factors of the economic strength of the USA in 1945, started to put a heavy strain on its reserves. In time, delinking the dollar from gold became inevitable. The only alternative would have been a large dollar devaluation, but this was not acceptable to Washington for reasons of prestige and influence. It was also opposed by holders of large dollar assets, because it would have depreciated their value to an unacceptable degree. When delinking finally took place and the gold price ceiling was removed, the price went up, quite naturally. This gave a windfall gain to countries with large gold reserves (e.g. France and the FRG), not to mention the major supplier of gold to the market: South Africa. Washington, therefore, proclaimed a crusade for the universal demonetization of gold.

This required, in the first place, that the industrialized countries stop exchange market interventions tending to maintain any relationship between their currencies and gold. As compensation, they would be allowed to revalue their gold stocks periodically to keep in tune with the price of gold in the open market. It was hoped, however, that once gold was disqualified as a monetary asset the consequent reduction in demand for it by central banks would restrain price increases and that a price ceiling would soon be reached. Secondly, the IMF, itself a major holder of gold, would have to liquidate its holdings. To have kept them could have fed hopes of a possible

return to gold as an element of a new international currency.

The Second Amendment

Like the introduction of floating exchange rates, the abandonment of par values in terms of gold and the sale of IMF gold stocks could not be accommodated within the IMF system, except by amending the Articles of Agreement. For such amendments, a large majority in both voting power and the number of members is needed.* Thus, the USA and its supporters needed the agreement of Third World members to get the amendments through.

They obtained this by offering the Third World the carrot of the profits from the sale on the open market of 25 million ounces of gold (one-sixth of the IMF's stock). Just under 30 per cent of these profits, determined in relation to the old official gold price of 35 ounces, was to be distributed directly to Third World countries. The balance was to be paid into a Trust Fund, managed by the IMF and providing medium-term loans at nominal rates of interest to low-income countries needing 'additional balance-of-payments assistance'. Countries requiring such loans would have to obtain IMF approval of programmes of balance-of-payments adjustment, i.e. the carrot was offered attached to the stick of 'conditionality'.**

Discussions on amendments to the Articles, known collectively as the Second Amendment, took place in the IMF Committee of 20 and its successor, the Interim Committee.† It was in the latter that the agreement of the Third World members was obtained. The meeting of the Interim Committee in Kingston, Jamaica, in January 1976 wrapped up the package, which was ratified by the required majority of the IMF votes and membership in April 1978. From that date—which, as fate

would have it, was April 1st—the foundations of the Bretton Woods system disappeared.

The US strategy succeeded, therefore. As for the Third World, its carrot turned out to be not all that juicy. Up to mid-1979, resources available to the Trust Fund amounted to SDR 1.7 billion (of which 1.2 billion were actually lent), while SDR 0.8 billion of gold profits had been distributed directly. One can well ask whether such sums justify the Third World's acquiescence in the dismantling of the Bretton Woods system, in the absence of the establishment of a new system supportive of development. For, despite the opportunity given by the negotiation of amendments to the Articles, the concept that Third World development problems need treatment which is suited to them remains absent from the statutes of the IMF.

* See Background Notes on the IMF, paragraph 18, for the present majority requirements.

** See Background Notes on the IMF, paragraphs 54 and 62 for more details about the IMF gold sales and the Trust Fund.

† See Background Notes on the IMF, paragraphs 42–46.

7 The International Monetary Fund, 1980

International monetary disorder

It is now unanimously acknowledged that the international monetary system elaborated at Bretton Woods has fallen to pieces. No other system has been built to replace it and the international community lives among its ruins. Serious monetary reform has been set aside in favour of *ad hoc* arrangements. The moves of most EEC countries towards monetary union—the ‘snake’ and the 1979 European Monetary System—have revived memories of interwar monetary zoning (with the Deutschmark in the lead this time). Some people have gone so far as to predict the birth of an Asian monetary zone based on the yen.

Proposals for reform are now almost a fashionable exercise. But, with the exception of the ideas of a few far-sighted economists who have always warned against the Bretton Woods system and its consequences, most of the proposals emerging from academic circles or submitted to negotiating bodies tend to be mere attempts at restoring effectiveness to a system which has lost its foundations. This conceptual and institutional mess would be a worthy subject of quiet reflection if the international monetary and financial situation were not so alarming.

Let us cite at random some of the most relevant figures: the US trade deficits of US \$30.9 billion in 1977 and US \$34.2 billion in 1978; the dollar depreciation (1970 to end 1978) of between 45 and 50 per cent against the mark and the yen; the US \$200 billion held by non-US central banks; dollars awash in the Euromarket—a round-the-clock facility at the disposal of transnational banks and corporations—reaching up to 700 billion; and Third World indebtedness estimated at US \$400 billion, a good portion provided by transnational

banks as syndicated loans. These and other figures of the same sort intimate the apocalyptic dimensions of the financial crash which could occur at any time if the tightly-knit web of relationships between financial institutions—national, transnational or international—starts to unravel. We have already witnessed the tremors caused by the failures in 1974 of the Herstatt and Franklin National Banks. And, should a really serious shock occur, it would be all the worse because no one can be said to be in control of what has been rightly qualified, by one who served on the IMF Committee of 20, as a ‘non-system’.

In the meantime, double-digit inflation figures in most industrialized countries seem to be here to stay, while the rate of inflation in many Third World countries approaches or reaches three digits. Today, no national currency seems able to fulfil on a world scale the basic function of money as a store of value. This state of affairs gives rise to what economists call ‘commodity preference’ or, in other words, flight from money and financial assets. Gold is now officially a commodity like any other, but it remains the most sought-after store of value. Notwithstanding the role of speculation in the gold market, one cannot overlook the fact that in ten years the price of gold has been up to more than 20 times what it was until 1969.

The imbalance of power in the IMF

We have seen that the IMF was impaired at birth by the inherent weakness of the gold exchange standard system and the inadequacy of its provision for the particular needs of Third World countries. Nevertheless, the demise of the Bretton Woods system and the

present monetary disorder cannot but give rise to questions about the responsibility of the Fund for the present state of affairs. Why did the IMF behave as it did?

As an institution, the IMF has some built-in features which serve to explain its behaviour. First, the adjective 'international' in the name of the Fund is misleading; it does not have the same meaning as when applied, for example, to the United Nations Organization, with which the Fund has a tenuous relationship. This is because many socialist countries, notably the USSR and its East European allies, are not members of the IMF.*

These absences are rather extraordinary today. An international monetary system is necessary because of international commercial and financial transactions. These require an acceptable standard of prices and means of payment. The socialist countries of Eastern Europe now account for about 10 to 12 per cent of world exports and they import even more. As evidence, their foreign debt was estimated at US \$50 billion in early 1979. The greater part of their transactions, as a group, is with western industrialized countries. Intensification of East-West trade and finance is a corollary of *détente*. Consequently, looking beyond present crises, one can reasonably expect that the participation of these countries in world trade will grow.

The USSR and its East European allies have been reluctant to join the IMF for many reasons, foremost among which are the unfavourable power relations within the IMF itself. Yet these countries cannot continue to trade wide-

ly with the outside world and at the same time hope to escape the consequences of international monetary instability, in particular the world inflation which they import with foreign goods and services. They therefore have an interest in participating in a truly universal monetary institution. This would ensure that such an institution had rules and regulations which could accommodate the needs of socialist systems, which would in turn enhance its attraction for Third World countries, especially those which opt for a socialist path to development.

A second structural defect is the oligarchic power structure of the IMF. No single country leaves its monetary policy to be shaped by the shareholders of a bank. As a rule, all central banks are nationally owned institutions, either from their foundation or after nationalization. Even in the USA, where nationalization is anathema to most people, the Federal Reserve Board—a government agency—enjoys more powers than any central bank in non-socialist countries.

Yet in the IMF, where voting power is derived from quotas, the five major 'shareholders' (USA, UK, FRG, France and Japan) command 40.9 per cent of the votes, which they exercise through directly appointed Executive Directors.** Thus, short of amending the IMF Articles, these five western industrialized countries are able to direct the management of the international monetary system in the way they wish. In practice, a summit meeting of the leaders of the biggest western quota holders has always preceded major changes in the IMF. What was decided upon at Rambouillet or Puerto Rico was later endorsed by the governing organs of the Fund.

** For more details on voting power in the IMF, see Background Notes on the IMF, paragraphs 11–29 and Table 1.

* Other notable non-members are Angola, Cuba and Mozambique. The People's Republic of China has just regained its place in the IMF. For some notes on East European non-membership, see Background Notes on the IMF, paragraph 8.

The IMF—sheriff of the transnational banks

As the IMF has grown more and more lenient in responding to the requirements of big western powers, it has shown more conservatism and rigour in dealing with Third World countries. This attitude cannot be explained by the huge indebtedness of the latter, some of which are on the brink of bankruptcy. Such a situation certainly allows the IMF to tighten its grasp, but from the point of view of the stability of the international money and capital markets the greater risk lies in the much larger mass of Eurodollars. While a generalized default by Third World debtors appears most unlikely, the Eurodollars are primarily 'hot money', characterized by swift and massive movements especially in speculation on exchange rates.

Thus the hardening of the Fund's attitude towards the Third World must be explained otherwise. In the first place, it is only in dealing with Third World countries that the IMF, and in particular its staff, can exert influence and power—and then only if one of the big IMF patrons does not have its reasons for insisting that a 'friendly' country be treated leniently. The western industrialized countries, on the whole, elude the reach of the IMF. They have their own network of formal or informal consultative mechanisms outside the IMF (the G.Ten, the Bank for International Settlements, ministerial meetings and summits). It is not an exaggeration to say that the big western powers—and more broadly the OECD members as a whole—consider their monetary and financial problems too important for the technocrats of the IMF. For these countries, the IMF is irrelevant, a rubber stamp.* The Third

World countries, therefore, are the only 'victims' available.

Secondly, with the end of the 'glorious years of continuous growth', western countries became increasingly restrictive in providing development assistance and public loans to Third World countries (with the well-known exceptions of Scandinavia and the Netherlands). At the same time, transnational banks accumulated huge liquidities from the rapid growth of Eurocurrencies and then from the recycling of petrodollars, while the declining rates of investment in major western countries reduced lending opportunities. The main outlet for these funds was in the form of loans to Third World countries, in particular those with relatively high per capita incomes and ambitious economic growth plans or programmes.

Transnational banks involved in these Third World operations do not have the advantages of bilateral aid agencies: the possibility of imposing conditions on the borrowing country, including clauses that influence its socio-political orientation; the 'intelligence' provided by the donor's embassy and other services about the country, its policies and its political personnel. A single bank can, of course, pay to get the relevant information, and use pressure in negotiations behind closed doors. But this is rather costly, and moreover the information acquired is likely to remain within that bank.

In these circumstances, the IMF acquired its new role, which has been described as that of a 'financial sheriff' of the transnational banks in the Third World.⁵ Being an 'international' organization, it can take the liberty of inspecting all aspects of a country's economy and the society of the would-be borrower, without

* It is noteworthy that the USA, while retaining the monopoly of the presidency of the IBRD, has conceded the managing directorship of the Fund to the West Europeans.

These, in turn, do not appoint a person of high political stature, as they do when it comes to the office of Secretary-General of NATO.

raising the same kind of protest as if the inquiry were carried out by a bank or group of banks. Through appropriate conditions for its stand-by agreement and the country's 'stabilization programme', the Fund imposes on the borrower the behaviour pattern which reassures transnational finance and the West as a whole. Governments which agree to be economically timorous, socially conservative and

politically docile can thus hope to obtain from the IMF a certificate of good behaviour, which is then supposed to give a green light to purveyors of commercial credit. The best evidence for these statements is the modesty of the resources provided by the IMF in comparison with the borrower's estimated needs, on the one hand, and the price in terms of the borrower's sovereignty on the other.

8 Conclusions

The IMF has lost its legitimacy and efficiency

In the world community there is no political authority empowered to act as governments do within nation states. Accordingly, any international institution draws its effective authority primarily from its efficient operation, deemed satisfactory by the community at large. A formal international agreement provides a legal base; it cannot by itself guarantee successful functioning. International treaties are often undone, and more often fall into oblivion. But if an institution established by international agreement survives despite the abandonment of the principles that governed its foundation, it loses its legitimacy, even if it retains its membership.

The IMF is an institution set up by international treaty which, besides denying its own principles, offers a rather poor performance, gives the persistent impression of being at best insensitive to the interests of the majority of its members, and does not include all nations while dealing with matters of interest to all of them. Such an institution is no longer legitimate, it has lived too long. The IMF has demolished its own foundations and has proved unable to set up a new system. Loss of legitimacy added to lack of efficiency make its survival an oddity. As a matter of fact, the

public in the rich nations never hear or care about it. In the Third World, it is known because of the considerable number of people who suffer the consequences of policies it imposes.

The Third World should reconsider its attitude to the IMF

The people of the Third World remain the unorganized victims of what would be more adequately called the international monetary *disorder*, since a comprehensive system, agreed upon by the international community, does not exist. Nevertheless, the Third World cannot ignore the monetary issue. These countries suffer from inflation more than the rich nations. It is they who are now obliged to submit to control by the IMF.

The ideology which prevails within the Fund, and which inspires the conditions that it imposes on Third World supplicants, is in contradiction not only to the ever more widely accepted concept of Another Development but also to the proclamations of the President of the IBRD. There are always conditions on lending, and IMF conditionality is illustrated and discussed in the following contributions by Norman Girvan and Justinian Rweyemamu.

What it is important to retain here is that the Third World must work to expose the ideological content of IMF conditionality and the extent to which it infringes the principles of national sovereignty as set out in the Charter of Economic Rights and Duties of States adopted by the UN General Assembly. Taking the lead from President Nyerere, the Third World must ask itself: 'When did the IMF become an International Ministry of Finance? When did nations agree to surrender to it their powers of decision-making?'⁶

An international monetary system worthy of its name must make provision for the real and justified needs of all its members. The Third World can legitimately state that the Bretton Woods system did not meet this standard, and that the present situation falls even further short of it. The link between reserve creation and development finance remains a mirage. Third World countries have been receiving an inadequate share of new reserves, the bulk of which are created outside the IMF. Third World indebtedness to the IMF is minimal in relation to its total external debt.* The only real reason for many Third World countries to continue to participate in the IMF is fear of losing its seal of approval and thus of access to commercial credit. For those who do not rely on such credit, the threat is presumably the withdrawal of bilateral aid if they quit a system patronized by the donors, as well as loss of membership of the IBRD.**

In these circumstances, there is much to be said for the Third World considering seriously

the feasibility of setting up its own monetary and financial arrangements. Collectively, it has the means to do so, and the basis for the necessary study and negotiation has already been laid by the Colombo summit of the Non-Aligned Movement in 1976.

There is mutual interest in the fundamental restructuring of the international monetary system

Beyond the possibilities for Third World action, fundamental restructuring of the international monetary system is an element of a new international order with respect to which 'mutual interest' can be demonstrated—perhaps the only such issue at present. For this to be so, it must be realized that the financial problems of the Third World are no less serious for the future of world development than the 'stagflation' of industrialized countries. Of course, differences of view would be evident as soon as a global debate on the content of monetary restructuring began. But, assuming that 'interdependence'—a concept much advanced by representatives of western states—is not an empty word, these could be resolved. For this is an area in which interdependence is actually lived, where monetary expansion in the USA, for example, has repercussions on the price of food bought by Indian workers. Attempts have been made to persuade people that energy is the only really global issue. Yet money, the lubricant of all transactions, is just as important globally, if not more so, since its shortage or surplus provokes havoc in all economic activities.

A return to some concept of sound monetary management, together with the conviction that the world monetary system is the business of the entire international community, are necessary for the planning and construction of this

* The IBRD's *World Development Report, 1979* (p. 29) estimated Third World obligations to the IMF as less than 3 per cent of total debt outstanding at the end of 1977.

** Membership of the IBRD is open only to members of the IMF.

centrepiece of a new international order. Good ideas already exist concerning the content of a new monetary system. Its foundation stones should be:

1. A universal and democratic world central bank, accommodating the needs of different development patterns and economic and social systems.
2. An international currency unit, based on real values and acceptable in international payments.

In an ideal democratically run world, a world central bank would operate on the basis of 'one state, one vote', with the differing economic weight of members being reflected in their greater or lesser participation in the operations of the institution. At the present historical juncture, however, some form of weighted voting, more realistic and more equitable than the present IMF arrangements, would probably be necessary to obtain political acceptance for the institution. The absence of a 'world government' also cautions against adopting too flexible a system for the creation of international money. Since the money supply is subject to manipulation by the more powerful socio-economic groups, a degree of automaticity would be necessary to ensure the soundness of the international currency, which should be backed by commodities.

In addition to this monetary restructuring, it would be necessary to enable the international financial system, including the IBRD and other development banks, to respond adequately to the needs of the international community for medium- and long-term finance. Such radical changes in the world order would require tremendous work, with the widest participation, and would be a fitting agenda for a United Nations Conference on International Money and Finance.

Notes

1. A notable recent example was Tinbergen, J. *et al.*, *Reshaping the International Order* (RIO Report).
2. See *IFDA Dossier 17*.
3. See Keynes, John Maynard, *Proposals for an International Clearing Union*, April 1943, where he gave a full justification and clear description of the proposed institution and its ways of operation, including the rules of emission of the international currency, which he named 'bancor'.
4. See Pandolfi, Filippo-Maria (Interim Committee Chairman) in *Le Monde*, April 1st, 1980.
5. See *IFDA Dossier 17*, p. 55.
6. President Nyerere's address to the diplomatic corps, Dar-es-Salaam, January 1st, 1980 (reproduced in this issue of *Development Dialogue*, page 5).

Swallowing the IMF Medicine in the 'Seventies

By Norman Girvan

The preceding paper by Ismaïl-Sabri Abdalla has referred to the insistence with which the IMF prescribes and imposes the 'wrong medicine' in dealing with Third World payment problems. In the course of the project leading up to the Arusha Conference, a number of cases of the relationship between the IMF and indebted countries were analysed. Three full case studies were undertaken: they concerned two Third World countries (Jamaica and Peru) and a peripheral northern country which received 'Third World treatment' from the Fund

(Portugal).^{*} All these countries have tried to carry through programmes of social restructuring and, in all three cases, the IMF was one of their stumbling blocks. The studies were undertaken by people with direct personal involvement in the countries' dealings with the Fund or in the related technical analysis and research. The purpose of this paper is to assemble the main findings of the three case studies and to draw some conclusions from them.

1 The Setting, 1973-76

A new kind of deficit

In the four years from 1973 to 1976 the world economy, and particularly Third World countries which are not oil exporters, suffered a series of shocks that were without precedent since 1945. First, an inflationary explosion shook the world; 1973 and 1974 saw a 100 per cent increase in the general level of commodity prices, a quadrupling of the price of oil, and a 43 per cent increase in the average price of exports of industrialized countries. In this initial period, the prices of Third World exports other than oil were swept along in the general price boom. But 1975 and 1976 were years of recession in the industrialized countries, and this dampened both prices and volumes of Third World exports. As a result, most of these countries began to sustain large current account deficits: the IMF estimated that the cumulative total for the three-year period 1974-76 for the 'non-oil' Third World was US

\$94 billion, compared with US \$32 billion in the previous three-year period.¹

These deficits were not only much greater but also qualitatively quite different from those previously characteristic of this group of countries. Up to 1972, the major factors contributing to their deteriorating trade balances had been increases in import volumes, and to a lesser extent declines in export volumes and prices. The huge deficits of the 1974-76 period were principally the result of large increases in import prices, the failure of export prices to keep pace with these increases, and the falls in export volumes and prices in 1975 (see Table 1, page 56).² In fact, most non-oil Third World countries were forced to contract drastically their import volumes, domestic incomes and economic activity, in order to try to bring about some semblance of viability in their external accounts. As the opening passage of the 'Dell Report' points out, this means that:

...Recorded surpluses and deficits were smaller than they would have been if the existence of such disequilibrium had not in itself caused a constriction of output and employment. In effect, many of the developing countries were faced with a burden of

^{*} The authors of the case studies on which this paper is based are: Jamaica—Norman Girvan, Richard Bernal and Wesley Hughes; Peru—Carlos Amat *et al.*; Portugal—Antonio Rodrigues, José Brandão de Brito and Manuel Luis Amaral.

Table 1 Data on and factors affecting the balance of payments of non-oil-exporting Third World countries, 1971-76

	1971	1972	1973	US \$ billion 1974	1975	1976
Merchandise trade balance f.o.b.	-8.6	-6.4	-6.5	-22.2	-28.7	-15.9
Balance on services	-4.9	-5.1	-7.3	-10.4	-12.5	-13.7
Private unrequited transfers	1.3	1.8	2.5	2.6	3.5	4.3
Current account balance	-12.2	-9.7	-11.3	-29.9	-37.6	-25.2
<i>Indices</i>						
Unit values of exports						
Food	49.1	53.4	67.6	100.0	95.6	100.0
Raw materials	50.5	54.7	72.9	100.0	94.3	108.3
Non-ferrous metals	50.8	51.4	97.4	100.0	68.2	104.1
Quantum of exports ¹						
All exports ²	102	114	127	130	122	140
Food and beverages	102	109	115	105	112	122
Raw materials	102	112	120	118	105	106
Industrial products	107	128	149	167	169	205

Notes 1. 1970 = 100.

2. Includes oil exports of OPEC countries.

Source: The Balance of Payments Adjustment Process in Developing Countries: Report to the Group of 24, UNDP/UNCTAD Project INT/75/015, Table 8, p. 1-20; Table 2, P. 1-5; Table 3, p. 1-6.

adjustment out of all proportion to their degree of responsibility for the imbalances arising in the international payments system.³

Growing indebtedness

It is important to note that during this period of rapidly rising deficits the non-oil Third World countries made only minimal use of IMF credit and virtually none at all of the higher credit tranches of Fund resources. Of their US \$94 billion cumulative current account deficit, drawings on the IMF financed only some US \$5 billion. The bulk of these drawings were from the low-conditionality Oil and Compensatory Financing Facilities.* In fact, during the three years 1974-76, there were only five occasions on which the upper credit tranches

were used among the entire membership of the Fund. Again, the 'Dell Report' makes the point that:

...Even where countries were under the most intense pressure both in their external accounts and in their domestic economies, they hesitated to make use of the upper tranches of their quotas in the Fund, and avoided it if they could.... It has been suggested by the Managing Director of the Fund that the severity of Fund conditions has often reflected the failure of countries to approach the Fund at a sufficiently early stage in the evolution of a problem. This in turn, however, was due to a vicious circle in which countries were reluctant to draw on the upper credit tranches of the Fund ex-

* See Background Notes on the IMF, paragraphs 51, 60, 63, 71-72 and Table 3.

cept as a last resort, because of the exacting conditions they expected to be imposed...⁴

To finance their deficits, many non-oil Third World countries turned instead to loans from the transnational banks, to concessional flows from bilateral and multilateral sources other than the IMF, and to bond issues (largely on the Euromarket). In the three years mentioned, these sources provided some US \$60 billion,⁵ or nearly two-thirds of the amounts needed, with a corresponding increase in the burden of external indebtedness.

By 1976, however, a small but significant group of these countries were reaching the point where the private financial institutions were no longer willing to provide financing for their payments deficits because of what was perceived to be their loss of 'credit-worthiness'. At the same time, the bilateral and multilateral governmental organizations were either unwilling or unable to step in and make up the deficiency, at least on the scale required. The necessity for drastic adjustment became apparent to these countries. But, even if they were to take the most stringent measures, their dependence on imports for supplies of absolutely essential food, fuels and raw materials, together with their shrunken import capacity and the depletion of exchange reserves, predetermined that it would be impossible for them to stave off economic collapse without additional resources for import financing.

The non-oil countries found that the only institution which they could approach with these requirements was the IMF. It should be emphasized that the need for IMF financing was perceived not only, nor even mainly, because of the actual resources provided by the Fund, since these have tended to be small in relation to a country's total requirements.

Rather, an IMF credit is supposed to function as a signal to the commercial banks, and even to official lending agencies, that the borrowing country has instituted an acceptable 'stabilization' programme, that its credit-worthiness has been restored, and that loans to its government can be resumed.

The response of the IMF

The Fund, in the meantime, had been taking steps to attempt to respond to the much enlarged deficits of these countries. In August 1974, its Executive Board approved the establishment of the Extended Fund Facility, which allowed a period of up to three years 'to overcome structural balance of payments maladjustments',⁶ and entitled a member to borrow up to 140 per cent of its quota.* This was a considerable improvement over the regular stand-by facility in the credit tranches, which normally provided for adjustment in a one-year period and for drawings up to 100 per cent of quota. But the conditionality attached to the Extended Facility was still the same combination of monetary-cum-fiscal contraction and relative price adjustment that applied to drawings from the upper credit tranches, the corresponding implication being that the payments deficits to be treated with the new facility were still assumed to have their origins in imbalances amenable to such treatment. The countries which were now to be forced into the use of these high-conditionality facilities were therefore to become the first test cases for the application of the standard IMF prescriptions to the qualitatively and quantitatively new payments deficits of the mid-1970s.

* See also Background Notes on the IMF, paragraph 59 and Table 2, which shows that this facility permits the extension of cumulative drawings to 190 per cent of quota.

Among these countries were those whose cases have been studied. The three—Jamaica, Peru and Portugal—provide a sufficient variety of economic, political and historical circumstances to offer conclusions of general applicability. In each case, however, it is only possible to understand fully the nature of the

balance of payments problem giving rise to IMF involvement, and to analyse the impact of the IMF programme, against a background of the previous pattern of economic development in the country and the interplay of economic and political factors.

2 Legacies of Dependent Development

The breakdown of the model of expansion of the international capitalist economy in the 1970s—of which the collapse of the Bretton Woods monetary arrangements was a symptom—affected different parts of the system in different ways. In the countries which constitute the peripheral or dependent part of the system, the previous form of expansion had varied from country to country according to their economic structures, their relationships with the international system, and the configuration of social and political structures that corresponded to their economies and their historical development. Despite these variations, the common bond of their experiences was the overriding impact of the external sector on the behaviour of these economies. It was this factor that provoked economic and political crises when the model of economic growth broke down, paving the way for the intervention of the IMF in the national political economy.

Deterioration in the payments balances of these countries cannot be seen exclusively in terms of developments in the economic sphere, of changes in the relationships between certain economic variables, such as import prices, export sales, capital flows, money supply and fiscal expansion. At a more profound level, it also reflects changing socio-political relationships within the country as well

as the impact of the international crisis. In a sense, the balance of payments is fundamentally a manifestation of the balance of forces to which a country is subject, in both its internal and international relationships.

Jamaica—social protest against inequality

Jamaica is a classic case of dependent economic growth closely tied up with the expansion of the international economy (primarily with the USA). Between 1953 and 1972, Jamaica received approximately US \$1 billion in capital inflows, principally as direct foreign investment in the mining and refining of bauxite for export. These amounts, about US \$500 per head of the present population, represented 6 per cent of the GDP over the 20-year period; in the last six years of the period, this proportion reached an average of 9 per cent. Capital inflows financed 32 per cent of all domestic investment and about one-quarter of all imports. Foreign trade as a proportion of the GNP grew from 53 to 64 per cent and over three-quarters of merchandise exports were derived from the production of bauxite/alumina, sugar and bananas. During the whole of the period, real GDP growth averaged 5 to 6 per cent per year. But just how dependent this performance was on the particular economic and political conditions of the 1950s and 1960s

was only to become apparent subsequently.

In 1972, the investment cycle in the bauxite industry came to an end. Coincidentally, there was also a change of government in that year. Militant trade unionism and nationalist politics had emerged in Jamaica back in 1938, in response to centuries of colonial exploitation. By the 1950s, a stable two-party system had been established. Both the conservative Jamaica Labour Party and the mildly socialist People's National Party had a popular trade union base and subscribed to the model of development through foreign capital investment. Independence from British rule was attained in 1962 and during the next ten years the JLP formed the government. Rapid economic expansion was accompanied, however, by growing inequalities, unemployment and social alienation. The rise in the unemployment rate from 12 to 24 per cent between 1962 and 1972 and the fall in the relative and absolute income of the poorest 30 per cent of the population between 1958 and 1968 were consequences mainly of the neglect and stagnation of the agricultural sector and the capital-intensive nature of growth in the mining, refining, manufacturing and construction sectors.

The election of Michael Manley's PNP administration in 1972 was a result of widespread social protest against inequality, unemployment and foreign domination and this defined the nature of the reforms to be undertaken in the 1972-76 period. The coincidence of these reforms and their repercussions with the end of the bauxite investment cycle and the impact of the international crisis provoked the acute foreign exchange crisis of 1975-76.

Peru—breaking the power of the oligarchy

The rhythm of post-war economic growth in Peru was interrupted by major balance of

payments crises on three occasions: 1951-52, 1957-59 and 1967-69. These were due to price declines and/or sales contractions in the primary products which constitute the bulk of the country's exports; minerals, fishmeal, sugar, coffee and cotton account for over 80 per cent of these. A state which was controlled by the traditional landowning oligarchy responded to these crises by undertaking steep devaluations, budget cuts and other measures associated with the techniques of monetarist orthodoxy, aimed at contracting real income and consumption. These measures encountered various forms of political and social resistance, which were met with governmental repression in the 1951-52 and 1957-59 crises but led to the overthrow of the civilian government by the armed forces in 1967.

The government of President Velasco Alvarez undertook a series of reforms to break the political dominance of the landowning oligarchy, strengthen the role of the state sector, and respond to the demands of the popular classes for greater participation in the economic and political processes. Economic performance was relatively favourable between 1968 and 1972, with average real growth of over 4 per cent per year, an average inflation rate of just over 7 per cent, a stable exchange rate, and adequate foreign exchange reserves. All this was achieved in spite of a worsening in the terms of trade. However, after 1972, performance deteriorated rapidly as a result of ambitious expenditure programmes undertaken against a background of shrinking resources provided from the external trade sector.

Portugal—overthrowing fascism

The dictatorship which installed itself in Portugal in 1926 set about the construction of a

project of national development modelled on the early industrial revolution in Britain and Western Europe. Wages were kept low by the deliberate repression of workers' organizations and control over land by the landowning classes, leaving the majority of the people no option but to work at levels of remuneration which barely provided for their subsistence. Together with a highly protected national market and an elaborate apparatus of industrial regulation, this was the basis for industrial growth and financial accumulation in the post-war period. In addition, colonial possessions gave Portuguese capitalists access to certain resources at prices considerably below world market levels, as well as market outlets for the products of an inefficient manufacturing industry. Successive waves of mergers among banking and manufacturing groups gave rise to a growing concentration of capital and monopoly power within the economy. Direct foreign investment was tightly restricted, and foreign borrowing was limited only to the financing required for specific projects, so that capital inflows were not significant in import or investment financing.

Despite an apparent pattern of internally oriented growth, Portugal came to exhibit more and more of the characteristics of a de-

pendent economy during the 1960s. There was little technological change in the export sector and its competitive capacity declined. Domestic industry, which was highly protected from imports, became increasingly inefficient. Imports grew at a considerably higher rate than exports; this was particularly marked in the case of food imports, a result of the backward and stagnant nature of Portuguese agriculture, which had been consciously neglected in favour of industry. The terms of trade also deteriorated because of the increasingly 'modern' nature of the goods imported in relation to the slowly changing nature of exports. Over the ten-year period 1963–72, the cumulative trade deficit amounted to US \$4.7 billion. Of this, US \$4.4 billion were covered by remittances of Portuguese emigrants, and earnings from tourism amounted to another US \$1.7 billion, actually permitting a growth of reserves. However, with the advent of world price increases in 1973, import levels and exchange reserves could no longer be sustained and major contradictions within the financial bourgeoisie emerged. These, together with the effects of the colonial liberation struggles on the domestic political situation, culminated in the 1974 revolution.

3 Development of the Crises: External Shocks and Internal Contradictions

Jamaica—destabilizing backlash

In Jamaica, the doubling of import prices between 1972 and 1974 was more than fully compensated by increases in export volume in 1973–74 and in export prices in 1974–75. In the latter two years, the capacity to import was about one-third *higher* than in 1973. In 1976, there was a precipitate decline in the capacity to import owing to both volume and price de-

clines in exports. Yet the rapid deterioration in Jamaica's balance of payments position in 1975–76 (shown in Table 2, opposite) cannot be attributed mainly to the merchandise trade account, which actually improved in 1976. Far more important were reductions in the inflows from tourism, from unilateral transfers and on capital account, together with rising outflows of investment income. Again, these phenome-

Table 2 Jamaica: Balance of payments data, 1973-76 (in millions of Jamaican dollars; J \$1 = US \$1.10)

	1973-74	1975-76	Difference, 1975-76 compared to 1973-74
Balance on merchandise trade, f.o.b.	-268	-265	3
Balance on services	-93	-297	-203
Foreign travel	179	112	-67
Investment income	-114	-199	-85
Other	-158	-210	-52
Unilateral transfers (net)	45	29	-16
Private	60	21	-39
Official	-15	8	23
Balance on current account	-316	-532	-216
Net capital movement	346	234	-115
Official	115	185	70
Private	231	49	-182
Balance on non-monetary operations	30	-298	-328

Source: Jamaica Case Study.

na can only be understood by referring to internal political and social developments, as well as to the impact of the global economic crisis.

From the time of assuming office, the PNP administration instituted a variety of programmes and policies aimed at redistribution of income and economic power and securing greater national control over the economy. Programmes were implemented or announced within the first two years for employment creation, skill training for young people, adult literacy, land reform, food subsidies, rent restrictions, free education, school uniform subsidies and equal pay for women. Rigid price controls were imposed, while minimum wage legislation was adopted. The government negotiated a takeover of a number of important public utilities and enterprises in export agriculture. Perhaps the most spectacular move

was the government's assertion of national control of the bauxite industry. A special 'production levy' was imposed on the bauxite companies in 1974, which in one year increased government revenue eightfold (from US \$25 million to US \$200 million). This was complemented by moves to acquire a 51 per cent share in the bauxite mines, to repurchase all lands owned by the bauxite companies not immediately needed for mining, and to organize the construction of a state-owned alumina plant in partnership with Mexico, Venezuela and Hungary. Jamaica also played a leading role in the formation of the association of bauxite producing countries (International Bauxite Association). On the foreign policy side, Prime Minister Manley was active in the non-aligned movement and in developing close and friendly relations with Cuba, amongst other countries.

Local and foreign reaction was not slow in coming. The bauxite companies cut back production by 25 per cent in 1975 and a further 11 per cent in 1976, reducing revenue in the latter year by US \$54 million compared with the 1974 level. Foreign capital inflows declined from US \$254 million in 1973–74 to US \$115 million in 1975–76; in 1976, a net outflow was recorded. Local private investment was drastically reduced; in 1976 alone, real gross investment fell by 31 per cent and its ratio to the GDP from 22.4 to 16.9 per cent. A hostile press campaign in the USA practically destroyed the tourist industry, whose net receipts in 1976 were less than half the level of two years before. Receipts from remittances from abroad also slowed to a trickle and a thriving black market in the Jamaican dollar sprang up. By March 1976, the international commercial banks had ceased making new loans to Jamaica. This came in the middle of a wave of violence and arson in the capital city, in which the government claimed CIA involvement. The combined result of all this was a loss in exchange reserves of US \$74 million in 1975 and a disastrous US \$254 million in 1976. The PNP's electoral victory of December 1976, which was a resounding endorsement of its political and social programme, came at the same time as the exhaustion of the central bank's liquid reserves, and the issue of recourse to the IMF became a matter of urgency.

Peru—expectations disappointed

The Peruvian experience contrasts somewhat with those of Jamaica and Portugal. In the case of Peru, the payments crisis was mainly due to a reduction below expectations of production for export and export prices. Reforms had been undertaken in the first five years of the new regime (1968–72) which included national-

ization of petroleum, mineral and fishmeal enterprises; establishment of control over imports, the allocation of foreign exchange and the financial system; agrarian reform and democratization of industrial enterprises. These were achieved in an environment of relatively steady growth, stable prices, and a stable foreign exchange situation. In the early 1970s, the discovery of oil in the Amazonian region of Peru and the project for constructing a trans-Andean pipeline to the Pacific Ocean generated a high degree of optimism about growth prospects and made Peru an attractive proposition for the transnational commercial banks. The government embarked on an ambitious programme of infrastructural investment embracing electrification, irrigation, communication, highways, fishing ports, oil and minerals. In addition, expenditures on military equipment were increased substantially in response to the modernization of the armed forces in neighbouring Chile. The expansion of the value of imports by nearly 200 per cent over the three-year period 1973–75 was in large measure due to the impact of this development programme, and the availability of foreign exchange provided by large external commercial loans.

By 1975, it was clear that the economy was running into serious problems. The merchandise trade deficit amounted to an enormous US \$1.1 billion, compared with a surplus of US \$78 million just two years before, owing mainly to an increase in imports of US \$1.4 billion within two years (see Table 3, opposite). In spite of capital inflows of about US \$1 billion, the overall balance of payments deficit amounted to US \$0.6 billion and reserves were run down to an amount representing about two weeks' imports. Other indicators of serious problems were a large deficit on the government's current account, amounting to 5.5 per

Table 3 Peru: Current account transactions, 1973–76 (in millions of US dollars)

	1973	1974	1975	1976
Merchandise trade, f.o.b.				
Exports	1112	1503	1290	1359
Imports	1033	1909	2390	2100
Balance on trade	78	-406	-1099	-741
Balance on services	-313	-447	-489	-509
Unilateral transfers (net)	42	45	49	58
Balance on current account	-192	-807	-1538	-1192

Sources: Peru Case Study; IMF *International Financial Statistics*, May 1978.

cent of the GDP, deficits in the public enterprises amounting to a further 4.9 per cent of the GDP, a fall in the domestic savings ratio to 9 per cent of GDP, and a rise in the inflation rate from 14 to 24 per cent over two years. Moreover, it was evident that the development programme was based on assumptions which were not holding, for the new oilfields proved less productive than expected, copper prices began to decline after 1974, and there was a drastic fall in fish stocks from 1973. In early 1976, Peru started to prepare an economic stabilization programme, and the first in a long series of negotiations with the IMF began.

Portugal—another case of destabilization

Turning to Portugal, we find similarities with the Jamaican experience in that external and internal destabilization was an important factor in its payments crisis. From early 1974, Portugal's balance of payments began to weaken rapidly, and the economy began to experience its first external payments deficit for more than ten years. In the two years 1974–75, the cumulative deficit on current account amounted to US \$1.5 billion, in contrast with a cumulative surplus of nearly US \$0.9

billion in the preceding three years (see Table 4, page 64). Undoubtedly, external economic factors were major contributors to this deterioration. The terms of trade declined by 11.8 per cent in 1974 and a further 12.4 per cent in 1975, while export volume also fell by 13.2 per cent in 1975. The latter, however, was in part due to international reaction to domestic political developments.

In fact, the deterioration of the Portuguese balance of payments was to a large extent a consequence of the economic effects of the political changes set in train by the April 1974 revolution. The release of social forces which had been pent up by 50 years of fascist rule affected commodity and factor markets, the behaviour of fiscal and monetary variables, and external monetary flows. Decolonization resulted in the repatriation of thousands of settlers from the African colonies, generating new demands on the government budget as well as additional consumption expenditure and import demand. At the same time, the metropolitan economy lost an important source of foreign exchange earnings. Land reform and nationalization of the main centres of monopoly capital in the economy, as integral parts of the process of democratization, re-

Table 4 Portugal: Balance of payments data, 1971–75 (in millions of US dollars)

	1971	1972	1973	1974	1975
Balance on trade and services	-490	-522	-755	-1989	-1670
Unilateral transfers (net)	664	873	1104	1111	1037
Balance on current account	174	351	349	-878	-633
Net capital movement	92	-73	-6	248	-195
Medium- and long-term	64	-129	-142	272	-90
Short-term	28	56	136	-24	-105
Balance on non-monetary operations	267	278	343	-633	-1013

Source: Portugal Case Study.

duced investment and provoked capital flight. The abolition of the 'corporative' (state-controlled) trade union system and the guarantee of trade union freedom and collective bargaining resulted in a wave of wage demands. In 1975 and 1976, real wages advanced by 8.9 per cent in industry and transport and 11.7 per cent in agriculture. Since price controls were instituted which prevented the full amounts of wage increases from being passed on in the form of increased prices, the share of wages in the national income increased sharply, from 51.5 per cent in 1973 to 66 per cent in 1974.

One result of these internal changes was that many small and medium-size businessmen abandoned their decapitalized and debt-loaded businesses, went abroad, and lobbied their former customers and creditors to have nothing to do with the enterprises they had left behind, which had been taken over by the workers. This led to a reduction of foreign purchases and trade credits. Moreover, the important inflow of emigrants' remittances was adversely affected by the media campaign against Portugal in the countries where most of these emigrants work. Finally, capital flight was facilitated by a growing black market in the currency.

These various factors became particularly

overt after the resignation of the conservative General Spínola from the office of President, in September 1974, and a shift of the government to the left. Foreign retaliation took the form of the cancellation of export orders and their diversion to other suppliers, the shortening of credit repayment periods, strict credit ceilings, and the closure of factories operated within the country by transnationals such as Timex, Plessey and ITT. As for national retaliation, in 1974 and 1975 underinvoicing of exports robbed the economy of an estimated US \$120 million in foreign exchange receipts; the reversal in 1975 of the previous year's net capital inflow drained the reserves of US \$386 million; and net unilateral transfers declined in 1975 by US \$76 million, reflecting the reduction in remittances and the thriving black market in the currency. The last three factors had a total impact of some US \$582 million in the two years, representing about 35 per cent of the overall balance of payments deficit. (It should be remembered, moreover, that this reflects only the measurable estimates that it has been found possible to undertake.) By the beginning of 1976, the Portuguese authorities were thus moving to the position where an IMF-type programme was felt to be necessary.

4 The Impact of the IMF Relationship

Official mythology represents technicians of the IMF staff and a member government sitting down to discussions in which the IMF advises on the causes and the remedies of the country's balance of payments problem. If an agreement on these and an appropriate 'stabilization programme' is reached, it is set out in a 'Letter of Intent' to the Managing Director of the Fund, signed by the Governor of the Central Bank and the Minister of Finance, and accompanied by a 'Technical Memorandum of Understanding'. These documents contain:

1. A qualitative description of the problems of the economy and the policies the government intends to follow.
2. The main quantitative targets, expressed as proportions of the GDP, for the balance of payments, the fiscal accounts, the monetary variables and the savings and investment accounts.
3. The quantitative ceilings, or 'performance tests', which serve as conditions for drawings on Fund resources over the duration of the stabilization programme. These tests usually relate to the net international reserves and the net domestic assets of the central bank, and the net banking system credit to the public sector.

In reality, the process leading to such an outcome is a long and complex one, marked by subtle economic and political manoeuvring on both sides. Initial domestic resistance to an IMF stabilization programme must be overcome; sometimes this is achieved by changes of technicians, ministers or even governments. Strong and intense internal debate is often provoked on the issue—debate which is not exclusively or even mainly about the technical aspects of the programme, but is more about

its political repercussions and the overall orientation of the economic strategy that flows from it. The IMF officials, for their part, often adopt tactics designed to weaken the domestic opposition to such a programme and to strengthen the local constituency in favour of it. Support for the Fund's position by the transnational banks and the main western aid donors is also often a major factor in securing acceptance for its proposals.

Jamaica—the road to the 'IMF elections'

Jamaica provides such a revealing experience of the impact of the IMF relationship on the economic performance and political life of a Third World country that it is worth examining in some detail here. Since Jamaica is a parliamentary democracy with a functioning two-party system, active media, an articulate public opinion based on a wide spectrum of civic organization, and a socialist government flanked to the left by a small but vocal communist movement and to the right by a well-entrenched conservative opposition, its relationship with the Fund has in fact been under close national scrutiny for the better part of the past three-and-a-half years. The attitude of the PNP government has changed from one of initial defiance in 1974–76, to an uneasy truce in 1977, to accommodation in 1978–79, and back to defiance in 1980. The general election to be held later this year was called as a direct result of the failure of Jamaica's second IMF agreement in less than three years, and the IMF issue is likely to be a major one in the election campaign.

Analysis of the IMF diagnosis of the causes of Jamaica's balance of payments disequilibrium, as expressed in the IMF staff consulta-

tions and negotiations with the government over the period 1974–80, shows that there were eight items of economic policy or behaviour which were the subject of IMF concern at one time or another. Underlying these concerns, in the IMF's view, were three main issues: the level of real wages, the level of aggregate demand, and the degree of government intervention in the market. These can be presented as follows:

Item considered 'excessive' by IMF	Underlying issue as seen by IMF
wage increases exchange rate (over-valued)	Excessive real wage levels
fiscal deficit monetary expansion	
restrictions on trade and payments state economic activities price controls lack of business 'confidence'	excessive aggregate demand, boosted by excessive money supply
	excessive government intervention in the economy

In summary, the IMF diagnosis was that balance of payments disequilibrium was due to the uncompetitive nature of exports and that this was in turn due to the high level of real wages, too many imports owing to excess total demand, and distortions in resource allocation, as well as flight of capital, caused by too much government intervention in the market. But the analysis of actual economic performance in 1975–76 undertaken in the case study on Jamaica leads to the conclusions that:

1. Excessive imports were not a major factor in the widening of the deficit, as both the value and the volume of imports fell steeply in 1976.

2. Export reductions in 1975–76 cannot be attributed to the impact of wage increases, but rather principally to the reaction of the bauxite companies to the imposition of the production levy.
3. Capital flight was due to the adverse reaction of local and foreign businessmen to the reform programmes of the PNP.

The outcome of the IMF diagnosis, however, was that in order to secure resources from the Fund and its 'Good Housekeeping' seal of approval, the government would have to agree to a programme of adjustment whose main elements would be drastic cuts in real wages, severe compression of demand, and policies designed to appease the very social and economic groups that were diametrically opposed to its political programme.

The government's resistance to IMF proposals through 1975–76 and in early 1977, in the immediate aftermath of the general election, was mainly on the question of its wages and incomes policies and the related issue of devaluation. In early 1977, the government appointed a task force to prepare an Emergency Plan which would be an alternative to an IMF programme. The Emergency Plan emphasized tight control over foreign exchange outflows and imports, expansion of bauxite and tourism earnings, development of local agricultural production and small-scale activity to substitute for imports, and expanded trade with an assistance from the socialist countries. However, while the plan was being prepared, the foreign banks and local private sector put the squeeze on the government, threatening to lay off up to 50,000 workers in the manufacturing sector owing to shortage of imported raw materials. At the same time, the new Carter administration in the USA offered a package of assistance to Jamaica which was

conditional on the government reaching agreement with the IMF, while the Fund suggested that it was prepared to soften its position on the major points in dispute. With no clearly apparent alternative to recourse to the IMF, other than economic collapse, the government changed its position and reopened negotiations in April 1977. This initiated a period of bitter internal wrangling within the ruling party and a slide in its popular support.

In July 1977, the Fund agreed to a two-year stand-by programme for Jamaica which fell short of its own views on what was required in the areas of exchange rate adjustment and wages policy, but which, in return, insisted on a tight fiscal programme. In December 1977, having made one drawing of SDR 19 million amounting to less than 30 per cent of the credits approved, Jamaica failed one of the fiscal performance tests by a margin of only 2.6 per cent. One immediate consequence was that the Fund suspended the programme, insisting that Jamaica negotiate an agreement under the Extended Fund Facility which would involve major and drastic economic adjustment. Another was the dismissal of Minister of Finance, Deputy Prime Minister and PNP Chairman David Coore, who carried the political responsibility for the failure. In order to obtain the agreement (which was approved in June 1978), and in pursuance of it, major devaluations of the Jamaican dollar were carried out in January and May of 1978 and small monthly devaluations took place through to May 1979, giving rise to a total devaluation of 49 per cent by comparison with 1977. In addition, a package of J \$180 million of additional indirect taxes was imposed, price controls were lifted, and it was planned that the price level would rise by 40 per cent in the first year of the programme while wage increases were limited to 15 per cent.

The effect of these measures on living standards has been quite dramatic. In 1978 alone, real wages fell by an estimated 35 per cent, the share of labour income in the national income fell from 55.2 to 52.3 per cent, and average real per capita consumption declined by 13 per cent. In 1979, the decline in living standards continued, with a further fall in real wages of 5 to 10 per cent, and the state of the public services, especially in education and health, began to show serious defects. One senior IMF official was moved to comment that in every other country in which such a programme was instituted it had led 'either to the death of democracy or the overthrow of the government'. If neither happened in Jamaica in 1978-79, it was due to the reservoir of goodwill that the Manley government had inherited from the 1972-76 period, and its continuing efforts at communication and consultation with the people.

This Draconian programme of real wage reduction and demand compression did not meet, however, with economic success. The balance of payments deficit, after improvement in 1977, widened by US \$40 million in 1978 and by another US \$78 million in 1979, owing mainly to increases in outflows for interest and repayment on private and official debts. Export volumes have recovered very slowly and, despite devaluations, imports have been checked only by maintaining a rigid system of import licensing. Although payments surpluses have increased, private investment has not; the overall investment rate remains at about 12 per cent of the GDP, and real GDP declined at an annual rate of 2 per cent in 1978 and 1979.

In December 1979, Jamaica failed by a substantial margin the Fund's performance test relating to the net international reserves of the Bank of Jamaica and the Extended Facility

programme was suspended. The reasons for the failure related mainly to extraneous factors over which Jamaica had no control: oil price increases in 1979 in excess of what had been anticipated (21 per cent of the shortfall); higher international inflation and interest rates than expected (31 per cent); and flood rains which reduced agricultural exports (13 per cent). The balance of the margin of failure was due to errors in estimation by the Fund staff and Jamaican officials. The country also failed by a wide margin the test concerning the net banking system credit to the public sector, owing mainly to lower-than-projected inflows of foreign and local loans. But Fund officials defined the problem as one of fiscal mismanagement, and demanded J \$300 million in budget cuts (above 20 per cent of government expenditure excluding debt service) as the condition for a waiver of the performance tests and the approval of a modified agreement.

But this time the ruling party, only three years after the most decisive victory in Jamaica's electoral history since 1944, was trailing the opposition JLP by 41 per cent to 57 per cent in the opinion polls. In January, the government rejected the Fund's conditions for a waiver from the performance tests and in March it broke off the negotiations for a new stand-by agreement. The forthcoming general election will be fought on the issue of 'the IMF or the non-IMF path', perhaps the first election to be held anywhere in the world on this question.

Peru—a failed attempt to outflank the IMF

It may seem paradoxical, but the fact that there was a military government in Peru did not mean that the IMF stabilization programme for the country was any more palatable or easier to impose. In 1976, the govern-

ment of President Morales Bermudez differed from the Fund not so much on the nature of the required adjustment as on its speed. The government proposed a phased programme of changes over an 18-month period, while the Fund wished to have all the changes instituted at the very outset. The Fund was to adopt an identical position when negotiating with Jamaica in 1978, when the argument was couched in terms of the need for 'shock treatment' for the Jamaican economy. This position is probably based on the judgment that the longer the period of time over which unpopular measures are introduced, the greater the build-up of social and political resistance and the lesser the chance of the government sticking to the programme. The political judgment is probably correct, but in practice this policy is inconsistent with the objective of an extended period of adjustment which the high-conditionality IMF facilities are supposed to support.

In response to this IMF position, the Peruvian government took the bold step of negotiating an IMF-type stabilization programme directly with a consortium of transnational banks. In return for a programme including an immediate 31 per cent devaluation followed by a regular monthly 'crawling-peg' adjustment, phased budget cuts and price increases, and an 18-month freeze on public sector wage claims, the consortium provided a loan package of US \$398 million. Had this agreement held, Peru would have made history by proving that the IMF was not indispensable. But, after four months, it began to come unstuck owing to special pay increases for the armed forces, a relaxed attitude towards budgetary expansion, and the postponement of certain programmed price increases.

By March 1977, the banks, which were unable to monitor the agreement, had suspended

it and demanded that Peru come to terms with the IMF before any new loans were made. However, it took eight months, two deadlocked negotiations and the resignations of two finance ministers before a stand-by agreement was finally negotiated and approved by both sides in November 1977. Within one month this agreement was inoperative, as Peru failed the very first performance tests under the programme in December 1977. This precipitated a general crisis of confidence resulting in the refusal of the banks to proceed with discussions on refinancing, a flight of capital, the mushrooming of the black market in Peruvian *soles*, loss of exchange reserves, and a general discrediting of the government.

The failure of performance tests within a month of the start of an agreement calls into question the technical expertise and judgment of IMF staff responsible for determining the content of these tests. In Jamaica, in 1977 and again in 1979, performance tests were failed within six months of being fixed, the latter by a very wide margin indeed; and a major factor in the Jamaican government's rejection of a new stand-by agreement in March 1980 was the conviction that the tests proposed by Fund staff would be failed by September. But the question also arises whether these 'technical mistakes' might not be to some extent part of a political strategy. For, once a country fails its tests, its government is discredited, both in the eyes of its own people and in those of its international creditors. A crisis is precipitated, the government's position is weakened, and the Fund is able to make demands upon it for harder adjustment.

In Peru, it was not until several months later, in July/August 1978, that a new stand-by agreement was successfully concluded, under yet another Minister of Finance. It was followed by a credit agreement with a consortium

of international banks, explicitly conditional upon the government's adherence to the IMF agreement. If the IMF stand-by is now 'working', the reasons have much more to do with the rise in copper and silver prices on the world market and growth of Peru's petroleum exports in 1978 and 1979 than with the efficacy of the monetary and fiscal contraction and further exchange rate devaluation which Peru has had to undergo. In any case, by this time, the ideals and the programme of socio-economic reform of the generals who made the 1968 revolution had given way to the imperatives of 'sound economic management'.

Portugal—democratic planning defeated

Faced with the rapid deterioration in the foreign exchange situation in 1974–75, the socialist minority government in Portugal began to take a series of IMF-type measures from the beginning of 1976. The *escudo* was devalued by 18.4 per cent in 1976 and by a further 27 per cent in 1977; interest rates were raised by 5.5 per cent in 1977; both direct and indirect taxes were raised through 1976–77; price controls were relaxed and wage ceilings were imposed. However, the balance of payments deficit worsened in these two years. The trade gap increased to US \$2.6 billion in 1976–77, a substantial part of which was due to underinvoicing of exports (an estimated US \$200 million in 1977) and speculative build-up of stocks of imported goods (estimated at US \$260 million in 1977). Remittances from emigrants also fell by another US \$65 million in 1976 and speculative activity in reaction to the political changes continued to destabilize the balance of payments. Towards the end of 1977, the government appealed to the Federal Republic of Germany and the USA for a massive 'Marshall Plan' rescue operation for the Portuguese

economy. As in the case of US aid to Jamaica, earlier in the same year, the answer was that such assistance would be conditional on reaching agreement with the IMF.

The IMF programme for Portugal, which commenced in March 1978, intensified the measures which had been instituted in 1976–77 on the advice of Fund officials. The principal measures included a further 15 per cent devaluation during 1978, further increase of interest rates to 22 per cent, additional taxation and removal of subsidies, restrictions on wage increases, limits on domestic bank credit and on new foreign borrowing, and removal of import surcharges and import controls. In 1978, speculative activity was checked, net capital inflows and remittances from emigrants increased, and a small surplus was recorded on the balance of payments. But the merchandise trade deficit remained very high, at US \$2.4 billion, since trade performance remained relatively insensitive to exchange rate changes.

'Correction' of the balance of payments deficit was achieved at high economic, social and political cost. The overall rate of GDP growth has continued to decline through 1978 and 1979, several critical intermediate and capital-goods sectors are experiencing stagnation, and overall investment declined in real terms in 1979. These trends are a direct result of the severe compression of the domestic economy which is an objective of the programme. Inflation increased to a rate of 25–26 per cent in 1979. Real wage reductions have been quite dramatic, amounting to 30 per cent in industry and 22 per cent for males in agriculture by the end of 1979, in comparison with 1975. A drastic process of income redistribution from urban and rural workers to groups associated with foreign trade (importers and exporters) and certain sections of the old ruling class has

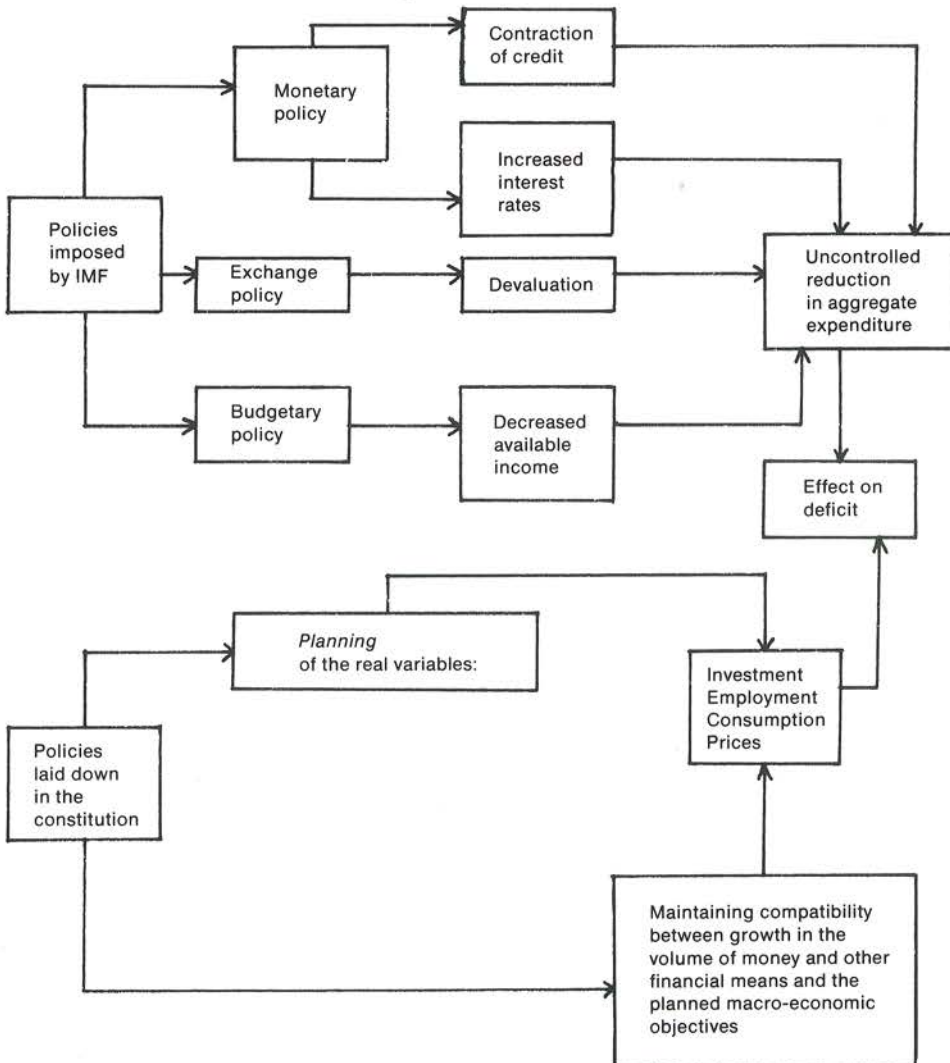
taken place.

Both the devaluation-cum-compression policies of 1976–77 and the IMF programme were strongly opposed by political elements within and outside the Socialist Party, as well as by sections of the independent intelligentsia. The position of these groups was that the acknowledged need for containment and reduction of the balance of payments deficit should not be met by techniques which, in effect, destroyed the gains made since the revolution by the most exploited social sectors and restored the economic pre-eminence and ultimately the political power of the parasitic classes. The alternative approach advocated was one in which the principal macro-economic variables affecting the balance of payments would be subjected to planning, and such planning would also be an instrument for the medium-term transformation of the economic structure in ways which corresponded to the on-going process of political democratization. Schematically, the mechanisms of the IMF adjustment process are contrasted with those of the alternative approach in the figure on the opposite page.

The Socialist Party, however, had entered into a range of domestic and international commitments which rendered it incapable of the political firmness and coherence needed to proceed on such an alternative path. Thus objections to specific proposals of the IMF could not be sustained because of the absence, within the context of the politics of the party, of an alternative option. While the Letter of Intent of March 1978 did refer to the underlying aim of 'overcoming the structural problems of the economy' through a 'medium-term programme', and work began on a four-year development plan, in practice this was superseded by the actual programme of short-term adjustment through monetary and fiscal meas-

ures. The inevitable political consequence of this programme was the defeat of the Socialist Party in the general election of December 1979.

Figure 1 The democratic planning approach versus the IMF adjustment process (from the Portugal Case Study)



5 Conclusions

IMF stabilization programmes do not suit Third World circumstances

Ismail-Sabri Abdalla's paper has shown how the congenital defects of the IMF have prevented it from providing appropriate treatment for the structural deficits of Third World countries. The preceding synthesis of three case studies has illustrated that argument, emphasizing the irrelevance of IMF stabilization programmes to the new kind of payments deficits which have emerged since the early 1970s in the non-oil Third World countries and others facing comparable problems.

Similar conclusions were reached by the 'Dell Report', which is based on both an analysis of global variables and case studies of 13 Third World countries. What is more, the IMF staff have derived similar conclusions from their own analysis, outside the context of negotiations on specific country programmes.

In December 1978, an economist on the staff of the influential International Trade and Exchange Relations Department of the Fund published the results of his research on 21 stand-by arrangements with 18 member countries between 1973 and 1975. He found that:

...The magnitude of the balance of payments disturbances and the existence of strong external factors seriously affected the design and implementation of the programs. As a result, of the 21 programs under review, only 7 are considered successful, and even then only with some qualifications.⁷

This 33 per cent rate of 'success'—relating to criteria concerning balance of payments, economic growth and inflation—was much lower than that emerging from a similar analysis by IMF staff of stand-bys in the period 1963–72.

Referring to the success of IMF stand-by

programmes in improving the borrowing country's balance of payments, the 1978 study found that while there had been improvement in 14 out of the 21 cases, in only three of these had the programme been put into effect. In the other 11, the improvement was due to factors independent of the country's control. Moreover, there were three other cases in which the balance of payments had deteriorated despite the full implementation of the stand-by programme.

It may also be noted that the Executive Directors of the IMF, while stating that the current account deficits of non-oil countries were expected to rise by US \$22 billion between 1977 and 1979, pointed out in their *Annual Report* for 1979 that:

...Of the \$22 billion rise implied by the estimates shown... some \$16 billion would be attributable to deterioration of the terms of trade of these countries, whose export prices did not keep pace with prices of their imports in 1978 and are expected to lag again in 1979, while about \$6 billion would reflect increased net payments of interest and other forms of investment income.⁸

Yet the Fund continues to promote stabilization programmes based on the premise that any individual country's deficit is due to excess money supply and an overvalued exchange rate. It is little wonder that Third World countries still continue to avoid the IMF's conditional credit facilities in spite of their growing difficulties. In 1979, an internal review by the IMF of the operations of the Extended Fund Facility showed that, of the three countries to make use of the Extended Facility prior to Jamaica, two (Mexico and Kenya) stopped drawing as soon as their ex-

port performance improved as a result of exogenous factors and the other (the Philippines) registered a continued adverse performance in spite of fully implementing its programme. Jamaica, as we have seen, abandoned its programme in spite of the obvious difficulties and uncertainties that the absence of much-needed credit necessarily implies.

The IMF is not politically or ideologically neutral

The IMF claims that its programmes are of a purely technical nature, and are ideologically and politically neutral. Given the evidence to the contrary, the IMF should not be allowed to continue to make this claim. In the discussion of the cases of Jamaica, Peru and Portugal, the changes of ministers and of whole administrations associated with the consequences of IMF intervention, the political stand of the Fund Staff concerning the need for 'shock treatment', and the possibility that performance tests might be used to enhance the Fund's political leverage and discredit the government have been noted. More broadly, IMF programmes are very evidently based on the ideology that the price mechanism and the market system are intrinsically superior to planning and physical controls in the allocation of resources, and hence in dealing with the problems of development.

Not only have the vast majority of countries—industrialized as well as Third World—found that the implementation of a development strategy unavoidably requires a considerable degree of state intervention in economic processes, but most countries also regard this presumption of the IMF as an unwarranted imposition on their discretionary and sovereign authority to address their problems with the particular combination of meas-

ures which they believe suits their circumstances. It is quite absurd to pretend that IMF-type programmes are politically neutral. Their logic is evidently to support the socio-economic groups which control capital, property and finance and which are therefore in a position to take advantage of the 'market'. This necessarily leads to, and in fact requires, the entrenchment of these groups in the centres of political power. It is no accident that in the widely varying conditions of Peru under progressive military rule, post-fascist Portugal and PNP-led Jamaica, the political result of IMF stabilization programmes has been the same: the discrediting of processes of economic and social restructuring aimed at improving the lot of the deprived majorities and the strengthening of the position of the conservative opposition to the governments and to the personalities who have attempted to implement these processes. One has only to compare the Fund's treatment of these cases with its intervention in Christian-Democratic ruled Italy to realize that the IMF cannot justifiably claim that its policies are even-handed.

We need a new approach to balance of payments adjustment

What is required is a theory and strategy of adjustment to balance of payments disequilibrium which takes into account the fundamental origins of the deficits and which places such adjustment within the perspective of a longer-term strategy of economic and social transformation. The use of physical controls and planning—in foreign exchange allocation, import budgeting, and credit and investment budgeting—will necessarily be a major instrument in such a strategy. The development of agriculture, industrial activities and energy industries which make maximum use of local

resources and develop national technological capabilities must also be sectoral priorities. There will be no option but for the state to play a dynamic role in this process, for the traditional mercantile and speculative groups that tend to dominate private sector activity in many countries have shown a poor capacity for economic transformation. Ample room should be left, however, for innovative private sector activity, especially that which shows a potential for democratizing economic decision-making and spreading income more equitably, such as small- and medium-scale activity, and cooperative and self-managed enterprises.

Balance of payments assistance that is made available should be designed to support such an adjustment process. What is at issue is not the need for some form of conditionality, but its nature. Conditionality which throws the burden of adjustment on the poor deficit countries, and on the poor within these countries, through demand compression and real income reduction is neither equitable nor appropriate. Conditionality which weakens the capacity of the government to plan for transformation and to manage the economy in support of this process, while it strengthens those socio-economic groups which are tied up with the traditional structure of dependent underdevelop-

ment, actually worsens the condition it is supposed to alleviate. The conditionality needed, therefore, is one which facilitates the linking of balance of payments adjustment to a strategy which addresses the structural requirements of development and viability, and strengthens the ability of the government and the country as a whole to pursue successfully the programmes which flow from this. A new form of conditionality must be one of the elements of a programme to reform and restructure the international monetary system.

Notes

1. IMF, *Annual Report*, 1979, Table 8 and *Annual Report*, 1976, Table 9.
2. Data from *The Balance of Payments Adjustment Process in Developing Countries: Report to the Group of 24* (Dell Report), UNDP/UNCTAD Project, INT/75/015, pp. 2, 1-4 and 1-7.
3. Dell Report, paragraphs 2-3.
4. *Ibid.*, paragraphs 19 and 22.
5. Calculated from IMF *Annual Report*, 1979, Table 8.
6. Quoted in *IMF Survey*, September 1979, p. 7.
7. Reichmann, Thomas, 'The Fund's Conditional Assistance and the Problems of Adjustment, 1973-75' in *Finance and Development*, December 1978, pp. 38-41.
8. IMF, *Annual Report*, 1979, p. 23.

Restructuring the International Monetary System

By Justinian F. Rweyemamu*

1 The Reasons for Restructuring—A Recapitulation

The paper by Ismail-Sabri Abdalla has surveyed the functioning and collapse of the gold-dollar exchange standard established at Bretton Woods and has shown how the concern of the founding fathers with the stimulation of economic growth led them to underestimate the inflationary proclivities of their creation. The paper by Norman Girvan has discussed, with reference to a few specific cases, the inability of the IMF to provide an adequate response to the structural problems of the majority of its members, the countries of the Third World. The conclusions drawn from this analysis are that the IMF, which has always lacked universality, having abandoned the principles governing its foundation—i.e. fixed exchange rates and dollar convertibility—has now lost both its efficiency and its legitimacy.

This evolution reflects a fundamental contradiction between the new structure of geopolitical interests which has been emerging since the 1960s and the structure of relationships embodied in the Bretton Woods system. That system in practice depended on the hegemony of the USA; the most powerful of the world's nation states, with a highly self-sufficient domestic economy, it appeared at the time to be relatively safe from the repercussions of economic breakdowns elsewhere. So long as there was confidence in the US dollar's unchanging value and the USA remained committed to its convertibility into gold, liquidity for international trade and finance could be ensured by the net outflow of dollars in such forms as military expenditure

and overseas investment by American corporations.

However, the faith of dollar holders in the convertibility commitment of the USA, and thereby in the gold-dollar exchange standard, depended on the USA's ability to offset these outflows with large trade surpluses to balance its payments account and thus to avoid running down its gold assets.** It also depended on the willingness of dollar holders to ignore the impact on domestic stability and export performance of US adventurism, e.g. in Vietnam. These conditions became increasingly difficult to meet due to the post war expansion of Western Europe and Japan, which was made possible by US financial aid and by the stability of the monetary system. Growing trade surpluses by the USA would have implied European and Japanese acquiescence in permanent industrial inferiority to the USA. This was obviously unacceptable to the former. Between 1945 and 1979, the share of the USA in total OECD industrial production declined from 60 per cent to almost one-third. A vastly increased US income from international services to offset deficits on other 'invisible' items, such as travel and overseas military spending, would have deprived Europeans of a large part of their traditional role as bankers and traders.

In order to maintain the system and its position in it, the USA attempted to persuade the surplus West European countries and Japan to revalue their currencies relative to the dollar. Faced with the failure of these attempts, the

* The views expressed by the author are personal and do not necessarily reflect those of the United Nations Secretariat, of which he is a member.

** However, if these surpluses were to become large enough to offset capital and invisible outflows, a different crisis would arise. With no dollars injected, reserves would stagnate, depressing trade and production.

US administration under President Nixon concluded that these countries would only be persuaded to revalue 'adequately' by a continuing accumulation of inconvertible dollar balances. As a result, in the words of the RIO Report, world reserves in terms of US dollars 'more than doubled from the end of 1969 to the end of 1972, increasing over this short span of three years more than they had in all previous years and centuries since Adam and Eve'.¹

By closing the gold window and devaluing the dollar—unilateral actions which repudiated previous commitments—the US government in August 1971 put an end to the dollar's function as an unchanging standard of value. These actions led inevitably to the gyrations and eventual breakdown in March 1973 of the par value system. Moreover, by undermining public confidence in the management of the international monetary system, this breakdown contributed to the inflation syndrome. Confidence in money, once undermined, is not easily restored.

Attempts at full-fledged reform of the international monetary system in the framework of the IMF Committee of 20 (1972–74) were unsuccessful. The official explanation was that the timing was inopportune, that the unsettled state of the world economy—including the onset of world-wide inflation, the breakdown of the par value system and the increase in the price of oil—was not conducive to agreement. A gradual approach to reform was preferred. According to this optimistic view, gradualism would allow the different parties to settle their differences and provide time for the new regime of floating exchange rates to function.

The issue of monetary reform since then has been on the back burner. There is no doubt today that the optimistic prognosis summarized above has been proven wrong. The present *ad hoc* arrangements, far from ushering in

an era of exchange rate stability, have been marked by substantial exchange rate volatility. This has usually been caused by factors operating in the financial markets, often quite independently from and almost always more violently than the basic long-term factors affecting international trade. In any case, floating could not have worked as anticipated by its adherents, as it reflected an unresolved conflict between the major western powers as to appropriate relative parities and corresponding mechanisms for their adjustment. It confirmed the unwillingness of these powers to be bound by a minimum of conventions agreed upon by all.

Meanwhile, the USA has continued to flood the world with its liabilities. The combination of floating exchange rates with the size and persistence of the US deficits has tended to contribute to domestic inflationary policies in other industrial economies by practically eliminating any substantial loss of reserves by countries with floating currencies. The soaring gold price and the consequent revaluation of gold reserves added over 65 per cent to reserve increases between 1972 and 1978, to the benefit of the few countries where gold reserves are concentrated.* In fact, the major beneficiaries of this gold resurgence have been the USA and France—two countries which, though pulling in different directions, brought about the demise of the Bretton Woods system and subsequently devised the current arrangements for gold on the island of Martinique in December 1975.

These developments have tended to shift the burden of adjustment even more dramatically than before to the non-oil Third World and smaller industrialized countries. The recycling

* See Table 1, page 44. Seven OECD countries hold 75 per cent of world gold reserves.

process, as it has worked so far, has not implied a real relative resource shift in favour of the Third World. And the USA's freeze of Iranian assets, by striking at the heart of the existing dollar-based international monetary system, including the Eurocurrency market, has awakened the interest of major asset holders in the reform of the system. The aborted negotiations on a substitution account, which would by implication have officially conceded a reduced role for the US dollar, and the 'Programme of Action on International Monetary Reform', submitted by the Group of 24 and endorsed by the Group of 77, can be used as means to reopen the way for the restructuring of the monetary system, even though in their present form they are incompatible.*

The critical questions in restructuring the system are political: the form in the organization which can encompass the interests of participants with differential power while submitting them to a symmetrical adjustment process; the choice of the mechanisms for

creating and distributing the international means of exchange (liquidity); and the nature of such a means of exchange which must be both a standard and a store of value.

What is needed is a fundamental restructuring based, as was stated by Ismaïl-Sabri Abdalla, on two foundation stones:

1. A universal and democratic world central bank, accommodating the needs of different development patterns and economic and social systems.
2. An international currency unit, based on real values and acceptable in international payments.

However, since the construction of such a new system is likely to be a long process, a number of urgent reforms need to be carried out within the existing framework, especially—but by no means only—in order to meet the pressing needs of Third World countries. The following pages include some proposals towards these ends.

2 A World Central Bank

Geopolitical framework

Experience with the gold exchange standard, in its interwar and post-1945 manifestations, leads to the conclusion that the future international monetary system should have a pluralistic basis, in which no single political entity plays such a predominant role that it can jeopardize the freedom and interests of others. Moreover, it should not be a conventional

* The use of IMF gold to underpin the substitution account is not acceptable to the G.77 or the G.24. No set of basic changes not addressing their priority concerns is likely to be perceived as acceptable by a substantial number of Third World countries.

multilateral system, since such systems tend either to be a cover for hegemony or to have little coordinating power. The ingenuity of international bureaucrats notwithstanding, their ability to resolve genuine conflicts among strong partners is extremely limited. Inevitably, the tendency for bureaucrats is to retreat from confrontations.

This suggests a need for serious innovation towards creating an appropriate institutional framework for the monetary system. A desirable international monetary institution would have to take into account the emerging global configuration of power, while providing reas-

urance that any country conducting its affairs with due prudence will be relieved of anxiety concerning its ability to meet its international liabilities if it should suffer payments deficits not of its own making. Furthermore, an effective institution would have to contend with the following reality: modern states will seek (with varying degrees of optimism and success) to retain control over their national economic environments and to regulate their participation in the international system so as to screen out disruptive external forces. This should not contradict the imperative of respecting rules which would encourage mutual restraint and good faith.

Institutional arrangements for international money constitute an international 'collective good', which has to be paid for in voluntary cooperation. In the absence of an international authority with legislative, regulatory and fiscal powers, the necessary sanctions must be built into the arrangements themselves, by denying specific benefits to non-members and transgressors. In this context, the new monetary institution would have to be underpinned by automatic mechanisms organized around certain accepted rules of the game, particularly those pertaining to the creation and distribution of international currency and to the adjustment process.

The evolution of such an institutional framework would probably need to be based on the organization of its members—the world's nation states—in strong units or groupings, each capable of sustaining international equilibrium and prosperity as well as undertaking independent external relations. Such groupings are already emerging. The European Community is the most conspicuous, having gone so far as to establish its own 'zone of monetary stability'. There is also the CMEA (socialist European countries), with a multilat-

eral monetary arrangement assisted by the transferable rouble. And the Third World countries could, in the context of their mutual economic cooperation, establish a collective monetary arrangement. Indeed, they may well have no choice if they are to avoid remaining inferior partners in a competitive world. A viable geopolitical structure for monetary management might be based on the following elements: the USA, the USSR, China, Japan and the Pacific, the European Community, Eastern Europe, and the Third World—plus some smaller European countries. These groupings would not, of course, be immutable. But they would ensure that the leadership and management of the future international monetary system would be broadly based.

Banker of central banks

On this basis, a world central bank could be established to issue legitimate international money. It would be endowed with the responsibilities of the 'banker of central banks'. National central banks would keep with it a certain percentage of their liabilities as obligatory deposits. As a counterpart to this requirement, the world central bank would be obliged to provide loans to national central banks, according to rules to be decided by the main governing body of the institution, thus adding to world reserves. The bank would also harmonize short-term lending with medium-and long-term loans for development.

A necessary condition for the operation of such a mechanism would be a commitment by all countries, singly and within their groups, to enter into a general and collective undertaking that a country finding itself in a creditor position against the rest of the world should ensure that its creditor position would not exercise a

contractionary pressure on the world economy, and by repercussion on itself. Such a

commitment would naturally depend on the character of the reserve system.

3 A Commodity-Backed International Currency

No return to the gold exchange standard

Today's serious world-wide inflation is stimulated by the present international monetary arrangements and the monopolistic nature of the transnational economic system. The inflationary tendencies of the monetary system can only be checked by introducing an appropriate standard to replace the present eroded one. It is well known that every monetary system is based on a specific standard of value which determines its operational characteristics. Experience has shown that, when a standard does not ensure reasonably stable prices and a fair degree of justice in economic transactions, markets become atrophied. Moreover, economic activity tends to be misdirected by the purely artificial profits which an inflation-generating standard can obtain for some of its members, at the expense of chronically low incomes and employment opportunities for others. A return to the gold exchange standard is unacceptable because:

1. It is based on dominance-dependence relationships and therefore serves as a means of promoting imperialism.
2. It gives rise to a process of real resource transfer from countries holding claims in reserve currencies to countries issuing them.
3. It is inherently unstable, since the liquidity needs of a growing world economy can only be met through growing deficits of the reserve currency countries, inevitably ending in a loss of confidence in the latter.

Moreover, in the absence of a link with gold or

another real value, which has not existed for nearly ten years, there is no logical basis for deciding which would be the strong currencies in a restored gold exchange system.

A commodity-backed SDR

It was in response to the ever more apparent weaknesses of the gold-dollar exchange standard that the Special Drawing Rights were created. They were initially designed to supplement the existing reserve assets. Their wider purpose, which has yet to be realized, was to provide a secure and controlled base for world monetary reserves. However, the allocation of SDRs was dwarfed by the uncontrolled expansion of US dollar holdings, emanating from the ramifications of the Vietnam war and the programmes of the 'Great Society' (see Table 1, page 44). SDRs could become the centrepiece of the international monetary system—'the principal reserve asset' in the words of the IMF—only if they were given the role of determining the overall increase in global liquidity and used in the attainment of an improved adjustment mechanism.

The creation of SDRs was an important advance in the restructuring of the international monetary system. They are the only means of international payment established through international contract. In contrast, gold and reserve currencies are created by unilateral action (production and sale of gold, reserve countries' payment deficits) and their status is based primarily on custom. Thus the SDR represents a clear first step towards an inter-

national monetary system of which an internationally issued and controlled reserve asset would be a main pillar. In the search for a viable international currency, therefore, one may start from the basis of a concept which already exists: the SDR.

However, to acquire the attributes of an international currency, the SDR would have to be radically improved:

1. It should not continue to be a 'cocktail' of currencies.
2. It should have solid backing, redeemability and more automatic forms of issue limitation.
3. It should be equitably distributed and be an attractive enough asset to be held by countries in preference to other assets.
4. It should be issued by the world central bank whose establishment has been proposed.

A major advance might be to establish the SDR as a viable international standard and store of value, if it were valued in terms of commodities. The SDR could in that way be transformed into a commodity-backed international currency.*

* The idea of a commodity-backed currency is by no means new; several schemes have been put forward in this direction in the past. The commodity standard discussed below is derived from a 'theoretical commodities standard' which is composed of 'basic' commodities, i.e. a set of commodities which enter into the production of at least one other among them, associated in equal quantitative proportions to those in which they occur in current production methods. For practical purposes, the standard must meet a number of specifications, e.g. homogeneity, divisibility, stockability, definability, etc. It is such a combination of commodities that can unambiguously determine value.

How the commodity standard could work

The mechanism for issuing the commodity-backed SDR could work along the following lines:

- A 'commodity unit'—a basket of commodities which are 'basic', storable and in common use—would be established by international treaty. This could be done in the framework of a strengthened and greatly expanded Common Fund, which would have to be brought under the control of the world central bank.
- The relative amounts of the commodities included in the unit would be determined by their relative importance in international trade. The size of the unit would be such as to make it convenient for deposit and redemption.
- The value of the new SDR would be defined in terms of the commodity unit, in the same way as the value of the present SDR and national currencies used to be defined in terms of gold. The only difference is that the new SDR would be based on a bundle of commodities rather than on just one.
- The world central bank would fix the buying and selling prices for the commodity units, denominated in SDRs, with a margin of, say, 5 per cent between them. Purchases and sales of commodities by the Common Fund would be paid for in SDRs.
- The world central bank would issue legal tender SDRs against the deposit of the warehouse receipts, such as are currently dealt in on commodity exchanges, for commodities constituting one or more commodity units.** Conversely, the bank would surrender warehouse receipts in exchange for an equivalent amount of SDRs.
- In effect, the new SDR would be a warehouse certificate having all the desirable

characteristics of a gold certificate and gold-secured money—solid backing, redeemability, limitation of issue. These are important qualities lacking in the gold exchange system.

The SDRs issued would be fully covered by commodities (including gold), except for a fiduciary issue which could be fixed in amount (e.g. as a proportion of total SDRs outstanding) and could be in the form of loan obligations to members of the world central bank, i.e. national central banks. Initially, it would remain a deposit currency, held only by central banks of member countries; a wider role in the international payments could be envisaged once the system had gained acceptance. The fiduciary issue of SDRs should be 'linked' to development finance by being allocated to Third World members of the world central bank.

There would be suitable provisions for:

1. Periodic but infrequent changes in the composition of the commodity units, in accordance with shifts in the relative commercial importance of the various commodities comprising the SDR.
2. Defraying storage expenses.
3. Substitution, under stated conditions, of 'futures' contracts for the actual warehouse receipts.

If, for whatever reason, the market price of the group of commodities comprising the SDR should begin to fall below their initially-set

reserve value, any national central bank could buy the commodities on the exchanges or from the Common Fund, deliver to the world central bank the corresponding warehouse receipts and take the equivalent in SDRs. This would have the effect of supporting the market price of the commodities comprising the SDR, but as it would also increase the supply of money, it would tend to support the general price level. If, on the other hand, the price rose above their total redemption value, commodity units could be bought by central banks from the Common Fund and sold on the market. The currency thus redeemed would be retired. This would have the effect of lowering the price of specific commodities backing the SDR and, since it would reduce the supply of money, it would tend to check any rise in the general price level. The limits of fluctuations of the market price of the group of commodities in the SDR would thus be narrow, depending on the commissions and charges adopted and other costs of withdrawing and selling units or of assembling them for deposit in the reserve—altogether probably not exceeding 1 or 2 per cent.

The plan outlined above would not involve the fixing of the prices of individual commodities. What would be fixed directly and within narrow limits would be the aggregate price of the bundle of commodities in the SDR, but the relationship among the prices of individual commodities in the bundle would be free to vary. The procedure would be almost automatic, and would not involve the vesting of discretionary powers in any country or in-

** It would not be necessary to combine commodities in fixed proportions. They could be combined in variable proportions, but with purchase prices varying according to a rule such that an acceptable price index of what one SDR would buy (in terms of the included commodities) is exactly stabilized. In this way SDRs or warehouse receipts

could be issued when any single homogeneous commodity is tendered to the world central bank. For the mechanics of this, see Luke, Jon C., 'Inflation-Free Pricing Rule for a Generalized Commodity-Reserve Currency' in *Journal of Political Economy*, August 1975, Vol. 83, No. 4, pp. 779-90.

stitution for the management of the currency or for regulating the prices of production and consumption.

Benefits of the scheme

The main result of the commodity-backed SDR scheme would be the provision of a sound, solidly backed currency unit of substantially constant purchasing power, thus preventing the far-reaching and serious consequences of monetary inflation and deflation.

There could be other advantages, too. First, since exchange rate adjustment as a means of improving competitiveness in exports is mainly relevant to industrialized countries which export manufactured goods, a commodity-backed SDR would ensure that any industrial exporter which devalued its currency in terms of the international standard would bear the same real cost irrespective of whether it was a large or small country. For, in each case, the price of the value added by manufacturing would be lowered in the same manner in relation to the prices of industrial inputs or food, the basic wage goods of industrial workers. It can therefore be expected that countries would only devalue their currencies in terms of the international unit to the extent that the benefits gained thereby through higher exports more than offset the costs in the form of a deterioration of their terms of trade.

Second, a commodity-backed SDR would give producers of commodities included in the basket, taken together—albeit not necessarily producers of excluded commodities or of each included commodity taken separately—a steadily growing income in terms of international currency in proportion to the physical growth of production. In this way, the purchasing power of primary producers over industrial goods would increase in proportion to

the increase in their exports of primary products. The growth of demand for industrial goods emanating from the primary-producing sectors would set up multiplier and accelerator effects which would ensure that world industrialization would proceed to the maximum extent possible. It should be noted that global economic growth can only take place if there is a certain harmony between the expansion of the production of food and raw materials and that of the industrial or processing activities which absorb raw materials and food and convert them into finished goods. This harmony is threatened whenever industrial expansion runs ahead of raw materials production, or in the opposite case when the raw materials base runs ahead of the growth of industrial absorption. The latter causes a collapse in raw material prices, and in the past has normally tended to bring industrial stagnation in its wake. In the long run, a commodity-backed SDR, by encouraging stable expansion of the supply of raw materials, would promote world industrial production.

Another advantage would be its stabilizing influence on commodity markets, taken together and separately. The problems of commodity price fluctuations and their harmful effects on the economies of producing and consuming countries are well known. A commodity-backed SDR would not only dampen these fluctuations, but in the present inflationary world it offers the related advantage of an international liquid asset which is stable in terms of commodities. Countries whose domestic price levels rise as a result of inflation would thereby devalue their currencies in terms of the international unit. But the real value of the unit itself would not be affected by the inflation of individual countries. However, stabilization of the average price of a basket of major commodities combined with a broader

ranging Common Fund programme could have substantial stabilizing effects even for excluded and individual commodities. The greater the weight of basket commodities in trade and production, and the more 'basket' and Common Fund measures cause speculation in commodities to be perceived as unprofitable (and/or unnecessary), the greater this stabilizing spread effect will be.

Lastly, depending upon the composition of the commodity basket, e.g. if it included gold, a commodity-backed SDR could provide an incentive for the USSR and East European countries to participate in the international monetary system.

A commodity-backed SDR would be able to address the three problems that are hindering the viability and proper functioning of the international economy: inadequate growth of output and employment, persistent rise in prices, and instability of primary exports. These problems are interrelated. Under a fiduciary monetary system, wages and prices become unstable at high levels of employment because they are arbitrary—in the sense that they can vary in any way when they are expressed in credit money, the value of which is itself arbitrary. A commodity standard, on the other hand, has a physical cost in labour units and the inverse of this cost determines the wage rate expressed in that standard. It also has a user-value based on the utility of the commodities of which it is composed.

Difficulties to overcome

Having related all the advantages of a commodity-backed currency, it is necessary to recognize that it would not be easy to obtain acceptance for this idea, for broader reasons than the change it would obviously demand in central banking procedures, commercial

banking and treasury habits. The share of commodities in world trade has been declining. If the creation of the new currency were to depend only on commodity trade, it is likely that it would provide liquidity well below the needs of world trade. Commodities do not all lend themselves equally to a monetary function. If the basis for the new unit were limited to those commodities which fulfil the technical and economic requirements for stocking (i.e. non-perishable, homogeneous, not bulky in relation to value and not cartelized), then the price variations affecting the unit would not necessarily correspond with those affecting primary products as a whole. If, on the other hand, the range of products were widened by overlooking the imperfections in each of the markets concerned, the overall price movement of such a bundle might be unduly influenced by particular factors at work in the markets for the component commodities. In both cases, the stabilizing effect would be greatly impaired.

Other technical issues must also be faced, e.g. the composition of the commodity unit, the choice of the unit price, mechanisms for stabilization (fixed or moving), period revision of the unit (time and method), substitution of futures for spot under certain conditions (especially timing), absorption of reserves into commodity uses in the case of emergency, storage costs and transitional arrangements.

There is reason to believe that these difficulties can be overcome. What must be appreciated is that price changes for commodities, at least those used in industry, not only affect the economy of their producers but are also very sensitive indicators of industrial production as a whole. Commodity prices, therefore, are the best criteria for deciding on a speed-up or slow-down in the creation of international liquidity. It would, of course, be

necessary to subject the proposal for a commodity-backed SDR to the scrutiny of people with many kinds or expertise, but the priority now is to relaunch the idea—since, after all, it is not an entirely new one—and to ensure that it commands the attention of policy-makers. For, in the absence of such a broad and imaginative programme of commodity-cum-currency stabilization, there is a risk that the world economy will be pushed towards further currency chaos and a growing role for gold, with all the stagflationary dangers this entails.

Towards a global monetary and financial conference

These proposals for restructuring the international monetary system deserve serious consideration and elaboration. However, ingrained habits and preferences lead people to draw back from the quest for optimal solutions in favour of those that are seen as politically expedient and of proven administrative practicability, which do not demand drastic revision of prevailing beliefs or cast doubt on established procedures and bureaucratic prerogatives. In the kind of crisis in which the world finds itself today, the initial reaction by governments to innovative proposals is normally evasive. Dangers are denied, the

seriousness of the situation is underplayed, the event of the moment is read to conform with experience and to confirm orthodox remedies. Reiterated faith in established policy is advanced as a pretext for avoiding direct attack on the root causes of our problems.

This is due to several factors. There is the overpowering concept of national interest that blurs the vision of mutual interdependence and hampers attempts to solve common problems. The daily struggle of governments to meet the concerns of ever-anxious political constituencies leaves little time for global concerns in their full complexity. But underlying all these concerns, and inhibiting action, are doubts about the proper shape of any new arrangements and their implications for the distribution of net benefits. And there are great conflicts of interest, since different monetary arrangements are bound to benefit participants in different degrees, reflecting the structure of power at the inception of those arrangements. The path towards monetary restructuring will be long and tortuous, but that is no reason not to set out on the journey, indeed it is a reason to begin now. The first step should be for the General Assembly of the United Nations to convene a global conference on international money and finance.

4 An Immediate Need—Official Resources for Third World Adjustment

While the process of negotiating the fundamental changes needed in the international monetary system is unfolding, a number of urgent measures should be taken within the existing institutional framework to meet the pressing needs of Third World countries for adequate adjustment assistance.

The growing power of private credit

The monetary problems of Third World countries have not been resolved by the Second Amendment to the Articles of Agreement of the IMF. Adjustment now depends on the private credit markets and, for the key currency countries, on floating exchange rates. For

countries which were initially regarded as credit-worthy by the market, the intermediation of the international banking system, in the absence of significant flows of official finance, has been timely and useful. But the capacity of commercial banks to meet international liquidity needs is clearly limited. Liquidity is inevitably allocated in a discriminatory way; countries in weak positions—however responsible their economic management—have little or no ability to borrow in international markets on commercial terms or can do so only at high cost. Moreover, lending through private banking and capital markets suffers from crises of confidence since, as recent experience demonstrates, they tend to overlend when times are good and to underlend in times of greatest need. Market credit also tends, because of its terms, to exacerbate the problems of servicing and refinancing debt. The supply of reserves from the market is in the form of national currencies, through a transnational financial network which is very imperfectly subject to international monitoring, let alone control. Market-generated liquidity is inevitably concentrated in those countries which have access to it and are able to pay for it; it does not conform to actual reserve needs. In the past few years, this discrepancy has been exacerbated by the revaluation of gold reserves.

An added element of concern on the part of Third World countries has been that this expansion of the role of the private financial markets appears to be viewed by the leaders of the present international monetary disorder as an important substitute for official regulation and not merely as a supplement.* The market is seen by them to provide the necessary

discipline and pressure for adjustment, as well as a responsive mechanism—operated automatically by the ‘invisible hand’—to meet demands for international credit and reserves. Consequently, official action in these spheres has come to be perceived as having a secondary role. And such supplementary official action as is taken is being concentrated on facilities which themselves put maximum emphasis on discipline and adjustment, i.e. high-conditionality windows such as the Extended Fund Facility and the Witteveen Facility rather than freely available additional reserves.

Expanded finance for structural development deficits

The present processes of adjustment to international imbalances are clearly inequitable. There is inequity not only between surplus and deficit countries and on account of the privileged position which the USA continues to enjoy in spite of repudiating its commitments, but also between the treatment of deficit countries with access to private capital markets and those which do not have such access. The major burden of adjustment is placed on those poor countries which have to make use of IMF conditional resources; the short repayment periods and the rigorous conditionality of such finance for ‘stabilization’ frequently lead to contractionary effects on these countries, conducive neither to stability nor to creating any basis for resumed growth or development. Official resources available for adjustment finance from the IMF and elsewhere must therefore be increased and the type of such resources must be related to the form of adjustment required.

As the discussion in the preceding papers by Ismaïl-Sabri Abdalla and Norman Girvan indicates, the IMF has been preoccupied with

* IMF quotas as a percentage of world trade have consistently declined from 16.2 in 1945 to 8.2 in 1971 and 4.3 in 1978.

bringing about arithmetic equilibrium in the balance of payments, hence its preference for monetary remedies which inevitably prescribe a short-term adjustment process. But it should be obvious that disequilibrium in the payments position of a country may be due to a variety of factors. Some of these may be reversible in the short run, e.g. fluctuations in crop yields owing to weather or demand fluctuations, misguided or inappropriate policy actions, or sudden changes in capital inflows. In such cases, the disequilibrium in the current and capital balance of payments is temporary and short-term adjustment programmes are appropriate. The overall level of Fund liquidity for such adjustment, other than for compensatory financing, is generally adequate, though appropriate quota changes must be made to ensure that these resources are available to countries which need them.

However, disequilibrium may also be due to long-term structural changes. These may be internal to an economy or external to it. The IMF acknowledged the existence of structural deficits in creating the Extended Fund Facility in 1974, but it erred in assuming that its normal type of stabilization programmes would work in treating internally-generated structural deficits, given a somewhat longer adjustment period. For, in the absence of a diversified and integrated national economy—which is the case in many Third World countries—the imposition of IMF-type stabilization tends to reduce consumption without increasing investment, thus worsening prospects for economic growth and structural change. Moreover, the magnitude of the resources available through the IMF for financing adjustment to such deficits is grossly inadequate. This is because the internal structural deficit of Third World countries is, in effect, a ‘development deficit’ and is related to the ‘trade gap’ which is a manifesta-

tion of the disparity between the rate of growth of the primary exports of the Third World countries and their imports of manufactured goods. What is required to bridge this gap is a substantial expansion of programme lending by existing institutions and the creation of a new one, such as the World Development Fund proposed by the Independent Commission on International Development Issues (The Brandt Commission). And the IMF should consolidate residual deficits in the form of medium-term loans.

A new facility for externally-induced deficits

In the last decade, however, externally-induced deficits have acquired greater significance. The unprecedented world price movements of the 1970s (especially in capital goods, intermediate goods, oil and grain), the slackening of business activity and hence of import demand in the industrialized countries, protectionist restrictions imposed by (or at the insistence of) industrialized countries on manufactured imports from the Third World, major crop failure in a context of low world grain reserves, and structural factors tending to cause surpluses in the balance of payments of some countries are among the new phenomena confronting the non-oil Third World countries. These new factors suggest that the traditional stabilization measures aimed at reducing excessive aggregate demand are unlikely to be either effective or appropriate. They also call for large financial resources and low-conditionality access to them.

Action to remedy externally-generated deficits must be taken jointly by the surplus and deficit countries. Yet, under present arrangements, no machinery exists to relate the rate of adjustment of deficit countries to that of surplus countries. Indeed, surplus countries are

not called upon to adjust at all. When only deficit countries are required to adjust, they are invariably forced to deflate their economies. These individual actions contribute further to global deflation. It is in the interest of the world community to provide a multilateral means for intermediation between surplus and deficit countries. This could take the form of a new facility in the IMF with automatic access, minimal conditionality, flexible repayment terms and an interest subsidy element for the poorer countries. There is already a precedent in the 1974-76 Oil Facility, or was this only possible and proper because it was the industrialized countries which were then faced with collapse?

Changes in IMF mechanisms

In addition to the new sources of finance proposed above, whether outside or inside the IMF framework, there is a need to change present IMF mechanisms to make them more equitable and supportive of Third World adjustment to payments deficits. One set of changes should be in the spirit of 'linking' liquidity creation to development needs, facilitating the transition to the restructured monetary system discussed above.

A first proposal concerns the size of *allocations of SDRs* (in their present form) and, more fundamentally, the rules for allocating them. The next issues of SDRs should be significantly larger than previous ones. This is a topical question, since the current issue of SDRs is due to be completed on January 1st, 1981. The argument that there is excess liquidity at present is not really convincing in the absence of some agreement on the appropriate valuation of gold as a reserve asset. SDRs should not be issued to reserve currency countries or to those with structural surpluses. Moreover,

since most industrialized countries have easy access to other sources of liquidity, SDRs should be issued essentially to Third World deficit countries.

Related to this proposal is the broader suggestion that there should be a change in the *criteria determining the allocation of all IMF resources*. At present, access to Fund resources is based on the country quotas. The original method of calculating these was determined by considerations relating to contributions. National income and reserves were important elements in the original formula, thus ensuring a large contribution from the USA. Although the formula has been modified since then to give smaller countries a larger share in the Fund, it still results in the biggest quotas going to countries in the least need of IMF resources.

The number of IMF members with strong economies, freely usable currencies and surplus positions has increased since Bretton Woods and, moreover, the IMF is able to create its own resources through the issue of SDRs. It should thus be possible to work out a scale of contributions in which the countries which were dominant at Bretton Woods do not have so great a share as at present.

Access to Fund resources, including SDRs, should be related to the criterion of 'adjustment cost', or relative economic vulnerability. Four structural attributes may be considered of particular importance in determining vulnerability: diversification of production, degree of industrialization, direction of net capital flows, and secular economic growth rate.

Thus, countries with a highly diversified production structure, a considerable degree of industrialization, large capital exports, and a high rate of economic growth over an extended period can be presumed to have relatively low

vulnerability. Countries with low scores on these tests would be considered highly vulnerable and thus in need of more resources.

This distinction between criteria for contributions and those for access to resources would imply, of course, a complete change in the present quota system and, consequently, in the distribution of voting power in the IMF.

Similarly, the Fund's rules for the *Distribution of benefits from the sale of IMF gold* should be altered to reflect different needs and access to alternative ways of meeting them. Under present arrangements, the IMF restores to all its members, at the old official price, half of the gold released for sale and sells the rest on the market. The profits from the latter sales are either given or lent to Third World countries.* All the remaining IMF gold should be sold for the benefit of Third World countries, with no further restoration of gold to members.

Such an improvement in the present arrangements would be in the spirit of the agreements reached by the Interim Committee in Kingston, Jamaica, in January 1976. It would compensate Third World countries more equitably for their inability to profit from the rise in the price of gold through revaluing gold reserves (since they hold very little) and it would help to make up for the dampening effect of reserve revaluation by gold holders on the size and frequency of SDR allocations. There is no doubt that, if world reserves had increased through SDR allocations, as was generally agreed upon by the Committee of 20, then, even in the absence of an 'SDR link', the reserve position of most Third World countries would have been far better than today. This can be confirmed by recalling that in May 1975—when the official gold price of US \$35

per ounce still prevailed—the Group of 10 and Switzerland held US \$37 billion worth of gold and US \$70 billion of foreign exchange reserves. The rest of the IMF members held US \$7 billion worth of gold but US \$68 billion of foreign exchange reserves, mostly in US dollars.

Finally, the IMF must address itself to ways to become more effective in bringing about *adjustment in surplus countries*. This is something it may in principle do under its present rules. The world economy will always produce payments imbalances and in the immediate future they are likely to be more severe because the costs of energy, capital goods and grains are likely to increase and the terms of trade for other primary producers to worsen. But deficits have their counterpart in surpluses. The situation whereby only the adjustment measures of deficit countries which turn to the IMF for credit are internationally enforced is neither equitable nor economically efficient. It jointly maximizes inflation and unemployment while minimizing growth and development. The IMF's 'surveillance' function should include ensuring that countries with persistent current account surpluses make their resources available on a long-term basis, and preferably in a multilateral framework, to deficit countries which are undertaking needed adjustment.

The willingness of surplus countries to accept such adjustment, as well as to agree to a reduced share in SDRs and other Fund resources, will presumably depend on the acceptance by the USA of 'asset settlement', i.e. the principle that its outstanding liabilities in dollars should be redeemed in gold or hard currencies.

* See page 47.

5 A New Form of Conditionality

Additional resources alone would not be enough to improve the efficiency and equity of the adjustment process of the Third World countries. The rules and practices of IMF conditionality in the use of its resources need to be changed to achieve that aim. Fund conditionality is used as a lever to open Third World countries to private capital. This new invasion of the sovereignty of these countries must be condemned and IMF members must be urged to insist that the Fund should not abuse its status as a multilateral institution and its access to sensitive governmental information in the interests of transnational banks.

It is both inevitable and legitimate for a lending institution to impose conditions on members who borrow from it. A degree of conditionality is acceptable to borrowers. But, over the years, the IMF has imposed such rigorous and undifferentiated conditions that deficit countries have underutilized its conditional facilities or made use of them too late, preferring credit from the private international banks wherever possible. The philosophy of adjustment which permeates the IMF thinking must be radically changed. To say this is not to overlook the recent attempts by the Fund to review its conditionality, as reflected in the new guidelines adopted in March 1979. But there has been little practical demonstration since then of the Fund's endeavour to 'pay due regard to the domestic, social and political objectives of member countries'.

The credit conditions of the IMF are based on the presumption that balance of payments problems are a result of too much domestic demand, brought about by the proclivity of governments to expand the supply of money and credit, and can therefore be solved by balancing the budget, curbing the money sup-

ply, cutting subsidies, liberalizing imports, and setting a 'realistic' exchange rate. The Fund normally prescribes a one-year period to reverse such disequilibria. It has been shown, however, that there are different types of disequilibria. When disequilibrium in the balance of payments is not reversible in the short run (even if in part due to mismanagement), the viability of an adjustment programme must be measured not in terms of success in achieving a balance at any level of activity in a short period of time, but in terms of how and at what levels such a balance is restored. Past mismanagement may justify requirements to change in a way consistent with the state's goals, but not total denial of access or insistence on sweeping political economic strategy and goal reversal.

Moreover, the imposition of certain measures, such as the liberalization of controls on foreign exchange and imports, on countries deficient in foreign exchange seems paradoxical. Of course, the establishment of a 'realistic' exchange rate is a corollary of import liberalization. The increased demand for foreign exchange drives the price of foreign exchange up and that of the national currency down. The stabilization package, with its anti-growth bias, can thus be understood only if it is perceived as a means of encouraging imports and foreign investment, and not necessarily as a support for development. This is the ideological orientation of Fund conditionality which many member countries resent. And, as there are countries with a different political, social and economic structure, where allocation of resources takes place in a different way, such a framework is neither ideologically acceptable, socially workable nor economically efficient.

The IMF should abstain from detailed

regulation of the economies of members seeking resources for structural adjustment. It should not, for example, automatically seek to impose a restructuring of prices, including interest rates.* It should, on the contrary, endeavour to place the process of adjustment in the context of maintaining and speeding up economic and social development. This means that it should not prescribe deflationary adjustment, including devaluation, unless it justifies such action with an assessment of its probable consequences on income distribution, employment and social services. There are two reasons for stating this. First, economic growth performance shapes the profit expectations of investors and it is easier for a country to eliminate a structural deficit if investment is running at high levels. Second, a successful record of growth has an impact on access to private financial markets. It influences bankers' estimates of a country's prospects and determines the extent of the availability of financial resources to carry out balance of payments adjustment.

Stabilization programmes should explicitly address the question of ensuring consistency between short-run and long-run objectives. And an effort must be made by the Fund to determine broadly the extent to which a potential or actual balance of payments deficit is due to factors within the responsibility of the country concerned, as against factors beyond its control, including structural and persistent surpluses in the balance of payments of other countries. This distinction should be taken into

account in determining the magnitude of adjustment, the amount of balance of payments support required, and the measures and policies to be adopted as a condition for drawings on the Fund.

There is, moreover, a strong case for greater flexibility in the application of general principles and the administration of performance criteria. Many Third World countries have complained that the IMF uses an almost medieval bargaining technique in negotiating programmes. It tries to extract maximum concessions, when it should aim at offering a country a choice in terms of the speed of adjustment. Many countries also feel that a number of the Fund's staff members lack sensitivity to political and social realities, which in the last analysis provide the constraints within which technical considerations can prevail. Their rigid doctrinaire approach may be due to the 'in-breeding' which is a feature of career service, with direct recruitment of staff from the universities and promotion from below. There is a need for greater understanding by Fund staff of development problems. To this end, Fund management should make a start in recruiting staff members among national policy-makers or other social actors in Third World countries. Political and social considerations are always given great weight when national economic decisions have to be formulated and such experience should help to enrich their analysis and advice as Fund staff members.

A special problem exists in respect of Fund performance tests or trigger clauses. These are usually based on inadequate data (all there is in Third World countries) and on very imprecise projections, e.g. of export and import prices. Yet they are set as rigid single figures with little or no margin for error and with no automatic adjustment in the case of external

* This is not to argue that price adjustments are always inappropriate or unnecessary, even in socialist economies. Except in a pure rationing/material balanced economy, 'getting the prices right' is an important consideration. But it is neither the only issue nor one necessarily soluble by the use of free market mechanisms with no subsidies, special taxes or physical controls.

shocks unforeseen either by the country or the IMF at the time they were formulated. This is hardly good analysis, much less sound policy-making. A range of target variable levels, more stress on overall performance, and provision for adjustment to take account of unforeseen adverse external developments should be introduced into performance criteria.

Finally, an independent dispute resolution mechanism is needed. At present, the IMF staff and/or Executive Director are prosecutor, judge and jury in respect of failed negotiations and failed performance tests. This is hardly a pattern in which justice and equity are likely to be served, much less seen to be served. An independent body of experts with its own staff and budget and with access to relevant IMF and country papers should be created to hear, mediate and/or arbitrate disputes. Ideally, its findings would be binding on the Fund and the state.

Conclusion

In sections 4 and 5 of this paper, a package of reforms of present monetary arrangements has

been put forward—new sources of finance, improved IMF mechanisms, more flexible conditionality. The implementation of these reforms would significantly enhance the capacity of the IMF to respond to the needs of its members. But, even if the entire package were to be adopted, it would not amount to the construction of a new, universal monetary system. It would not fill the vacuum left by the disappearance of the system set up at Bretton Woods. The establishment of such a new system must, therefore, be an overriding political aim. A reform package is no substitute. A United Nations Conference on International Money and Finance remains a fundamental need.

Notes

1. Ndegwa, Duncan and Triffin, Robert, 'The International Monetary order', *Reshaping the International Order* (RIO Report), Annex I, P. 202. The pattern has continued. If gold is valued at US \$500 an ounce, 1980 reserves are at least four times those of 1972.

Comments on the Long-term Proposals for Restructuring the International Monetary System

The paper on the Restructuring of the International Monetary System was the subject of a long discussion at the South-North Conference at Arusha. Many different views were advanced and some of them have been taken into account in the revised version of the paper printed above. One of the participants, the Italian economist Luigi Spaventa, who is also a member of the Italian parliament, concentrated in his interventions on the three main issues—a World Central Bank, symmetry and a commodity-backed SDR—and put a number of queries, which, in his view, remained unanswered and upon which further elaboration seemed to be needed. Professor Spaventa has summarized the main points in his interventions for DEVELOPMENT DIALOGUE.

A World Central Bank

On page 78 it is stated that a World Central Bank (WCB) should be established to issue international money and to become a banker of central banks. The latter should deposit a percentage of their liabilities and the WCB would provide loans to national central banks.

My first query concerns the deposits of the national banks with the WCB: should they consist of national currencies or of foreign exchange reserves or of both in given proportions?

Next, what would be the counterpart of the assets thus acquired by the WCB? Drawing rights attributed to the national banks? In this case the mechanism of the WCB would be pretty much the same as that of the IMF and the same familiar problems of scarce currencies would arise.

The other possibility is that deposits denominated in an international currency—say the SDR—are created as a counterpart of the national banks' deposits in national currencies and foreign exchange reserves. Two problems arise here. The first concerns the rules according to which such deposits could be used as a means of settlement. The second and more important problem in the context of the paper under consideration concerns what relation such deposits denominated in SDRs would bear with the proposed commodity-backed SDR? Would

there be two sources of creation of international currency?

The issue of symmetry

This is an old issue. The paper correctly states the general requirement that creditor countries should not impose 'a contractionary pressure on the world economy' (see pages 78 and 88). Two problems are however left unsolved: one of definition, under the present conditions of international payments, and one of implementation.

If creditor positions are defined with reference to current balances, we should restate the problem to take account of the fact that, now and at least in the near future, almost the only countries running a current surplus will be some OPEC countries, whereas most industrialized and all the non-oil Third World countries will have heavy current deficits. Surplus OPEC countries have a structurally low absorptive capacity, so that the problem of their huge surpluses cannot be solved by asking them to grow faster.

Individual oil-importing countries, on the other hand, though running a current deficit, may still exert deflationary pressures on the world economy. This happens if an oil importer attempts to shift a part of its oil-caused deficit onto other countries by internal deflationary policies and/or by aggressive trade policies and open or disguised protectionism. With a surplus of over 100 billion dollars concentrated in a few countries, the mere existence of a surplus or of a deficit ceases therefore to be a criterion according to which the impact of a country's external position on the rest of the world can be judged.

This being the case, however, how are we to define the 'right' deficit which each oil-importing country ought to bear? The definition is impossible unless there is some agreement (a) on the desirable growth rate for the international economy and for the major countries and (b) on the way in which orderly financing of each country's current deficit can be ensured.

Unless there is some agreement on the first point, a reduction of the overall deficit may be brought about by recession. Unless there is an agreement on

the second point, and hence on the way in which the OPEC surplus is going to be recycled, competitive policies aimed at attracting capital flows to finance current deficits would eventually cause equally dangerous effects on the world economy: the interest rates wars now in fashion are no less disruptive than the exchange rate wars of the past.

The problem of implementing a true symmetry of obligations between deficit and surplus countries (however defined) has always proved almost intractable. The 'scarce-currency clause' was a cumbersome and inapplicable mechanism. More recent attempts at devising an objective indicator, undertaken in the course of the negotiations for the European Monetary System, have turned out to be not only operationally empty, but also technically useless.

A commodity-backed SDR

It is an old and fascinating idea, which can boast many famous supporters. As one gets down to details, however, a number of very thorny problems arise to which, I am afraid, the paper provides no clear solution.

The author envisages a 'commodity unit', made up of a basket of the most important traded commodities. 'The relative amounts of the commodities included in the units would be determined by their relative importance in international trade'. 'The value of the new SDR would be defined in terms of the commodity unit', just as the value of the dollar used to be defined in terms of gold. The WCB 'would fix the buying and selling prices for commodity units', within a margin, and would issue SDRs against the deposit of warehouse receipts for commodity units (page 80f).

The author claims that the plan 'would not involve the fixing of the prices of individual commodities': only the aggregate price of the bundle would be fixed, whilst 'the relationship among the prices of individual commodities in the bundle would be free to vary' (page 81). He claims at the same time that an advantage of such plan 'would be its stabilizing influence on commodity markets' (page 82f). Finally, he seems to imply a regime of fixed but adjustable parities between currencies.

Suppose n commodities enter the commodity unit (CU). Let q_i be the quantity of the i th commodity entering the unit. The

$$(1) \quad 1\text{SDR} = \sum p_i q_i \quad (i=1\dots n)$$

(or, supposing a 5% margin:
 $1.025\text{SDR} \geq \sum p_i q_i \geq 0.975\text{SDR}$)

The p_i 's are the commodities' prices in terms of the SDR. Only the q_i 's are fixed however, whereas, as explicitly stated, there is no intervention mechanism setting limits to the changes of the p_i 's. Of the n prices, $n-1$ can be freely determined on the markets, while the n -th price will be determined by constraint (1). There follow, then, two corollaries: (a) If the SDR prices of some commodities entering the CU rise, the SDR prices of other commodities entering the CU must fall; (b) The value weights of individual commodities entering the CU will change as relative prices change; as a result, the relative potential reserve position of individual commodity-producing countries would accordingly change.

One then fails to see the advantages of such a scheme for the Third World countries with respect to the present situation. As happens now, the rich would get richer and the poor would become poorer. For suppose there is one commodity—say oil—the selling price of which can be made to rise steadily, there will then be other less privileged commodities, whose SDR value will steadily decline. Those who would benefit most from the scheme would be the importers of commodities, since the combination of (1) and of fixed exchange rates would insure a stable average commodity price level. (Suppose the price of 'oil' rises and is expected to rise. Holders of SDRs would transform them into CUs; they would then store the 'oil' and sell other commodities entering the CU.)

The outcome would of course be different if either the $p_i q_i$'s were fixed or limits were set to the changes of the p_i 's and suitable intervention mechanisms were devised. In such case, however, it is highly doubtful that oil and gold producers would accept a scheme which would imply an external control on the price of those two commodities, if the latter were to enter the CU.

Irrespective of the above-mentioned difficulties, the scheme poses other problems, which are left unsolved and which I shall merely list.

Does the scheme imply compulsory asset settlement of a (commodity-backed) SDR-exchange standard? What relation would the commodity-backed SDRs bear to the SDRs issued by the WCB as a counterpart of national central banks' deposits? Would there be some kind of substitution account to

deal with the problem of overhanging international liquidity?

The proposed plan is bold and its philosophy may be attractive to many. May I suggest that its analytical foundations need to be strengthened and its operational implications deserve further considerations?

Luigi Spaventa

Background Notes on the International Monetary Fund*

Establishment

1. The establishment of the IMF, together with its sister institution the International Bank for Reconstruction and Development, was negotiated at the International Monetary and Financial Conference of the United and Associated Nations which took place at Bretton Woods, New Hampshire, USA, July 1st–22nd, 1944.

2. The technical preparations for the conference were made under the direction of Harry Dexter White, of the United States Treasury, and John Maynard Keynes, Adviser to the United Kingdom Treasury. The White and Keynes Plans were the main bases of negotiation and the governments of their two countries dominated the proceedings at Bretton Woods and shaped the results of the conference. However, in this Anglo-Saxon parentage of the Fund, it was the USA that had the last word.

3. Representatives of 44 governments assembled at Bretton Woods. From what we call today 'the North', in addition to the two leading actors, delegates came from the USSR, Britain's 'White Dominions' and several European governments in exile, including France. Evidently, the countries against which the USA and the UK were then waging war (i.e. principally Germany, Italy and Japan) were not invited. Nor were the neutral European states (such as Sweden and Switzerland) represented.

4. From 'the South', the main bloc of representation consisted of 19 Latin American countries (i.e. all except Argentina). In addition, there were three African countries

(Egypt, Ethiopia and Liberia) and four Asian (India, Iran, Iraq and the Philippines)—none of which, for different reasons, enjoyed full freedom of manoeuvre.** None of the other colonized countries of Africa, Asia and the Caribbean had any part in the proceedings. China was present, as was Yugoslavia, later to become a moving force in Third World affairs.

5. The Bretton Woods Conference drew up the Articles of Agreement of the IMF. These came into force on December 27th, 1945, when signatures had been deposited by 29 countries representing 80 per cent of the Fund's quotas (see paragraphs 11–17 below). The IMF headquarters was required by the Articles to be in the USA, and the site selected by the US government was Washington, DC. The Fund opened offices there early in 1946 and started active operations on March, 1st, 1947.

Membership

6. By December 31st, 1945, 35 countries had signed the Articles of Agreement. Current membership of the Fund (May 1980) comprises 140 countries: 23 OECD countries (all except Switzerland†) are members and Third World membership—defined by reference to present membership of the Group of 77—has grown from 24 to 114 countries. The members not falling into these categories are China, Israel

** Egypt and Iraq were effectively under British control; Ethiopia had not recovered from the Italian occupation; Iranian territory was occupied by British and Soviet troops; India (whose territory included present-day Bangladesh and Pakistan) was not yet independent; the Philippines were a US 'Commonwealth' and were largely occupied by Japan; and Liberia, while legally independent, had close ties with the USA.

† The Swiss National Bank, however, lends money to the IMF and its President attends some IMF meetings as an observer.

* These Background Notes were compiled for the South-North Conference by Michael Zammit Cutajar. Material was furnished by Justinian F. Rweyemamu, Michael Moffitt and E A Brett.

and South Africa. Table 1 (pages 98–99) contains the names of all IMF members.

7. It is interesting to observe the varying ways in which countries seeking to construct socialist economic systems have responded to the question of whether to join, or stay in, the IMF.

8. Yugoslavia (a founder member) and Romania (which joined in 1972) are the only East European countries presently members of the IMF.* Of the three other than Yugoslavia which participated at Bretton Woods, the USSR chose not to join, Poland resigned in 1950, and Czechoslovakia was required to withdraw in 1954. The reasons advanced for the abstention of East European countries from participation in the Fund relate to the system of weighted voting according to members' quotas;** the requirement that members report their gold and foreign exchange holdings and keep part of them in the USA, and the terms on which members are allowed Fund credits (conditionality).

9. China was a founder member of the IMF and from 1949 to 1980 its seat was held by a representative of the Taiwan regime. The People's Republic of China sought to regain possession of its rightful place in the IMF and did so on April 11th, 1980.

10. Noteworthy for their absence from the ranks of Third World members are Cuba, Angola and Mozambique. Cuba was a founder member but withdrew in 1964, while Angola

and Mozambique did not join after independence. On the other hand, the Socialist Republic of Vietnam assumed the place previously held by South Vietnam and Guinea-Bissau, Cape Verde, São Tomé et Príncipe and Zimbabwe chose to become members, while Afghanistan, Ethiopia, Kampuchea, Laos, Grenada and Nicaragua maintained their membership (at least nominally) after radical changes of political direction.†

Purposes

The declared purposes of the IMF are cited in full by Ismaïl-Sabri Abdalla in his paper on 'The Inadequacy and Loss of Legitimacy of the IMF'.

Decision taking

Quotas and voting power

11. Each member country of the IMF has 250 basic votes, plus one vote for each SDR 0.1 million of its 'quota' of the Fund.†† Quotas play a key role in the functioning of the Fund; in addition to voting power, they determine members' obligatory contributions, the limits of each member's borrowing, and the distribu-

† As did Iran, in a different context. The only Third World withdrawal from the IMF other than Cuba's was that of Indonesia in 1965, although the country rejoined the Fund in 1967.

†† The Special Drawing Right (SDR), created in 1969, has become the Fund's official unit of account; its value is determined by reference to a basket of currencies. It is also being used as an accounting unit for transactions between governments and by some other international financial institutions. Its current value is of the order of US \$1.3.

* Yugoslavia and Romania, being members of the Group of 77, are included in the Third World figures in paragraph 6 above.

** A system designed to give veto power to the USA in respect of important decisions.

tion of SDRs and part of the profits from IMF gold sales.

12. The distribution of quotas in the Fund is thus the key to its power structure. At present, Fund quotas total SDR 39 billion. Within this total, individual quotas range from the USA's SDR 8.4 billion to the Maldives' SDR 0.0009 billion (900,000). Despite the importance of quotas, their distribution is sometimes less than realistic. Thus, as a hangover from the 1944 balance of power, the quota of the UK is still the second largest, while France has a larger quota than Japan.

13. Quotas other than that of the USA in excess of SDR 1 billion, in descending order and in SDR billion, are those of: UK 2.9, Federal Republic of Germany 2.2, France 1.9, Japan 1.7, Canada 1.4, Italy 1.2, and India 1.1. The seven biggest quota holders—all western industrialized countries—thus have half of the total. The allocation of all quotas as of April 30th, 1979 may be deduced from Table 1, which shows the distribution of voting power in the IMF; it has not changed appreciably since that date.

14. IMF quotas are allocated to new members as they join and are subject to general review 'at intervals of not more than five years'. It is through such reviews that the balance of voting power can be changed, but this can only happen with the agreement of those countries which benefit from the existing distribution of power.

15. The sixth general review, decided in 1976 and effective in 1978, was the first one after the emergence of substantial financial surpluses in some Third World oil-exporting countries. It increased total quotas by one-third, from SDR 29.2 billion to SDR 39 billion, and its results are in force today. Within this increase, the 'major oil-exporting countries' received above average allocations so as to double their share

of total quotas from 5 per cent to 9.9 per cent. This represented a perceptible shift in voting power, while maintaining the dominant position of the western industrialized countries. Within the latter group, the review resulted in the enhancement of the voting power of the FRG and Japan, without changing the ranking of the biggest quota holders.

16. The seventh general review was completed in 1978. Its results are expected by the IMF to come into effect late in 1980, but this will depend on national approval processes, particularly those of the US Congress. In this general review, it was agreed to increase by 50 per cent the quotas of all members except China and Kampuchea, and to make special selective increases in quotas of 11 Third World countries, notably those of Iran, Iraq, Kuwait, Libya, Saudi Arabia and the United Arab Emirates. If all members were to accept the maximum quota increases, total quotas would rise to SDR 58.6 billion. Of the overall increase of nearly SDR 20 billion, the selective increases would account for only SDR 0.4 billion. Clearly, this amount is too small to change the balance of voting power significantly.

17. Barring 'a major change in the world economy and its financing needs', a further general review of quotas is not foreseen until five years after the latest one takes effect.

Voting majority requirements

18. Certain of the IMF's Articles of Agreement can only be changed with the agreement of *all* members; these concern the unqualified right to withdraw from the Fund, the provision that no change shall be made in a member's quota without its consent, and the provision that no change shall be made in the par value of a member's currency except on the proposal of that member. Changes in the other articles require the acceptance of three-fifths of the

Table 1 Voting power in the IMF (Votes in the Executive Board as of April 30th, 1979)¹

Country	Votes by country ²	Total votes	Per cent of Fund total	Country	Votes by country ²	Total votes	Per cent of Fund total
United States	84,300		19.85	Bahrain	450		
United Kingdom	29,500		6.95	** Iraq	1,660		
Germany, F. R.	21,810		5.14	Jordan	550		
France	19,440		4.58	Kuwait	2,600		
Japan	16,840		3.97	Lebanon	370		
Saudi Arabia	6,250		1.47	* Libya	2,100		
Costa Rica	660			Maldives	259		
El Salvador	680			Pakistan	3,100		
Guatemala	760			Qatar	650		
Honduras	590			Somalia	480		
** Mexico	5,600			Syrian Arab Republic	880		
Nicaragua	590			United Arab Emirates	1,450		
* Spain	5,820			Yemen Arab Republic	380		
Venezuela	6,850	21,550	5.08	Yemen, People's Dem. Rep. of	660	15,589	3.67
Cyprus	590			** Austria	3,550		
Israel	2,300			* Belgium	9,150		
**/* Netherlands	9,730			Luxemburg	560		
Romania	2,700			Turkey	2,250	15,510	3.65
Yugoslavia	3,020	18,340	4.32	Afghanistan	700		
Bahamas	580			Algeria	3,100		
Barbados	420			Ghana	1,310		
* Canada	13,820			**/* Iran	6,850		
Grenada	280			Morocco	1,750		
** Ireland	1,800			Oman	450		
Jamaica	990	17,890	4.21	Tunisia	880	15,040	3.54
** Greece	2,100			* Brazil	6,900		
* Italy	12,650			Colombia	2,180		
Malta	450			Dominican Republic	800		
Portugal	1,970	17,170	4.04	Guyana	500		
* Australia	8,150			Haiti	480		
Korea, Rep. of	1,850			Panama	700		
** New Zealand	2,570			Peru	1,890		
Papua New Guinea	550			Surinam	500		
Philippines	2,350			** Trinidad and Tobago	1,070	15,020	3.54
Seychelles	263			Bangladesh	1,770		
Solomon Islands	271			* India	11,700		
Western Samoa	280	16,284	3.84	Sri Lanka	1,440	14,910	3.51

Country	Votes by country ²	Total votes	Per cent of Fund total	Country	Votes by country ²	Total votes	Per cent of Fund total
Denmark	3,350			Ivory Coast	1,010		
* Finland	2,870			Madagascar	590		
** Iceland	540			Mali	520		
Norway	3,200			Mauritania	420		
Sweden	4,750	14,710	3.46	Mauritius	520		
Burma	980			** Niger	410		
** Fiji	430			Rwanda	480		
* Indonesia	5,050			São Tomé and Príncipe	270		
Lao People's Dem. Rep.	410			Senegal	670		
Malaysia	2,780			Togo	440		
Nepal	440			Upper Volta	410		
Singapore	740			Zaire	1,770	11,322	2.67
Thailand	2,060			Argentina	5,600		
Viet Nam	1,150	14,040	3.31	Bolivia	700		
* Botswana	340			* Chile	2,420		
Burundi	480			Ecuador	950		
Ethiopia	610			** Paraguay	480		
Gambia, The	340			Uruguay	1,090	11,240	2.65
Guinea	550					410,515 ³	96.68 ³
Kenya	940						
Lesotho	320						
Liberia	620						
Malawi	440						
Nigeria	3,850						
Sierra Leone	560						
Sudan	1,130						
Swaziland	370						
Tanzania	800						
** Uganda	750						
Zambia	1,660	13,760	3.24				
Benin	410						
* Cameroon	700						
Central African Rep.	410						
Chad	410						
Comoros	273						
Congo	420						
Equatorial Guinea	350						
Gabon	550						
Guinea-Bissau	289						

* Country providing Executive Director.

** Country providing Alternate (there was no Alternate for the Bangladesh, India, Sri Lanka group; there is now one from Sri Lanka).

1. Votes are those in the General Department (424,612).

2. Quotas can be worked out from this column, by deducting the 250 'basic votes' and multiplying the result by SDR 100,000.

3. This total does not include the votes of China, Egypt, Democratic Kampuchea and South Africa, which did not participate in the 1978 Regular Election of Executive Directors, and of Cape Verde, Djibouti and Dominica, which became members after that election. The combined votes of those members total 14,097—3.32 per cent of those in the General Department. N.B. St Lucia (1979) and St Vincent (1980) became members after the date of this table.

Source: IMF, *Annual Report*, 1979.

members having 85 per cent of the voting power.*

19. Majority requirements for decisions not involving amendments to the Fund's Articles do not specify a minimum number of members; they are based on voting power alone. Although the general requirement is stated to be a simple majority of votes cast, most important decisions need a majority of 70 per cent or 85 per cent of the total voting power. The 85 per cent rule applies to such key elements of IMF operations as changes in quotas, exchange arrangements, extension of IMF credit facilities beyond the normal five-year maximum repayment period, use of IMF gold, increase in the number of executive directors (see paragraphs 25–26 below), allocation and cancellation of SDRs and the principles of their valuation.

20. The significance of the 85 per cent rule is that it enables the USA, on its own, to veto any decision requiring this majority. The share of the USA in total voting power is now just under 20 per cent. In the schedule of quotas drawn up at Bretton Woods, the USA was allocated 31 per cent of the total; at that time, the upper majority requirement was 80 per cent. As the Fund grew, the voting power of the USA declined; but the majority requirement was increased in the two amendments to the Articles, thus allowing the USA to maintain its privileged position. Of course, the blocking minority can also be exercised by a group of countries acting in concert (e.g. UK, FRG and France, whose voting shares add up

to 16.7 per cent, or the eight participants in the European Monetary System, accounting for 18.5 per cent, or the G.77 members).

The Board of Governors and the Executive Board

21. The present permanent organs of the IMF are the Board of Governors, the Executive Board, and the Managing Director and his staff.**

22. The Board of Governors is formally the highest authority of the IMF. Each member country appoints one Governor and an Alternate to cast its votes. The Governors are ordinarily equivalents of Ministers of Finance or Governors of central banks. They meet once a year, towards the end of September, jointly with the Governors of the IBRD. These meetings take place alternately in Washington, DC and other locations. Governors may also take decisions by postal vote.

23. The Governors' meetings have something of the character of jamborees. Prepared statements are made for the record and there is no public debate on any issue. Key decisions are brought out for rubber-stamping from behind closed doors, where the real business takes place—it has not been pre-cooked before the meeting. Meanwhile, in the lobbies, the Governors confer with Fund staff, as well as with bankers and other private sector representatives who attend.

** The establishment of a Council to 'supervise the management and adaptation of the international monetary system.... and in this connection [to] review developments in the transfer of real resources to developing countries' and to 'consider proposals.... to amend the Articles of Agreement' awaits 85 per cent majority approval. It would be a decision-making body, with a structure and powers similar to those of the Executive Board. Its establishment was proposed by the Committee of 20 in 1974 (see paragraphs 42–44 below), but is not considered imminent.

* Two sets of amendments have been adopted. The first (approved in May 1968, effective in July 1969) introduced the SDR system; the second (approved in April 1976, effective in April 1978) legitimized the abandonment of the fixed exchange rate system, delinked currencies from gold, and permitted the IMF to sell its gold and dispose of the profits therefrom.

24. In effect, the Board of Governors has delegated many of its important responsibilities to the Executive Board, which is the core of the Fund's decision-taking structure. The Executive Board is 'responsible for conducting the business of the Fund', and for this purpose is in permanent session at the IMF headquarters. In addition to powers delegated to it by the Board of Governors, the Executive Board has some powers conferred upon it directly by the Articles of Agreement, notably the responsibility for selecting the Managing Director. The latter chairs the Executive Board, where he has a casting vote.

25. Normally, the Executive Board consists of 20 Executive Directors, plus the Chairman. Five Executive Directors are appointed by the five member countries with the largest quotas (USA, UK, FRG, France and Japan), while 15 are elected for two-year terms by the remainder of the Fund's membership. Each Executive Director has an Alternate.

26. There is also a provision that, if the first or second largest creditor member of the Fund* is not among the 'big five', that member may appoint an Executive Director—either to one of the 15 elective places or (if so agreed by an 85 per cent majority) to an additional place. Under this provision, the Executive Board was enlarged to 21 members on November 1st, 1978, with the appointment of an Executive Director by Saudi Arabia. This is a two-year arrangement and will be extended this year for a further two years if the conditions continue to be fulfilled.

27. Voting on the Executive Board is on the basis of member countries' voting power, not of numbers of Executive Directors. The quorum for a meeting is a majority of Execu-

tive Directors having not less than one-half of total voting power in the IMF. Each of the 15 elective Directors casts the votes of the group of countries which elected him. The composition of these groups, or constituencies, may vary from one election to another; the current constituencies resulted from the 1978 election and are shown in Table 1 (pages 98–99).

28. The way in which these constituencies are formed serves to maximize the number of elective Executive Directors from industrialized countries, of whom there are now seven. Thus, to take the most striking current example, Spain provides the Executive Director for an eight-member constituency which includes seven Latin American countries; of these, Venezuela has a quota larger than Spain's, while Mexico has one only slightly smaller. In all, there are 21 Third World countries, with 7.14 per cent of the votes, similarly 'lost' in constituencies which elected Executive Directors from the North. It is noteworthy that there is no Third World Executive Director elected by northern constituents. The eight constituencies electing Third World Executive Directors comprise 85 countries and 26.13 per cent of the votes; Saudi Arabia brings Third World voting power in the Executive Board to 27.60 per cent.**

29. Voting power in the IMF is, in practice, a latent force. Actual votes are rare and consensus is the aim, based on consultations in which the weight attached to members' points of view reflects the votes they command. For the most part, Executive Board decisions are prepared before the meetings and, in this pro-

* Strictly speaking, the two members whose currencies in the Fund have been drawn on by the largest amounts.

** Total Third World voting power in the IMF as of April 30th, 1979, amounted to 35.65 per cent. This discrepancy with the figures in paragraph 28 is explained by the fact that a few Third World countries did not participate in the 1978 elections (see Table 1, note 3).

cess, the Managing Director and his staff wield great influence.

The Managing Director and his staff

30. Apart from chairing the Executive Board, the Managing Director conducts the ordinary business of the Fund under the Board's direction. His casting vote does not apply to meetings of the Board of Governors. He is responsible for hiring and firing the staff of the IMF. The Articles of Agreement also confer directly on him the task of making proposals, after consultations with members, concerning allocations and cancellations of SDRs.

31. It is so far an uncontested tradition that the Managing Director of the IMF is a West European (while the President of the IBRD is a US citizen). Managing Directors to date have been Camille Gutt, Belgium (1946–51); Ivar Rooth, Sweden (1951–56); Per Jacobsson, Sweden (1956–63); Pierre-Paul Schweitzer, France (1963–73); Johannes Witteveen, the Netherlands (1973–78); and Jacques de Larosière, France (1978–). Also by tradition the Deputy Managing Director is a US citizen, often a former Executive Director of the IMF. The Deputies have been Andrew Overby (1949–52), H. Merle Cochran (1953–62), Frank Southard (1962–74) and William Dale (1974–).

32. The key departments of the IMF are the Research Department and the Exchange and Trade Relations Department, which constitute the 'brain trust' of the Fund. The influence in them of men who joined the staff in the early years is considerable (e.g. J. J. Polak, of the Netherlands, Economic Counsellor and Director of the Research Department, who is credited with being the source of the monetarist prescription which the IMF staff try to apply indiscriminately to Third World countries seeking Fund credits). Most regional depart-

ments have directors from the respective regions, with the US presence starting at Deputy Director Level. The exception to this rule is the department covering Latin America and the Caribbean, reputed to be the most conservative. In this case, since it is styled the 'Western Hemisphere Department', a US citizen holds the post of Director (E. Walter Robichek, another 'old hand').

Groups and committees

33. In the preparation of decisions for adoption by the statutory organs of the IMF, a number of groups and committees, not always formally part of the IMF structure, have had an important—sometimes decisive—influence.

34. The most significant of these is the *Group of 10*. Its members are ten industrialized countries belonging to the IMF (USA, UK, FRG, France, Japan, Canada, Italy, the Netherlands, Belgium and Sweden).^{*} Switzerland, not a member of the IMF, is usually associated with this group, thus making its effective membership 11 countries.

35. The G.10 came into being in the early 1960s, outside the IMF framework. It sought to find ways of sustaining international liquidity, which was threatened by the decline of the dollar, following on that of the pound sterling. In 1961, the G.10 established the 'General Arrangements to Borrow', a mutual credit arrangement whereby each of the members agreed to make available a certain amount of short-term credit to help another member or members to overcome temporary currency difficulties (such as speculative attacks). Seen as a means of supporting the international monetary system, the management of these

^{*} Listed here in order of IMF quotas. Sweden's quota is, in fact, not as large as Australia's or Spain's.

Arrangements (which came into effect in October 1962 and have been renewed ever since) was entrusted to the IMF and funds transacted under them were channelled through the Fund. The GAB, in effect, gave the IMF access to additional resources (the amounts committed totalled US \$6 billion) for the benefit of a small, though dominant, part of its membership.*

36. Through the 1960s and into the early 1970s, the exclusive G.10 was the principal forum for negotiation on international monetary issues. Thus it was that, in the discussions from 1963 onwards which led to the establishment of the SDR, the G.10 adhered initially to the concept that a new reserve asset should only be available to a limited number of 'credit-worthy' industrialized countries. It was only in July 1966, after Third World criticism and exhortations from the IMF Managing Director, that the G.10 agreed that the new asset should be available to all IMF members. Up to that point, while the IMF staff had prepared studies, the Fund—as an institution—had not been active in the negotiation. Thereafter, while the G.10 continued to operate, the focus of negotiation shifted to joint meetings of the G.10 and the IMF Executive Directors,** until the SDR scheme was adopted by the IMF Governors in September 1967. It was then left to the IMF to draft the small print and to bring the scheme into effect (July 1969).

37. Similarly, it was the G.10—not the IMF—which tried to restore stability to the exchange rate system after it was shaken by

the August 1971 US suspension of the convertibility of its dollar into gold. And, when successive attempts at mutual realignment of the par values of its members' currencies failed to hold, it was the G.10 (supplemented by a few other industrialized countries) which decided to let exchange rates float in March 1973, in contravention of the IMF Articles of Agreement, leaving it to the IMF to legitimize this act by amending the Articles.

38. Since 1972, the IMF has had within its framework committees dealing with issues of monetary reform (see paragraphs 42–45 below). But the G.10 has continued to function as a caucus for its members and as a mechanism for negotiation among them prior to presenting their positions to the rest of the IMF membership (e.g., most recently, in the renewed discussions of the question of a 'substitution account' to redeem US dollar liabilities with SDRs). The monthly meetings of the Bank for International Settlements, (BIS)† in Basel, Switzerland, provide an opportunity for the central bank Governors of the G.10 to maintain regular contacts.

39. The Third World counterpart of the G.10, though nowhere near it in strength and effectiveness, is the *Group of 24*. Formally styled the Intergovernmental Group of 24 on International Monetary Affairs, the G.24 is an off-shot of the Group of 77 and has its roots in the work of UNCTAD.

40. The latter institution has a mandate, even if contested from time to time by western industrialized countries, to discuss international monetary issues in relation to trade and devel-

* In 1964, Switzerland associated itself with the GAB, making US \$0.3 billion available to the scheme.

** An arrangement which gave G.10 members double representation and reduced the Third World's weight correspondingly.

† Created in 1930, with a membership including most of Europe (notably excluding the USSR), Australia, Canada, Japan, South Africa and the USA, the BIS now serves as a G.10 meeting place and a source of financial reports (e.g. on the Eurocurrency markets).

opment. In 1965, when discussion on reserve creation was proceeding in the confines of the G.10, a group of experts convened by the Secretary-General of UNCTAD produced a set of recommendations on monetary questions which have remained at the core of succeeding Third World statements on these issues: namely, that there should be a symmetrical and equitable adjustment process, greater Third World participation in decisions on the reform and management of the international monetary system, and a link between reserve creation and development finance. Through studies and resolutions of intergovernmental bodies, UNCTAD has continued to elaborate these themes, which have been incorporated in the Programme of Action for the NIEO, latterly emphasizing the interdependence of trade, monetary and financial issues. An UNCTAD intergovernmental group met in July 1980 to review the evolution of the international monetary system.

41. The G.24 has operated at the interface between UNCTAD and the IMF since October 1971, when it was established by a Ministerial Meeting of the G.77 in Lima, Peru, in response to the US actions of August 1971. Its members are drawn equally from the three regional constituencies of the G.77.* Its mandate is to review the international monetary situation, evaluate events and decisions from the Third World viewpoint, and recommend coordinated G.77 positions on monetary issues. Its main function has been that of a Third World pressure group on the IMF. While receiving some

informal substantive support from the UNCTAD secretariat,** the G.24 tended over the years to lose contact with the mainstream of the G.77 and to let itself be enveloped by the mystique of the IMF.† A recent development counteracting this trend was the G.77 decision to meet at ministerial level during the 1979 IMF/IBRD Annual Meeting in Belgrade. This was the first time that the G.77 had manifested itself on such an occasion. In endorsing an 'Outline for a Programme of Action on International Monetary Reform' prepared by the G.24, the G.77 emphasized—at least formally—the relationship between the two groups.

42. Within the IMF itself, there have been two committees set up (successively) to deal with questions of monetary reform. The first was the Committee of the Board of Governors on the Reform of the International Monetary System and related Issues.†† Known as the *Committee of 20*, this was set up in July 1972 and delivered its final report in June 1974. Representation in the C.20 was derived from the structure of the 20-member Executive Board, so that the same balance of power prevailed in the former as in the latter. The C.20 met at ministerial level and was backed up by more technical discussions at the level of deputies, in which participation from the constituencies was somewhat broader.

** Recently with UNDP financing; see the Dell Report on *The Balance of Payments Adjustment Process in Developing Countries: Report to the Group of 24*, UNDP/UNCTAD Project, INT/75/015.

† For instance, G.24 meetings are reported in the *IMF Survey* in the same fashion as meetings of IMF bodies.

†† The 'related issues' were trade and finance, including development assistance. Note that, while the western industrialized countries are ready to accept the interdependence of these issues in a congenial forum like the IMF, they resist such an approach in UNCTAD.

* The current members are: Algeria, Egypt, Ethiopia, Gabon, Ghana, Ivory Coast, Nigeria, Zaïre; Argentina, Brazil, Colombia, Guatemala, Mexico, Peru, Trinidad and Tobago, Venezuela; India, Iran, Lebanon, Pakistan, Philippines, Sri Lanka, Syria, Yugoslavia. IMF Executive Directors and Alternates from Third World countries attend G.24 meetings.

43. As noted above, the main monetary issue at the time—the adaptation of the system to floating exchange rates—was negotiated outside the IMF. The C.20 had to accept the *fait accompli* presented by the G.10 with the best possible grace, recognizing that floating rates could be a ‘useful technique in particular situations’, while optimistically continuing to state its belief in the desirability of stable but adjustable rates. Nor was it able to meet the pressing need for a balance of payments adjustment process that would put pressure on the USA to reduce its deficit while also obliging surplus countries to take more imports (‘an effective and symmetrical adjustment process’). Again, it could only state the desirability of the aim, in the context of a monetary system in which the SDR would become the principal reserve asset and the role of gold and reserve currencies be correspondingly reduced.

44. The final outcome of the work of the C.20 (the ‘Outline of Reform’) was a statement of the general direction in which the international monetary system should evolve, plus a number of recommendations for immediate steps to be taken by the IMF and for further studies. The measures proposed included the establishment of the Oil Facility and the Extended Fund Facility. The subjects for study included the topic of promoting the transfer of real resources to the Third World, including reconsideration of the feasibility of a link between SDR allocation and development finance.

45. The institutional successor of the C.20, as proposed by the C.20, is the Interim Committee of the Board of Governors on the International Monetary System. The *Interim Committee* is so called because it would cease to exist on the establishment of the IMF Council, also recommended by the C.20. Unlike the proposed Council, the Interim Committee has no decision-making powers; it

serves as a source of advice to the Board of Governors. Its terms of reference include those subjects which would be dealt with by the Council (see footnote on page 100); in addition, it advises on how to deal with ‘sudden disturbances that might threaten the system’. Like the C.20, the Interim Committee’s membership is based on the composition of the Executive Board; for the time being, it has 21 members. However, since each member may be accompanied by up to seven associates, it is possible for most of the Fund’s membership to participate in committee meetings. The Interim Committee, whose members are of ministerial rank, has been meeting on average twice a year, once during the IMF/IBRD Annual Meeting.

46. The main task of the Interim Committee in its first two years was to consider the proposed adaptation of the IMF Articles of Agreement to accommodate floating exchange rates and the demonetization of gold. The far-reaching implications of these amendments are discussed in Ismaïl-Sabri Abdalla’s paper.* At its January 1976 meeting in Kingston, Jamaica, the committee endorsed those amendments which had already been prepared by the Executive Board and gave its advice on outstanding issues. Between that meeting and the current discussions on the subject of a substitution account, the Interim Committee was concerned not so much with the reform of the monetary system as with its management. It dealt with questions such as SDR allocation and quota review, while carrying out regular reviews of the world economic outlook.

47. Finally, in this outline of the groups and committees clustered around the IMF, mention should be made of the Joint Ministerial Committee of the Boards of Governors of the

* See Section 6 (pages 45–47).

Bank and the Fund on the Transfer of Real Resources to Developing Countries (the *Bank-Fund Development Committee*). Set up in 1974 in response to the recommendation of the C.20 that more should be done to promote the transfer of resources to the Third World, this committee belongs more to the Bank than to the Fund and is therefore of limited interest here. Its membership is based on the composition of the Executive Boards of both the Bank and the Fund, and is elected alternately by the members of each institution. At present, the committee has 20 members, including nine from the Third World; each member may have seven associates. Its chairmen have been the Ministers of Finance of Ivory Coast and the Philippines, and it usually meets in conjunction with the Interim Committee with which there is some overlapping of membership.

48. The Development Committee is a deliberative body, with no powers. Its work so far has been to undertake studies and comment on the activities of its parent institutions. In 1978, a joint Bank-Fund review of the committee's performance expressed—in the words of the committee's own report—a 'sense of disappointment' at its inability to produce 'concrete or significant results'. Needless to say, this disappointment is felt more strongly by the Third World countries. A further performance review will take place in 1981.

Resources

Origins

49. The regular resources of the IMF come from two main sources: members' subscriptions and borrowing from members.*

* It also manages the resources of the 'General Arrangements to Borrow' (see paragraph 35 above). As of April 30th, 1979, the amounts committed under the GAB totalled SDR 6.5 billion.

50. Members' *subscriptions* are the largest source. Individual subscriptions are determined by members' quotas, the total of which (as noted in paragraph 16 above) is expected to reach SDR 58.6 billion later this year. The first 25 per cent of a member's quota used to be payable in gold; now it is payable in SDRs or in 'hard' currencies designated by the Fund. The balance of 75 per cent may be paid in the member's own currency.

51. IMF *borrowing* has not been frequent.** In 1974 and 1975, the IMF borrowed SDR 6.9 billion from member countries (plus Switzerland) and central banks to set up the Oil Facility. This was created in 1974 to help members meet the impact on their balances of payments of the increase in costs of petroleum imports. It was renewed in 1975 and terminated in 1976, despite the continued need for such support for Third World countries. Of the total borrowing for this purpose, eight oil-exporting Third World countries contributed SDR 5 billion (Saudi Arabia alone lending SDR 2.3 billion and Iran 1 billion); the balance was lent by eight industrialized countries (of which the FRG lent SDR 0.6 billion).

52. In 1979, the IMF started to operate the Supplementary Financing Facility, intended to provide additional balance of payments support to members with relatively large imbalances. For this purpose, it concluded arrangements to borrow SDR 7.8 billion from members (again, plus Switzerland). In this case, eight industrialized countries (not all the same as before) committed the largest share, SDR 4.6 billion (of which the USA lent SDR 1.5 billion, FRG 1.1 billion and Japan 0.9 billion), while five OPEC members agreed to lend SDR 3.2 billion (of which Saudi Arabi gave

** The Brandt Commission has proposed that the IMF augment its resources by borrowing in private markets.

SDR 1.9 billion). Guatemala put up SDR 0.03 billion.

53. In addition to the above, the issue of SDRs enables the IMF to provide resources to its members. The Fund has effected two issues of SDRs, allocating them to members* in proportion to their quotas. The first issue, over the three-year period 1970–72, amounted to SDR 9.3 billion. The second issue, during 1979–81, will total SDR 12 billion; its third instalment of SDR 4 billion is to be made on January 1st, 1981. At that point, there will be SDR 21.3 billion in circulation.

54. Finally, the IMF has derived some resources from the four-year programme of *gold sales*, on which it embarked as a result of the 1976 decision to demonetize gold. Fifty million ounces were sold, half to Fund members at the former official price of SDR 35 per ounce and half on the open market at a profit. Part of the profit was distributed to 104 Third World members in proportion to their share of 1975 quotas (totalling 27.8 per cent). The balance was paid into a Trust Fund which, while formally separate from the Fund's regular resources, was administered by the IMF and used to provide balance of payments assistance to 'eligible' Third World members. A number of Third World members (some OPEC countries, Yugoslavia and Romania) have transferred all or part of their share of profits to the Trust Fund. The resources available to the Trust Fund in the first three years of operation (1976–79) amounted to SDR 1.7 billion. The last gold auction took place on May 7th, 1980.

Facilities

55. The normal mode of drawing on the re-

sources of the IMF is through access to the 'tranches', or—to translate from the original French—'slices' of credit.** The first of these is the *reserve tranche* (formerly called the gold tranche), which amounts to 25 per cent of a member's quota and thus corresponds to the SDR or 'hard' currency element of the member's contribution. Drawing on the reserve tranche may be made by any member in need of balance of payments support; no conditions are attached. The repayment period—as for all the other tranches—is three to five years.

56. The next line of credit is the *first credit tranche*, equivalent to a further 25 per cent of quota. To have access to this, a member must present the IMF with an economic programme demonstrating that it will make 'reasonable efforts' to overcome its balance of payment difficulties. In deciding what is 'reasonable', the member usually gets the benefit of the doubt. In practice, therefore, the first credit tranche is almost as easy to use as the reserve tranche.

57. Beyond this are the three *upper credit tranches*, each also equivalent to 25 per cent of quota. They are subject to 'conditionality'. This means that, in order to have access to them, a member must obtain the agreement of the IMF to a 'stabilization programme', usually of one year's duration (but sometimes two) and including 'performance' criteria relating to government policy on such matters as credit, prices, incomes, public spending, exchange rate, reserve levels, external debt and import controls. The agreement of the IMF, which serves as a green light to providers of commercial credit, is usually obtained after a

* With the exception of Kuwait, which was the only member still not participating in the SDR system in 1979.

** In IMF terminology, a member drawing a loan is said to 'purchase' (SDRs or hard currencies with its own currency); the repayment of a loan is a 'repurchase' (of the member's own currency by the IMF).

negotiation process in which the leverage of the Fund is in proportion to the seriousness of the plight of the borrowing country. Once agreement is reached, credit is made available under a 'stand-by arrangement', on which phased drawings may be made. Failure to adhere to performance criteria, which are checked at regular intervals, normally results in the suspension of access to the stand-by until the programme is renegotiated.*

58. A number of credit facilities exist in addition to the tranches. The *Extended Fund Facility* was established in 1974, on the recommendation of the C.20, in order to provide balance of payments support for longer periods and in greater amounts than under the credit tranches. Its aim is to help members overcome structural balance of payments maladjustments. Members may draw up to 140 per cent of quota under this facility. Stabilization programmes may be negotiated for up to three years and a detailed programme for each year must be agreed. Strict conditionality applies and repayments may be made four to ten years after drawings.

59. The newest facility is the *Supplementary Financing Facility*, also known as the 'Witteveen Facility' after the former IMF Managing Director. It started operation in 1979 (see paragraph 52 above). This facility is intended to supplement drawings from the upper credit tranches or the *Extended Fund Facility* or both, hence it carries the same conditionality. The maximum credit available is normally 140 per cent of quota, but this limit has been relaxed in some recent cases. Stabilization pro-

grammes may extend over three years and repayment is to be made between three-and-a-half and seven years after drawing.

60. The two remaining facilities have special purposes and are subject to minimal conditionality. The *Compensatory Financing Facility*, established in 1963, is intended to assist members (particularly primary commodity exporters) who get into balance of payments difficulties owing to temporary shortfalls in export earnings for reasons beyond their control. Export shortfalls are calculated on the basis of the latest preceding 12-month period, in relation to an estimate (worked out by the Fund and the member concerned) of what exports should have been according to a medium-term trend. Shortfalls in remittances from overseas and in earnings from tourism are now covered by this scheme. The only condition for access is that the member should 'cooperate with the Fund' in exploring solutions to its balance of payments difficulties. Drawings on this facility may go up to 100 per cent of quota. If drawings exceed 50 per cent, the Fund must be 'satisfied' that the member is indeed cooperating. The repayment period is three to five years.

61. The other specialized facility is the *Buffer Stock Financing Facility*, established in 1969 for the purpose of helping members to finance their contributions to buffer stocks within international commodity agreements. These agreements must be within the United Nations or else meet certain criteria. Drawings may be made up to 50 per cent of quota and the conditionality and repayment period are the same as for the *Compensatory Financing Facility*.

62. Not quite a facility but still a source of credit is the *Trust Fund* (see paragraph 54 above). Trust Fund loans are available to 'eligible' Third World members whose need for additional balance of payments assistance is

* Some cases of the operation of 'conditionality' and its effects on borrowing countries are discussed by Norman Girvan (page 55ff). N.B. The stand-by arrangement may also be applied to the first credit tranche. A similar instalment technique is used for drawings on the *Extended Fund Facility* and the *Supplementary Financing Facility*.

accepted by the IMF. Sixty-one low-income countries were considered eligible in the first Trust Fund period (1976–78) and 59 in the second period (1978–80). Conditionality on Trust Fund loans is the same as that for the first credit tranche, i.e. ‘reasonable effort’, unless the loan is taken in conjunction with drawings on the upper credit tranches or the other facilities with strict conditionality. Loans are to be repaid in equal instalment between five and ten years after they are drawn. There is no relation between the size of Trust Fund loans and that of eligible members’ quotas.

63. Finally, although it only existed from 1974 to 1976, the *Oil Facility* (see paragraph 51 above) should also be mentioned here. It was available to cover the increase in the cost of a member’s imports of petroleum and petroleum products in relation to 1972 prices, up to a maximum of 75 per cent of the member’s quota. Conditionality was the same as that for the Compensatory Financing Facility (i.e. co-operation and consultation with the Fund), with the addition of a pledge to refrain from imposing new or additional restrictions on international trade and payments. The maximum repayment period was seven years. In conjunction with the Oil Facility, a *Subsidy Account* was established in 1975, outside the Fund’s regular resources, to subsidize the interest rate on borrowings from the Oil Facility by the ‘most seriously affected’ Third World countries. This Account was funded by SDR 0.16 billion in contributions from 24 IMF members plus Switzerland.

64. The five tranches, the Extended Fund Facility, the Compensatory Financing Facility and the Buffer Stock Financing Facility are all funded from regular IMF resources. The other facilities and the Trust Fund have special sources of funding (see paragraphs 51–52 and 54 above).

65. Interest charges are payable to the IMF on all drawings except those under the reserve tranche. In addition to a flat service charge of 0.5 per cent on the total amount of each drawing arrangement, there is a charge on outstanding balances which rises with the length of time they have been outstanding. Charges on drawings from regular resources of the IMF now range from 4.375 per cent for balances outstanding for less than one year to 6.875 per cent for seven to eight year balances (under the Extended Fund Facility).^{*} In the case of the Supplementary Financing Facility, the charge is the rate paid by the Fund on its borrowing, plus a small margin. Oil Facility drawings carried rates ranging from 6.875 to 7.875 per cent (before deduction of the subsidy, if applicable). The Trust Fund has its own rules regarding interest on loans, which is payable at 0.5 per cent. It should be noted that the Fund also pays interest (‘remuneration’) to countries in a creditor position in relation to their quotas.

66. The manner in which drawings from all existing quota-related facilities may be accumulated is set out in Table 2 (page 110).

*Drawings***

67. From the time that the IMF started operations on March 1st, 1947, until the end of its accounting year 1979 (April 30th), total drawings by members amounted to SDR 48.7 billion and total repayments to SDR 28.6 bil-

^{*} Data from *IMF Survey*, September 1979, before the recent extension to ten years of the maximum repayment period under the EFF.

^{**} This section discusses how much IMF credit was actually used by members. It does not show the data for the credit arrangements (stand-bys, etc.) negotiated by members with the IMF.

Table 2 Limits of drawings on IMF facilities (in relation to country quotas)

Facility	Limit of drawing on facility (per cent of quota)	Maximum cumulative drawing (per cent of quota)
Reserve tranche	25	25
First credit tranche	25	50
Upper credit tranches	75	125
Extended Fund Facility (EFF) ¹	140	190
Supplementary Financing Facility (SFF) with EFF ²	140	330
Compensatory Financing Facility ³	100	430
Buffer Stock Financing Facility	50	480

1. A Member's 140 per cent drawing under the EFF may not raise its cumulative drawings above 190 per cent of quota. Maximum drawings under the EFF thus exhaust upper credit tranches as well.

2. If used with the reserve and credit tranches, the SFF can be drawn up to 102.5 per cent of quota, bringing the maximum cumulative drawing to 227.5 per cent. The SFF limit has recently been relaxed.

3. The limit on CFF drawings was initially 50 per cent of quota; it was raised to 75 per cent in 1975 and to 100 per cent in 1979.

lion. The Fund was therefore a net lender of some SDR 20 billion at that point.

68. It is interesting to compare the data for size and source drawings before and after the arrival of the new era of oil prices. In the 26 years up to April 20th, 1973, drawings amounted to SDR 24.8 billion; all but SDR 0.8 billion was drawn from the tranches. In the six years up to April 30th, 1979, drawings amounted to almost as much again, SDR 23.9 billion; only half of this (SDR 12.8 billion) came from the tranches. A breakdown by fa-

cility of drawings in this latter period is given in Table 3 (opposite).

69. The table shows clearly how important the low-conditionality Oil Facility was, while it lasted, providing over half the resources available in 1975 and 1976. Indeed, in the period covered by the table, the high-conditionality facilities (upper credit tranches and Extended Fund Facility) provided less than one-third of total drawings. This illustrates the point that rigorous conditionality has deterred countries from making full use of IMF resources.*

70. Underlying Table 3 are different patterns of distribution of drawings as between industrialized and Third World IMF members. The *Buffer Stock Financing Facility* and the *Extended Fund Facility* were intended essentially for Third World countries and have only been used by them. In the former case, drawings have been restricted by the paucity of working commodity agreements; the amounts drawn have been for participation in buffer stocks under the international agreements for tin and sugar. The main user of the Extended Fund Facility has been the Philippines, accounting for nearly half of the drawings (SDR 256 million), the rest being taken up by five other countries. The loans and other transfer noted *pro memoria* below Table 3 were also destined exclusively for Third World members; 48 countries have received Trust Fund loans up to March 1980.

71. In the period shown, Third World countries accounted for nearly two-thirds (SDR 2,359 million) of the drawings under the *Compensatory Financing Facility*, which was fairly widely used. The balance was drawn by several less-industrialized northern countries.

72. The *Oil Facility*, however, shows the reverse picture. Thirty-five per cent of the draw-

* See Norman Girvan's paper, page 55 ff.

Table 3 Drawings on IMF resources by facilities, 1974–79 (in millions of SDRs; fiscal years ending April 30th)

	1974	1975	1976	1977	1978	1979	Total
All facilities	1,058	5,102	6,591	4,910	2,503	3,720	23,885
Reserve tranche	607	981	1,324	161	136	2,480	5,690
Credit tranches, of which under stand-bys:	239	1,604	461	2,370	1,937	485	7,095
Buffer Stock							
Financing Facility	—	—	5	—	—	48	53
Compensatory Financing Facility	212	18	828	1,753	322	465	3,597
Extended Fund Facility	—	—	8	190	109	242	548
Oil Facility	—	2,499	3,966	437	—	—	6,902
N.B. Total repayments	672	518	960	868	4,485	4,859	12,362
<i>Pro memoria:</i>							
Trust Fund loans (Periods ending June 30th)					841	350	1,191
Direct distribution of profits from gold sales					363	396 (July)	759
Subsidy Account payments			14	28	25	19	86

Source: IMF, *Annual Report*, 1978 and 1979.

N.B. The Supplementary Financing Facility is not covered by this table, since the first drawing under this facility was made in May 1979.

ings from this source were taken by Italy and the UK, 23 per cent by seven other OECD countries and 2 per cent by Israel. Third World countries drew 40 per cent of the available funds. Since other Third World countries had contributed 72 per cent of the Oil Facility's funds, this represented a substantial transfer of resources from South to North. Within the Third World drawings of SDR 2,736 million, six countries (India, Yugoslavia, Republic of Korea, Chile, Pakistan, Philippines) took nearly 60 per cent; the balance was drawn by 39 other countries.

73. In the *reserve tranche* the biggest draw-

ing was by the USA, which drew SDR 2,275 million—its entire entitlement—in the fiscal year ending 1979, as part of the dollar rescue programme. The UK drew SDR 700 million in the fiscal year 1976 and Italy drew SDR 268 million in the preceding year. These three drawings made up more than half of the resources provided from the reserve tranche in the six-year period shown in Table 3. In that time, only 16.9 per cent of such drawings (SDR 960 million) were made by Third World countries.

74. In the *credit tranches*, Third World countries accounted for 34 per cent of drawings

Table 4 Distribution of drawings and other transfers, 1974-79 (in SDR million)

	Third World	Industrialized and others	Total
Tranches:			
Reserve	960	4,730	5,690
Credit	2,409	4,686	7,095
Facilities:			
Buffer Stock	53	—	53
Compensatory	2,359	1,238	3,597
Extended	548	—	548
Oil	2,736	4,166	6,902
All facilities	9,065 38%	14,820 62%	23,885 100%
Trust Fund loans, gold profits, Subsidy Account payments	2,039	—	2,039
	11,104 43%	14,820 57%	25,924 100%

Compiled from Table 3.

(SDR 2,409 million); the biggest users of funds under stand-by arrangements in this group were, in order, Pakistan (SDR 230 million), Argentina, Romania, Zambia, Bangladesh and Egypt (SDR 105 million). Here again, the largest drawings were made by the financially weak industrialized countries: the UK (SDR 1,700 million in the fiscal year 1977 and SDR 1,250 million in the following year) and Italy (SDR 1,000 million in the fiscal year 1975 and a

modest 90 million in 1978). These two countries took more than half the total under the credit tranches (63.6 per cent of total stand-by arrangements under the tranches). The third largest recipient of stand-by credit was South Africa, with SDR 392 million in fiscal years 1976-78.

75. If one adds the various amounts drawn under different facilities in the 1974-79 period by the UK, Italy and the USA, it turns out that they received 38.2 per cent of total drawings over the period. It should be noted, however, that the stand-by credits extended to the UK and Italy were financed by borrowings under the GAB.

76. In summary, the distribution of drawings and other transfers from the IMF in the fiscal years 1974-79 was as shown in Table 4.

Sources

77. The basic sources for these notes have been the *IMF Annual Report* (the yearly report of the executive Directors to the Governors), the *IMF Survey* (periodical) and the *IMF Articles of Agreement* (as amended effective July 28th, 1969, and April 1st, 1978). These documents, and others including detailed *International Financial Statistics*, are obtainable from: The Secretary, International Monetary Fund, Washington, DC 20431, USA; Cable: Interfund; Telex: ITT 440040, RCA 248331, WUI 64111.

The IMF and the Third World: The Case of Jamaica, 1974–80

By Norman Girvan, Richard Bernal and Wesley Hughes

Since late 1976, the International Monetary Fund (IMF) has been a major influence in economic decision-making in Jamaica and a major factor in the country's domestic politics. The People's National Party (PNP) administration of Prime Minister Michael Manley had been elected to office in 1972, at a time of heightened political and social tensions due to widening socio-economic inequalities and foreign domination over the economy. The PNP instituted a wide-ranging reform programme which won the support of the underprivileged classes, but it encountered growing economic problems due to the world economic crisis together with retaliation by foreign and local interests affected by the reform. This culminated in the complete exhaustion of foreign reserves at the end of 1976, coinciding with an overwhelming majority for the PNP in the national elections of December in that year.

Jamaica made a two-year stand-by agreement with the IMF in July 1977, which was suspended by the Fund in December. In its place, a three-year Extended Fund Facility agreement was made in May 1978, but this agreement too, eventually collapsed when performance tests were breached in December 1979. As a result of these agreements, the government made drastic changes in the nature of its economic policies. But economic recovery failed to take place and the trend of negative growth in the Jamaican economy was not arrested. The foreign exchange situation of the central bank continued to be precarious, literally on a day-to-day basis. The agreements merely allowed the economy to continue ticking over in slow motion, and permitted the international commercial banks to call in a portion of their loans to Jamaica.

What did result from the adoption of the IMF programmes was a marked decline in the political fortunes of Mr Manley's PNP administration. The class alliance of workers, unemployed, small farmers, small businessmen and nationalist professionals and businessmen was all but shattered by the impact of harsh economic austerity. The idea of a just, egalitarian and independent society within a framework of parliamentary democracy and the ideas of a new international economic order, has been increasingly discredited in the eyes of the people of Jamaica. As a direct result of the failure of the second IMF agreement, the government has decided to hold fresh national elections in late 1980, over one year before they fall due, to attempt to secure a new political mandate and to give the electorate an opportunity to decide what economic path the country shall pursue.

1 Background to the Crisis

Jamaica, a Caribbean island of 11,000 square kilometres in land area and with a present population of two million, became a British colony in the seventeenth century. Under British rule a sugar plantation economy was developed, based on slave labour imported from West Africa. Production was exclusively for export to metropolitan markets, and most food and manufactured goods were imported. The social structure was highly unequal and fundamentally racist.

The century after the abolition of slavery in 1838 was one of stagnation and underdevelopment. The freed slaves founded tiny hillside farms in the mountainous interior, but the planters still controlled the best land, and more and more emigration took place to the urban areas and to other countries in Central America and the Caribbean. Banana production was introduced, but economic activity remained limited to the cultivation of tropical agricultural staples and the first-stage processing of such commodities. By the 1930s, over one-quarter of the labour force was openly unemployed, another quarter was underemployed, and wages were pitifully low. Widespread strikes and riots against the planters and the Colonial Office broke out in 1938. The People's National Party (PNP) and the Bustamante Industrial Trade Union (BITU), precursor of the Jamaica Labour Party (JLP), were formed. The British government granted a new constitution in 1944, and initiated the long, slow process towards 'Self-Government' and independence.

The PNP, founded in 1938 by Norman Manley (father of the present Prime Minister), adopted a social democratic ideology in the British Fabian tradition. Universal suffrage and national independence were its principal

goals. Its leadership consisted of professionals, intelligentsia and small businessmen, with strong support from the lower middle strata. The PNP was outmanoeuvred in the first two elections held under adult suffrage by the more fundamentalist JLP, founded in 1942 by Alexander Bustamante, the hero of the labour uprising of 1938. Bustamante's politics were a mixture of populist bread-and-butter appeal with a strident anti-communism; he thereby gained the support of the masses of low-paid workers and the landed oligarchy, who were suspicious of the 'socialist' PNP. The PNP had a relatively brief term in office between 1955 and 1962, during which time it pursued respectable policies of promoting private investment and attracting foreign capital, while experimenting with the West Indies Federation and then opting for independence in 1962. The JLP won the 1962 election and then won again in 1967, thereby governing Jamaica for its first decade of independent status.

Boom conditions prevailed in the economy during the 1950s and 1960s. Between 1950 and 1962 foreign trade increased eightfold, nominal GDP grew sevenfold, and per capita national income also increased about sevenfold. In real terms, GDP growth averaged 5–6 per cent per annum overall, and 3–4 per cent per capita. Growth was propelled by direct foreign investment in bauxite-alumina and the exports of that industry. All the major North American transnational aluminium companies—Alcan, Alcoa, Reynolds and Kaiser—established bauxite mines and processing plants in Jamaica, which became the chief supplier of raw materials for the North American aluminium industry. Growth was supplemented by tourism, construction, manufacturing and an ex-

panding public sector. However, agriculture was relatively stagnant during this period, and much of the new investment was of a highly capital-intensive nature. As a result, income inequalities widened and unemployment grew; the sense of foreign domination also heightened.

These tendencies became particularly sharp in the 1960s, under the conservative JLP administration. The national unemployment rate grew from 13 per cent in 1962 to over 24 per cent in 1972, with unemployment highly concentrated among the youth and the women. Income distribution worsened, and it is estimated that between 1958 and 1968 the share of the poorest 40 per cent of the population in personal earned money income declined from 7.2 per cent to 5.4 per cent. Absolute poverty also grew, as between 1958 and 1968 it is estimated that the absolute income of the poorest 30 per cent of the population fell from \$32 to \$25 per capita, in constant 1958 dollars. In 1962, some 60 per cent of the labour force was earning less than \$20 per week, the amount fixed as the national minimum wage in 1975. Slum areas in Kingston, the chief receptacle of rural-urban migration, were riddled with high unemployment, poor housing and other social facilities, and violent crime. The contrast with the tourist posters describing Jamaica as an 'island paradise' could hardly have been more glaring.

Not surprisingly, political and social tensions escalated. In 1965, sections of the Kingston ghetto areas rioted against Chinese shopkeepers. The 1967 national elections were marked by widespread gun violence and a State of Emergency had to be declared. The following year saw the formation of a Black Power Movement with strong support from the unemployed and from members of the Rastafarian Cult, and there was widespread rioting

in October 1968 following the government's expulsion of Dr Walter Rodney, a radical Guyanese historian then teaching at the university. The JLP government responded with a variety of repressive actions to guarantee the maintenance of 'confidence'. Black Power literature and literature from socialist countries was prohibited, the passports of political activists and university intellectuals who travelled to Cuba were seized, and police activity against unemployed ghetto youth was intensified. Social protest then tended to be transformed into cultural and musical expression and this was the period of the most intense development of the Reggae musical idiom which has now become internationally famous. Early Reggae music is the music of suffering, protest, anger and violent retribution. 'Mi a suffa', 'blood and fire', 'dem haffi get a beatin', and 'I and I a go beat down Babylon' were some of the most popular Reggae songs as the 1970s began.

The mood of protest spilled over into and deeply influenced the opposition PNP, which was then reorganizing under the leadership of Michael Manley. The PNP's 1972 election campaign did not mention socialism nor did it espouse any particular ideological position, but rather focused on the issues of unemployment, social and economic inequalities, political repression, non-participation of the people in the political process and Jamaica's passive stance in international affairs. 'Power for the people' was the campaign slogan. The task was assisted by the deep schisms which were appearing in the JLP administration towards the end of its term of office, resulting in a substantial defection of support from its traditional private sector allies. The PNP victory in 1972 was, therefore, very much the product of a multi-class alliance with support from the unemployed, large sections of the workers and

the peasants, most of the professional and administrative middle class and intelligentsia,

and a substantial fraction of the local bourgeoisie.

2 Development of the Crisis

Once in office, Mr Manley's PNP administration instituted a variety of policies aimed at redistribution of income and securing greater national control over the economy (Table 1). In the first two years, the PNP announced plans and/or programmes in relation to unemployment, skill training, literacy training, land reform, food subsidies, rent restrictions, free education, school uniform subsidies and equal pay for women, to name only a few. Mr Manley also displayed a growing assertiveness in foreign policy matters. Jamaica declared itself a non-aligned country and Prime Minister Manley travelled to the Algiers Non-Aligned Conference in September 1973 in the company of Prime Minister Fidel Castro of Cuba. Jamaica led the four Commonwealth Caribbean states in the full diplomatic recognition of Cuba, thereby incurring the displeasure of the United States Ambassador.

The year 1974 was very much the political and ideological turning point for the Manley administration. With the economy's import bill increasing from approximately \$40 million to \$160 million, due to OPEC action, Mr Manley told the transnational mining companies in the bauxite industry that the old contracts negotiated in the '50s and '60s no longer applied. The Jamaican government imposed a Production Levy on the industry, equivalent to 7.5 per cent of the price of the aluminium ingot content of bauxite mined; this would increase bauxite tax revenue from \$25 million to \$200 million in one year. To support this, Jamaica played a leading role in the formation of the International Bauxite Association (IBA) in

March 1974. In continuation of the radical new policy on bauxite, Jamaica secured agreement for the smelting of alumina in the new state-owned aluminium plants to be built in Mexico, Trinidad and Guyana. As if to 'rub salt in the wounds', the government announced a policy of acquiring a 51 per cent share in the mining operations of the bauxite companies. The government also proceeded to negotiate a takeover of a number of the major enterprises in public utilities and export agriculture in the economy, and continued the expansion of social programmes. To crown all this, towards the end of the year, Mr Manley declared the adoption of 'Democratic Socialism' as the PNP ideology. Although subsequent official PNP pronouncements were careful to emphasize the difference between Democratic Socialism and Marxist Socialism, the unapologetic anti-imperialist (rather than anti-communist) accent of the new ideological turn sent shock waves of hysteria rippling through the local privileged classes and caused growing apprehension and concern within the Ford-Kissinger administration.

Adverse private sector reaction became evident in 1975 with a fall in business activity, a sharp contraction in private investment, and a growing wave of migration of professional persons and their capital. In addition, towards the end of the year relations with the United States administration deteriorated sharply. Mr Manley paid a state visit to Cuba in the middle of the year and praised Castro and the Cuban Revolution; later he endorsed the MPLA in the Angolan struggle and the support provided by

Table 1 New and/or expanded social and economic programmes introduced by Mr Manley's PNP administration, 1972-77

Year announced	Policy measure	Target
1972	Special employment programme Skill training programme Workers' Bank Literacy programme (JAMAL) Lowering the voting age to 18 Community health aides Operation GROW Land lease Civil service reclassification Youth training increased	Unemployed Unskilled Workers Illiterates Youth Rural Poor Landless Landless Civil Servants Youth
1973	Cultural training centre Food subsidies (flour, condensed milk) Uniforms for primary school children Free secondary education Free university education National youth service Rent restriction act revised Equal pay for women and women's affairs bureau established Jamaica nutrition holdings	Artists Poor Poor All classes All classes Youth Tenants Women All classes
1974	Self-supporting farmers development programme (loans) Family court National minimum wage NIS pensions increased Poor relief increased AMC outlets in low income areas New mental health law and free education for handicapped Construction of small industries complexes Sugar cooperatives Production levy Nationalization of bauxite multinational companies Development venture capital financing co. (loans) Jamaica public service co.(electricity) Jamaica merchant marine Jamaica omnibus service co.	Small farmers Children and unmarried mothers Lowest paid workers, household helps Old Aged and indigent Poor Mentally ill, handicapped Small businessmen Landless sugar workers All classes All classes Small businessmen All classes All classes All classes
1975	Worker participation National housing trust	Workers Poor
1977	Small enterprise development co. State trading corporation National commercial bank	Small businessmen All classes All classes

Cuba after the South African invasion of that country. By early 1976, the PNP government was in the grip of a savage and orchestrated destabilization campaign. In the first six months of the year, widespread violence and arson ripped through the ghetto areas of Kingston, leaving hundreds dead. A hostile press campaign was unleashed in the US media which, to all intents and purposes destroyed the tourist industry. By March 1976, international commercial banks ceased all new lending to Jamaica; later on, the US Exim Bank dropped the country's credit rating from A to D. Jamaica was listed publicly as a hazard post for United States Embassy personnel. Not surprisingly, the economic defensive deteriorated rapidly, and the government found itself on the defensive both politically and economically in an election year.

In June 1976, a state of emergency was declared in a stronger effort to contain the domestic violence. On the economic front, attempts were made to substitute bilateral loans from friendly governments for commercial bank lending: \$80 million was secured from Caricom partners (mainly Trinidad and Tobago)

in June, and \$75 million from Canada (most in illiquid form) towards the end of the year. These were inadequate to staunch the haemorrhage of foreign exchange reserves. Politically, the PNP made the issue of destabilization by imperialism and the local oligarchy the main theme of its 1976 election campaign. Strong evidence in support of the charge of CIA involvement was provided by Phillip Agee, the CIA defector, who visited Jamaica in July and named a number of agents at the US Embassy in Kingston. The PNP's campaign was a major success: in the national elections of December 15th, 1976, it secured 57 per cent of the popular vote and 47 out of the 60 parliamentary seats, the largest majorities in Jamaica's electoral history since Bustamante's victory in 1944. However, a few days after the election the central bank was forced to suspend foreign exchange payments: liquid reserves were almost zero and were inadequate to sustain payments for on-going imports, services and foreign debt. The PNP government had successfully defended itself against the CIA; now it would have to deal with the IMF.

3 Jamaica-IMF relations, 1974-80

As the foreign exchange situation deteriorated, Jamaica's bargaining position vis-à-vis the IMF weakened, and the government came under increasing pressure to change the nature of its economic policies.

Table 2 traces the progressive decline in the net foreign reserves of the Bank of Jamaica from 1974. Table 3 shows the questions that divided Jamaica from the Fund, and the nature of the changes that the government eventually had to make.

We have identified eight items of Jamaican economic policy which were, at one time or another, of major concern to the IMF over the period 1974-80. These were:

1. Excessive wage increases.
2. Overvalued exchange rate.
3. Excessive fiscal deficit.
4. Excessive monetary expansion.
5. Excessive restrictions on trade and payments.

6. Excessive state intervention in the economy.
7. Excessive price controls.
8. Lack of business 'confidence'.

The eight items can in reality be reduced to three core policy issues: i.e. those of (a) excessive real wages (b) excessive global demand, and (c) excessive intervention into 'the market'. It is instructive to follow the sequence in which the different policy issues became important, and the Jamaican government's position changed from outright defiance towards IMF demands to active co-operation with the Fund and its programme and then finally back to defiance.

1974–January 1977: Defiance

Jamaica had joined the Fund under Article VIII in 1963, but boom conditions in external trade and foreign investment combined with orthodox economic policies meant that there had not been a need to make major use of Fund resources. In July 1974, however, at the annual staff consultation report, IMF staff began to show anxiety at the trend of the Jamaican government's policies. Concern was expressed over a wide range of policy issues, including wage increases, the fiscal deficit, monetary expansion and restrictions on trade and prices. Clearly, the government was tilting the balance between the public and private sector, and between labour and capital. Contracted wage increases averaged 50–60 per cent in late 1974 and through 1975, and began to exceed substantially cost of living increases. By August 1975, IMF staff were expressing acute concern at the rate of wage inflation, which they now regarded as the key issue. But they also recognized the political difficulty of instituting wage restraint and advocated the

Table 2 Net foreign reserves: March 1974–December 1979

Date	Net Foreign Reserves* (J\$ million)	
1974	March	121.3
	June	144.8
	September	168.8
	December	130.2
1975	March	128.0
	June	136.7
	September	73.7
	December	56.7
1976	March	-1.9
	June	-31.9
	September	-102.0
	December	-181.4
1977	March	-151.8
	June	-157.0
	September	-198.9
	December	-196.0
1978	March	-218.9
	June	-328.7
	September	-402.4
	December	-447.4
1979	March	-401.6
	June	-525.8
	September	-677.7
	December	-758.5

* Net foreign reserves are total foreign reserves less sinking fund provisions.

Source: Bank of Jamaica.

traditional tools of demand management, especially fiscal restraint, as a substitute for the time being. However, the Jamaican government was to find it politically difficult to institute either measure under the especially difficult conditions of 1976.

While foreign exchange reserves remained positive in 1974–75 the government was able to

Table 3 Items in the Jamaica-IMF relationship, 1974-79

Item	Major concern expressed by Fund	Major disagreement between Fund and Jamaican government	Major (minor) change in government policy
Excessive wage increases	July 1974 August 1975 March 1976		(March 1976) (January 1977) (July 1977) May 1978
	May-July 1977 April-May 1978	May-July 1977	
Overvalued exchange rate	December 1976	December-January 1977	- (April 1977)
	May-July 1977 January 1978 April-May 1978	May-July 1977 January 1978 April-May 1978	- January 1978 May 1978
Excessive fiscal deficit	July 1974 August 1975		(February 1976)
	March 1976 December 1976		
	May-July 1977 April-May 1978 November 1979-January 1980	May-July 1977 April-May 1978 January 1980	(January 1977) July 1977 May 1978
Excessive monetary expansion	July 1974 August 1975 March 1976 May-July 1977	May-July 1977	July 1977 (May 1978) (January 1979)
	July 1974 August 1975 November 1976 July 1977 June 1978		
Excessive state intervention in the economy	August 1975 May-July 1977 April-May 1978	May-July 1977 April-May 1978	May 1978
	July 1974		May 1978
Lack of private sector 'confidence'	April-May 1978 April-May 1979		May 1978 May 1979

Source: Based on IMF staff consultations and IMF-Government of Jamaica negotiations

resist the pressure from the Fund. However, in March 1976 net foreign reserves became negative and commercial bank lending ceased. In that month, Jamaica applied for Special Drawing Rights (SDRs) \$29.2 million under the IMF Oil Facility, promising to pursue restrictive monetary and fiscal policies and drastic wage restraint. The Fund approved the request, noted the promises, and observed Jamaica's behavior closely. But performance was unsatisfactory. New wage guidelines were introduced in March 1976 which allowed wage increases to 'catch up' with cost of living increases since June 1973, i.e. during the period of OPEC price increases and world inflation. In a sense this would be restrictive, since many wage settlements in excess of this occurred, but future developments were to show that the IMF was opposed to the 'catch up' principle. Moreover, the guidelines allowed loopholes, such as inter-industry comparisons and ability to pay, and provided for a narrowing of income inequalities by freezing salaries in excess of \$16,000 per annum.

Performance in the fiscal area was even worse. A tax package was introduced to raise an additional \$80 million in the 1976 financial year, but since production was falling actual tax revenue did not grow. At the same time, it proved to be impossible to contain expenditure in an election year; and actual fiscal spending in 1976/77 exceeded the original budget by \$180 million (16 per cent) and the previous financial year by \$332 million (34 per cent). Since foreign commercial lending ceased and tax revenue was stationary, the huge expansion in expenditure was financed virtually entirely by money creation.

The IMF was not pleased. In November 1976, Jamaica made an application for US \$13.5 million under the Compensatory Financing Facility designed to deal with export short-

falls. The request was approved as the case was clearly documented, but

...the major industrial countries' representatives vied with one another in scolding President Michael Manley's government for slapping on unauthorized import licensing restrictions and otherwise *breaking their promises* to the fund ... Third World representatives at the meeting sympathised with the Jamaican government's dilemma. 'The social and political conditions were such that they could not be ignored,' maintained Festus G. Mogae, representing 16 African nations. This plea for understanding left US director Cross unmoved. 'The Jamaican authorities had departed substantially from the financial programme that had been presented to the fund,' he said reprovingly. (The programme would have required cuts in wages and government aid for the poor.) The concept of conditionality for the use of the fund's compensatory financing facility and its other facilities must not be weakened', he insisted.¹

By this time, it was clear that Jamaica was going to need major IMF assistance, and in early December officials of the Fund and the Jamaican government worked out the outline of a two-year stand-by arrangement. The main features were a major devaluation, a wage freeze, and a programme to achieve balance in the government budget. The closure of the foreign exchange market immediately after the election was the first action in the scenario. But in the triumphant atmosphere following the election victory, progressive elements within and outside the PNP, including the university, argued persuasively that the adoption of the proposed agreement would be inconsistent with the political mandate that the PNP had freshly secured. The government decided to reject the programme, and to reopen the foreign exchange market on an essential-payments basis. In a speech to the nation on January 5th, 1977, Prime Minister Manley was defiant:

...we are now facing a situation in which some of the people who could lend us money will apparently do so only on the condition that they should be able to tell us how to conduct our affairs ... the International Monetary Fund, which is the central lending agency for the international capitalist system, has a history of laying down conditions for countries seeking loans ... this government, on behalf of our people, will not accept anybody anywhere in the world telling us what to do in our country. We are the masters in our house and in our house there shall be no other master but ourselves. Above all, we are not for sale.²

On January 19th, the Prime Minister announced a new economic package to deal with the crisis. The main features were: (a) no devaluation; (b) a steep new gasoline sales tax aimed at raising \$50 million; (c) a six-month pay moratorium; (d) strict import licensing and the rationing of foreign exchange to essential payments only; (e) additional government takeovers in commercial banking and cement; and (f) preparation of an Emergency Production Plan to mobilize domestic production in agriculture, industry, bauxite and tourism. The taxation and wage restraint measures were steps in the right direction from the IMF's point of view; but the further restrictions on foreign trade and payments, the rejection of devaluation, and the fresh state incursions into the private sector were the very opposite of what the IMF wanted. The government was keeping its options open while it examined the possibility of alternatives and sought to increase its bargaining position in relation to the Fund.

February–December 1977: Uneasy truce

In the early months of 1977, the government took a number of international initiatives aimed at broadening its economic options. The

possibility of financial assistance was explored in visits by the Prime Minister to Trinidad and Tobago and Venezuela, and by Foreign Affairs Minister Patterson and PNP General Secretary D. K. Duncan to Cuba. None of these gave promise of providing the additional US \$250 million estimated as the external financing gap by the government. In the light of subsequent events, the most significant development turned out to be the replacement of the Ford–Kissinger administration by the Carter–Vance–Young government in the United States. Signals soon began to come from Washington to the effect that the new administration wanted a fresh start in its relations with the Caribbean, beginning with Jamaica. It was made known that US financial assistance, which had been practically terminated in 1975/76, would be forthcoming on a substantial scale, but that this would be easier to secure if Jamaica mended its relations with the IMF. At the same time, the local private sector began to exert economic pressure on the government, threatening a virtual collapse of the manufacturing sector with tens of thousands of workers being laid off, if additional foreign exchange were not made available to finance imported raw materials. Workers were encouraged by manufacturers to picket the offices of the Trade Administrator in support of their employers' demands for import licenses. The manufacturers were fully aware that fresh commercial bank loans would only be forthcoming if there were an IMF agreement, and that such an agreement would, in turn, strengthen the position of the private sector.

Faced with the 'stick' of a growing capitalist strike, together with the 'carrot' of substantial US assistance, the government by March 1977 was laying the basis for a strategy of fresh negotiations with the Fund. In April, it was announced that a fresh approach would be

made to the Fund as part of the Emergency Production Plan. Simultaneously, a dual exchange rate was adopted: a 37.5 per cent devalued 'Special Rate' to facilitate exports and to apply to inessential imports; and the old rate, the 'Basic Rate', for government transactions, bauxite exports and essential imports of basic foods and medicine. The deficit financed by the local banking system would be cut from \$447 million in 1976/77 to \$250 million in 1977/78. Wage increases after the expiry of the moratorium would be limited to \$10 per week, about 22 per cent on the average weekly wage.

These measures went only part of the way towards meeting IMF requirements. The dual exchange rate system was on the face of it an ingenious solution to the problem of meeting the IMF argument about export competitiveness, while insulating real wages from the effects of devaluation. By the same token, the IMF did not like it. Matters were not helped when the trade unions rejected the wages guidelines and the government decided to withdraw them; replacing them with new guidelines which allowed wage increases in excess of \$10 per week where it was necessary to 'catch up' with the real wage as at June 30th, 1973. The IMF team arrived in Kingston in early May, but the negotiations were soon deadlocked on the key issues of exchange rate and incomes policies. The domestic economic pressure on the government was maintained, but Mr Manley was able to utilize his international standing to mobilize considerable support for Jamaica's position from Prime Ministers Callaghan of Britain and Trudeau of Canada. Britain had only just emerged from its own, particularly contentious, bout with the Fund, while Mr Trudeau's government prided itself on its independence from the US and stood firmly with Jamaica during the period of

US supported destabilization in 1976. The Fund's bargaining position was also weakened as a result of the barrage of criticism to which it was subjected at this time: by the Group of 10 for its management of the world monetary system, by international banks and by Third World countries (though from different points of view) on the debt problem, and by Britain, Italy, Peru and Egypt on the nature of its adjustment programmes. Critical articles appeared in the establishment press, such as *Business Week*, *Time*,³ *Euromoney*,⁴ *The New York Times*,⁵ and *Fortune*.⁶

In the end, however, it was almost certainly the position of the Carter administration that clinched the issue. Rossalyn Carter included Jamaica in her Latin American tour as a personal emissary of the President in May 1977 and Ambassador Andrew Young followed in July. Left-wing elements were rapidly losing influence in the party and government, which had lifted the state of emergency in April and had invited Amnesty International to evaluate the state of civil liberties in Jamaica (Amnesty International demurred); its 'human rights' record could therefore pass inspection. Although right-wing groups in the United States were opposed to the policy of *rapprochement* with the Caribbean (Burnham's Guyana was included in the policy) it appeared that the Carter administration was able to 'lean' on the IMF to reach an agreement in July.

The Fund settled largely on Jamaica's terms with regard to exchange rate and incomes policies. In return, it secured a fairly restrictive fiscal and monetary policy, and stringent balance of payments requirements. These were expressed in the well-known performance tests relating to net foreign reserves and net domestic assets of the central bank, net banking system credit to the public sector and outstanding arrears, and limits on new external

medium and long-term borrowing. The amount to be provided was US \$74.6 million over the two years to June 1979. In fact both sides regarded the July 1977 agreement as a truce, giving time for further manoeuvring. Indeed, it was anticipated that negotiations for an Extended Fund Facility Programme would commence in early 1978 for completion by March of that year.

Jamaican officials knew that there was a likelihood of failing the fiscal performance tests of March 31st, 1978.⁷ The objective was to secure, through the IMF 'Good Housekeeping' seal of approval, sufficient commercial bank and bilateral loans to give them time for protracted negotiations in 1978, leading to an EFF agreement that would provide a longer period of adjustment for the fiscal and balance of payments disequilibria. It was also hoped that it would be possible to secure some concessions in relation to incomes policies. It was assumed that it would become necessary to agree to unification of the exchange rate (full devaluation), but the intention was to secure enough room on the fiscal side to continue substantial subsidies on wage goods and thereby cushion the effects of devaluation.

The IMF for its part remained preoccupied with the question of the exchange rate and incomes policies. Its tactic of securing a restrictive fiscal policy in lieu of a restrictive wages policy had been anticipated in its staff consultation report of August 1975. It received a further irritant in September when Jamaica devalued the Special Rate of Exchange by 2.5 per cent, rather than move some \$50 million of imports from the Basic to the Special Rate as it assumed would—and should—have been done (Jamaica argued that the effect on the weighted exchange rate was the same). But the IMF held a trump card the significance of which only later became apparent: the De-

cember 15th (1977) performance test. On the day in question, the net domestic assets of the Bank of Jamaica failed to be under the required ceiling of J\$355 million by the ridiculously small amount of \$9 million, or 2.6 per cent.⁸ This was because certain foreign loans on which the Jamaicans had counted failed to materialize, at least in time. But the Fund seized immediately on Jamaica's delinquency as grounds for suspending the agreement, refusing payment of US \$15 million due on the second tranche (i.e. instalment) of the stand-by facility, preventing disbursement of a \$30 million World Bank loan which had just been negotiated, and holding up a US \$32 million loan package from a commercial banking consortium. Jamaica's 'bad performance' was now the proof to Mr Manley's friends in the US, Canada and Britain that his domestic economic management was not worthy of any more sympathy or support: now, his government would be at the complete mercy of the Fund.

January–June 1978: Defeat

The message which came from the IMF in the first week of 1978 was short and to the point: (a) Jamaica must undertake a total weighted devaluation of 10 per cent as a *precondition* to fresh negotiations; (b) the negotiations would only take place within a framework where Jamaica agreed that, in the first year of the programme, monthly devaluations would take place equivalent to the difference between the Jamaican rate of wage inflation and that of its main trading partners. The exchange rate was therefore firmly linked to wages policy: the greater the degree of wage increases allowed, the higher the devaluations would have to be; the lower the devaluations the government wanted, the more restrictive the wages policy it would have to impose. Mr Manley's state-

ment to the nation on January 14th, 1978 was in painful contrast to the defiance of one year before and provided clear evidence of the IMF's use of foreign exchange leverage to enforce policy changes on a sovereign country:

... having failed the test at the end of the year, we entered into talks with the IMF to see what had to be done. As it has turned out, both sides agreed that some measure of devaluation is necessary, but the IMF feels the devaluation should be somewhat larger than we think necessary and justified at this time ... *we would have preferred a smaller adjustment, but, in the end, the fundamental consideration is that we must have access to foreign exchange in the future.*⁹ (Emphasis added.)

The worst, however, was yet to come. The IMF negotiating team which arrived in Jamaica at the end of January showed little interest at the outset in performance tests and percentages of the GDP. Far more interests was shown in the overall sense of the Jamaican government's readiness to undertake a radical change in the nature of its policies, and to follow this through with political determination. Talks between the IMF team led by C. David Finch and the Jamaican team led by Finance Minister David Coore dragged on inconclusively during February. Then, on March 1st, 1978, came a bombshell: Prime Minister Manley fired David Coore as Minister of Finance and Deputy Prime Minister. Coore had held the two posts since the PNP government took office in 1972 and was also Chairman of the People's National Party. But Coore had to go because he had the political responsibility for the failure of the December test, and because his credibility with the IMF had been badly tarnished by his association with previous economic policies. The dismissal marked the end of his political career, as he resigned as Party Chairman and as a Member

of Parliament, left politics, and eventually left Jamaica to work with the Inter-American Development Bank. The new Finance Minister was Eric Bell, a lawyer by profession like Coore, formerly Minister of Public Utilities and Transport and then Minister of Education. Bell was given the job of bringing the IMF negotiations to a successful conclusion as quickly as possible and of making sure that Jamaica failed no more performance tests.

Negotiations proceeded at a much accelerated pace during March. There was little that the government could now do but agree to a virtually complete overturn of its previous economic policies. It was agreed that the monthly 'mini-devaluations' would be undertaken in the first year of the programme, that wage increases would have to be restricted below cost of living increases, that the relative size of the public sector would be drastically restricted by eliminating the current account deficit and reducing the overall deficit, that the private sector would be given the leading role in economic recovery by giving it higher profitability and restricting further state incursions into the economy, and that the overall strategy would be one of export-led growth. But just as the two sides appeared to be on the brink of agreement in mid-April, the IMF position hardened.¹⁰ The message came through that Jamaica's credibility with the international banks was so poor that 'shock treatment' was needed, if there was to be any chance of having it reestablished.

Just what 'shock treatment' meant soon became clear: it meant that a major part of the required 'adjustment' would be necessary *immediately*, and virtually all of it in the *first year* of the three-year programme. In concrete terms this meant that a 15 per cent devaluation would be necessary at the beginning of the first year, in addition to unification of the exchange

rate, and monthly devaluations amounting to a further 15 per cent over the first 12 months of the programme.¹¹ When put together with the projected package of \$180 million in new taxes, and price liberalization to guarantee a 20 per cent rate of return on capital to the private sector, the projected inflation rate would be 40 per cent over the 12-month period. Since the wages policy called for a maximum increase of 15 per cent in employee compensation, the programme involved a deliberate reduction of real wages of approximately 25 per cent. IMF officials were quite adamant on this point: if higher wage increases were allowed, then greater devaluation would be required. The objective was to restore within *one year all* the competitiveness which the Jamaican economy had allegedly lost over the past seven years.

It was a bitter, painful pill for the government, the People's National Party, and the people of Jamaica to swallow. The trade unions stated their flat rejection of the wage guidelines if further devaluations were to take place; the Cabinet balked at the exchange rate and incomes policies;¹² even the manufacturers were now concerned, because of what a deflationary programme might do to domestic sales.¹³

The new Minister of Finance, Eric Bell, was driven to state that 'some of the conditions on which they [the IMF] have been insisting appear to us to be *unduly harsh* ...'¹⁴ But arrears continued to pile up, and reached over US \$80 million by early May. Shortages and lay-offs had appeared again, similar to the first half of 1977. Social tension was growing, and on April 17th a protest demonstration in western Kingston erupted into vandalism and looting, with three looters killed by the police. With major debt payments falling due in late May, the government had to cave in. Prime Minister Manley himself led the campaign to

explain the drastic terms of the agreement to the people in a public speech in late May: consumption had to be reduced to generate more savings and more investment to create more jobs; exports had to be made competitive to earn the foreign exchange so that the economy could begin to grow again, and in any case, what was the alternative?

IMF staff and directors were greatly impressed by the Jamaican government's acceptance and political endorsement of an agreement which virtually overturned every fundamental aspect of its previous economic policy. Some directors were sceptical of the government's ability to stick to such a drastic programme, while others also expressed scepticism that the domestic private sector, foreign investors and bankers would respond to the programme, at least with the speed and on the scale required. The text of Finch's cable, which was published in full by the government, read:

Happy to report that at 4 p.m. today, after thorough four-hour discussion, IMF Board gave its warm approval to EFF programme with Jamaica. No less than 14 executive directors spoke, including US, U.K., French, German, Netherlands, Scandinavian, Venezuelan, Brazilian, Indonesian, Sri Lanka and the two African Eds.

All who spoke praised Jamaican government for its courageous decisions and commended it for the appropriateness of the shifts in economic policy toward greater emphasis on economic growth and the expansion of employment. Most Eds accepted inevitable uncertainties in speed of response of private sector and several warned that restoration of confidence by investors inside and outside Jamaica could be slow.

In my opening oral comments I stressed the need for additional external financial assistance beyond amounts being provided by IMF and World Bank. With regard to commercial banks I said first priority was being given to try to ensure full rollover of existing loans as they matured but that it may prove

difficult to get assurance of net new financing from commercial banks at least in very early stages of programme. This underlined importance to Jamaica of quick disbursing assistance from friendly countries. This theme received warm response from many Eds, led by Ken (UK) who reported on progress in *ad hoc* consultation group.¹⁵

Jamaica had at last agreed to play by the rules and the government had done everything that had been asked of it. The Fund was now to bend all of its efforts to ensure that the 1978 agreement would be a success.

May 1978–79: Good behaviour

The Jamaican government proceeded to carry out every single aspect of the new agreement both in letter and spirit. Tight monitoring of the performance tests was established. The devaluations were carried out, prices were liberalized, and the tax package was imposed. As expected, there were huge price increases, giving rise to a 39 per cent increase in the consumer price index between May 1978 and May 1979 (the increases during the calendar year 1978 amounted to 49.4 per cent). The wages policy held, and the objective of cutting the real wage by approximately 25 per cent was met (in fact, the National Planning Agency estimated that the high-wage sector of the economy suffered a real wage reduction of 35 per cent in calendar year 1978).¹⁶ The government officially adopted a strategy of export-led growth: in addition to the devaluations, a Certified Exporter Status scheme was introduced giving exporters who qualify preferential access to import licenses. The State Trading Corporation was restricted to its existing activities. A Mixed Commission was established to promote dialogue with the private sector, and much time and political resources were spent on mending relations with them.

All these changes were faithfully reproduced in the Five-Year Development Plan published at the end of 1978: while the social policies in the Plan retained the concerns of Democratic Socialism, the macroeconomic targets and policies were mainly a restatement of the IMF agreement.¹⁷

Nonetheless, Jamaica experienced continuous difficulty in keeping within the ceilings established on the reduction of arrears on foreign payments and in meeting the fiscal performance criteria. The Fund cooperated with the World Bank in organizing a consortium of donor countries for the Caribbean and at the first meeting, in June 1978, Jamaica received US \$55 million in pledges. But the commercial banks continued to be cautious; and agreeing to refinance only seven-eighths of Jamaica's debts as they fell due and to make no incremental loans. Since export growth was sluggish while import demands kept increasing, continuous pressure was put on the foreign exchange position. Failure of economic recovery to materialize quickly also jeopardized fiscal performance, as the additional taxes were not fully realized. In the financial year 1978/79, a current account deficit equivalent to 2.5 per cent of the GDP was sustained compared to the target surplus of 2.9 per cent. However, Jamaica could hardly be punished for adopting a programme of the Fund's own making, and the IMF helped the government technically to pass the arrears tests and adopted an understanding and sympathetic attitude towards the shortfalls in fiscal performance (performance *tests* were not actually breached).

The success of the Jamaican programme now became as important to the IMF as it was to the government. For the second year of the programme (1979/80), the IMF arranged an expansion of its lending and a stretching out of

the period allowed for the elimination of arrears and the achievement of fiscal balance. In its turn the government made a commitment to the development of a 'social contract' between the government, the private sector and the trade unions. It was accepted that Jamaica's international competitiveness had been fully restored and that no further devaluations would be necessary, so long as wage increases were contained within the rate of wage inflation of Jamaica's main trading partners. It was also accepted that a proper relationship between profits and wages now existed, although the public sector was still pre-empting too large a share of bank credit. The main features of the package, therefore, were:

1. Wage increases would be kept to 10 per cent and price increases also kept to 10 per cent through the social contract.
2. Government would work to promote an atmosphere of harmony and mutual trust and confidence with the private sector.
3. Trade unions would undertake to minimize industrial disputes, especially those arising out of inter-union rivalry.
4. The private sector would undertake to reinvest profits and so promote growth and create jobs.
5. Government was to reduce the real size of the budget (the nominal increase was kept to 4 per cent with an assumed rate of inflation of 10 per cent) in order to release more credit for the private sector.
6. The Fund committed more resources for the second and third year of the programme, principally from the supplementary financing facility. The total would amount to US \$419 million compared to US \$240 million originally committed in 1978, making Jamaica the highest recipient of IMF assistance in per capita terms.

In effect, the IMF opted to substitute direct

Fund assistance for the commercial bank inflows which would normally have been expected to take place. The hope was that, through the additional resources provided, the basis for economic turn-around would be created, and eventually the commercial banks and foreign and local investors would be induced to support the programme. This strategy received a set-back in September 1979, when it was revealed that discussions for the refinancing of US \$450 million of Jamaica's commercial bank debts falling due in 1980, and US \$250 million of new loans were suspended by the commercial banks concerned, which had advised the Ministry of Finance that it would not be a propitious time to go to the market. After 15 months, the IMF programme for Jamaica had still not received the 'seal of approval' of the international banks.

Second failure and disengagement

In December 1979, Jamaica failed to meet one of the performance tests set for the second year of programme when the ceiling on the net international reserves of the Bank of Jamaica was exceeded by US \$117 million. Breach of the test rendered Jamaica ineligible to make further drawings under the Extended Fund Facility (EFF) programme, of which only 40 per cent of the approved amounts had been disbursed (see Table 4). As Table 5 shows, internal and external factors beyond the control of Jamaica were responsible for 60 per cent or US \$102 million of the breach. The external factors were particularly disruptive. Oil price increases in excess of what was anticipated forced Jamaica, which is over 90 per cent dependent on imported energy, to pay an additional US \$33 million for oil. Overall, international inflation which had been projected at 8.5 per cent by Fund staff and government offi-

Table 4 IMF resources approved and used under the Stand-by Agreement and Extended Fund Facility (US\$ millions)

Agreement	Approved		Disbursed	
	US\$M	% Quota	US\$M	% Quota
Stand-by agreement July-Dec. 1977	75	120	22	35
Extended Fund Facility May 1978-Jan. 1980	429	445	172	179

Source: Bank of Jamaica

Table 5 Factors responsible for shortfall in foreign exchange performance leading to the breach of the net international reserves ceiling on December 31st, 1979 (US\$ million)*

Factors	US\$ million	% of total shortfall
<i>External factors</i>	\$82 M	52.2 %
Increase in oil bill	\$33 M	21.0 %
Increase in debt payments	\$31 M	19.7 %
Increase in import prices	\$18 M	11.5 %
<i>Unanticipated internal factors</i>	\$20 M	12.8 %
Export production destroyed by flood rains	\$20 M	12.8 %
<i>Errors in estimation</i>	\$55 M	35.0 %
1978 import payments overhang	\$30 M	19.1 %
Unavailability of funds from the Export Development Fund	\$25 M	15.9 %
<i>Total</i>	\$157 M	100 %

Source: Bank of Jamaica

* Improvements in foreign exchange earnings and certain other adjustments which meant that the ceiling was exceeded by about US\$117 million.

cially exceeded 14 per cent, increasing non-oil imports by US\$18 million. Interest payments on the commercial part of the foreign debt increased unexpectedly, costing an extra US \$31 million, as LIBOR rates shot up in late 1979, in response to the high interest anti-inflationary policies in the industrialized countries. Internal factors involved severe flood rains in April, June and September which resulted in a loss of US \$20 million in export earnings and errors in estimation. The government's fiscal performance from April to December failed to meet the IMF targets by \$100 million, due to shortfalls in revenue consisting of \$40 million in foreign loans, \$40 million in domestic non-bank financing and \$20 million in tax revenue. The revenue and financing projections were arrived at in close consultation with the IMF officials. There was no over-expenditure up to December 31st, 1979.

As the full impact of the exogenous factors on the foreign exchange situation became evident, Fund staff initially took a realistic view on the need to secure a 'waiver' from the December tests and modification of the programme, including the augmentation of the IMF loans to take account of higher import

prices and interest rates. But towards the end of the year the Fund's position distinctly hardened. By December, the Fund management indicated that the conditions for a waiver and programme modification would include (a) a major reorganization of the structure government administration, (b) a paring down and rationalization of the public enterprises, and (c) massive public expenditure cuts. With regard to the last a \$300 million reduction was said to be required in 1980/81, which would mean a contraction of 26 per cent in real budget expenditure excluding debt service relative to 1979/80. The Government would have to institute measures to give effect to one-half of this reduction (\$150 million) before the waiver from the December 1979 performance tests would be granted; these measures should include a \$50 million cut in the wage bill of

central government to be undertaken preferably through retrenchment of up to 11,000 public sector workers. Further, the waiver would entitle Jamaica to one tranche (US \$30 million) of IMF money only—remaining tranches would be conditional on the actions to effect the remaining \$150 million of reductions. Finally the Fund management indicated that it could no longer contemplate augmentation of the lending programme to take account of the higher import prices and interest rates. This meant that the adjustment outlined above would only restore the resources committed in June 1969, before the exogenous factors took effect, and would therefore by definition be inadequate.

The pointed hardening in the Fund's position took place against a background of growing opposition to the IMF programmes within the population at large and within the ruling PNP. Harsh austerity without the compensation of new investment, employment and growth caused widespread disillusionment with the IMF programme itself and with the PNP Government who had implemented it. At the annual meeting of the Inter-American Development Bank held in Jamaica in May 1979, Mr Manley had complained that the extreme economic measures had not generated additional inflows of foreign capital. In August Mr Manley's speech at the non-aligned summit in Havana was militant and unapologetic as regards Jamaica's foreign policy. In September Dr D K Duncan, the former Party General Secretary, who had opposed the IMF programme in 1977 and who had subsequently resigned, was re-elected to the post—a clear indication of the mood within the Party. In October Mr Manley's address to the Third World Foundation in London pointedly referred to the inadequacy of the IMF to meet the special needs of developing countries. The

Fund's position towards Jamaica may well have been influenced by these political factors, and not only or even mainly by economic considerations.

Moreover these tactics coincided with a chorus of charges from the local private sector to the effect that the government was guilty of economic mismanagement and financial over-expenditure. In December the supplementary budget providing for modest increased expenditure—much of it inescapable—was presented to Parliament and then withdrawn under pressure from the Fund negotiators together with an upsurge in criticism from the opposition JLP and private sector interests. Private sector spokesmen also predicted widespread factory closures and unemployment as a result of the suspension of IMF loans. In January 1980 the powerful Private Sector Organization of Jamaica (PSOJ) called for the resignation of the PNP Government, the formation of an interim administration, and the holding of a general election to resolve the crisis.

In the meantime the internal structures of the PNP had started a detailed examination and discussion of the Government's policies, within the context of preparing for elections in 1981. In October and November 1979 the Party Secretariat solicited the written views of constituency groups on economic policy. The reports were used as the basis for a discussion of economic policy at a meeting of the 250-member National Executive Committees in November. At this time the concern was to find additional room to manoeuvre within the constraints of an IMF programme. However the failure of December 1979 test, the harshness of the new IMF demands and the PSOJ demand that the Government should resign, brought the issue into sharp relief within the PNP. In January 1980 a Special Delegates Conference

on the economy, attended by some 2,500 delegates, gave enthusiastic support to proposals that the Government should find a 'Non-IMF path'. As a result, the Party set up an Economic Affairs Commission to examine the feasibility of an alternative economic programme without IMF support. The Government also resolved to resist the full extent of the budget cuts being demanded by the Fund.

Throughout December and January officials of the Government and the Fund were meeting around the clock to develop a package of economic measures for presentation to the IMF Board. In December the number of Cabinet Ministries was reduced from 21 to 14, as a step towards restructuring the machinery of government to reduce the costs of administration. In January large price increases on locally consumed sugar and petroleum products were announced. A programme of auditing and management improvement for the public enterprises was agreed upon. It was also agreed that private enterprise would be invited to lease some Government-owned hotels, and to get involved in export crop production on Government-owned land. But the question of budget cuts remained impossible to resolve. In mid-January Prime Minister Manley met IMF Managing Director de Larosière in Washington, but the Fund Management remained adamant on the need for a \$300 million reduction. On February 3, 1980, Mr Manley announced that the Government and the IMF technical team were unable to arrive at an agreement, and that Jamaica would make its application for a waiver directly to the IMF's Board of Directors, without the approval of the IMF's technical team. The Government stated its intention to cut \$100 million from the recurrent expenditure, \$50 million less than that demanded, saving 11,000 jobs in the public sector. The Prime Minister announced that gen-

eral elections would be held before October 1980, in which the electorate would be asked to decide what economic path the country should take and the role of the IMF in this path.

In point of fact it proved impossible to find a mechanism by which Jamaica's application for a waiver could be sent to the Board without the endorsement of the Fund Management. As a result it was decided to commence negotiation on an interim stand-by agreement, which would provide foreign exchange until the elections were held. At the same time the Party's Economic Affairs Commission prepared the outline of an alternative economic programme based on bauxite expansion, agriculture, and tourism; a re-organized and dynamic public sector, and a negotiated debt re-scheduling exercise. This was accepted by the NEC at a meeting on March 8th-9th, but the question remained open of when the break with the IMF would come. At a follow-up meeting held on March 22nd, Finance Minister Bell reported that the performance tests proposed by the IMF under the interim stand-by agreement would be certain to be failed by September. Thereupon the NEC voted by a two-to-one majority to reject the proposed agreement and to proceed immediately to begin the implementation of the alternative programme. On March 24th, the Cabinet formally decided to discontinue negotiations with the IMF. Finance Minister Bell who had conducted the negotiations, resigned and was replaced by Hugh Small, then Minister of Education, Youth and Sports and a member of the PNP's progressive wing.

Lessons of the Jamaica-IMF relationship, 1975-80

The IMF was broadly concerned at the overall

nature and direction of the Jamaican Government's policies. The specific items of concern relating to real wage levels, aggregate demand, and state intervention, were regarded both as intrinsically significant and as indicators of the general orientation of Government policy. The issue of the level of real wages was represented by the disputes over the exchange rate and the linked issue of wages policy. These were the most important points of difference between the Government and the Fund from 1975 through 1978; and it was on this issue that the Government was finally broken in 1978.

In 1979 the Fund shifted its main attention to the issue of the public sector role and management, and the related question of the need for 'harmony' between all social groups and the 'confidence' of the private sector. This provided a framework within which subjective perceptions of the Government's management capacity and political intentions assumed greater weight in judging whether the Government was 'keeping' to the agreement.

The IMF manoeuvred with finesse to secure its objectives, evidently making a careful reading of both domestic and international politics. It gave a little in mid-1977 when its position was relatively weak and that of the Manley Government relatively strong; later on, it pounced when it had the opportunity and the Government was in a weak position. It was interested in securing a thorough reorientation

of the government's policies, with the wholehearted endorsement of the political leadership. Thus, the devaluation-wages policy question was important not only in itself, but also as a political test of the Government's determination. Developments towards the end of 1979, by contrast, were interpreted as a deterioration of the political conditions necessary for the Fund programme to 'work'.

IMF behaviour showed that, performance tests are important not exclusively as 'impartial' measures of economic performance, but also for the way in which the Fund can use them in their bargaining relationship with the government. The breach of a test may or may not be catastrophic, depending on the Fund's view of the overall economic programme.

The 1978 agreement demonstrated the Fund's preparedness to approve an inflationary process if this is the mechanism whereby income is redistributed from labour to capital (reduction in the real wage) and in theory resources reallocated from consumption to investment.

Finally, the Jamaican experience shows that an IMF agreement, even when it is strongly endorsed by the Fund and by western governments, and the country sticks to the programme, does not automatically trigger international commercial bank loans: the IMF 'seal of approval' may not be bankable.

4 IMF Economics in Jamaica: An Evaluation

IMF economics in Jamaica can be evaluated both with respect to the appropriateness of the diagnosis and the effectiveness of the prescription. To this end we have sought to examine the actual behaviour of the Jamaican economy over the following periods:

1. 1953–72, i.e. the period preceding the development of the crisis.
2. 1972–76, when the crisis developed.
3. 1977–79, performance under the IMF programme.

The period 1953–72

Economic growth was high and sustained but was accompanied by growing dependency. Key data on the external sector and on economic performance over this period are shown in Table 6, overleaf.

Column 1 in the Table, the current account deficit on the balance of payments, provides a crude measure of the extent of foreign capital inflows, net of reserve changes. The cumulative deficit over the period amounted to some \$807 million, a considerable amount in relation to the annual GDP. Columns 2 and 3 show the private capital inflow identified by the authorities and the portion of the private inflow attributable to the foreign bauxite companies. It can be seen that the private inflow represented a considerable fraction in relation to the current account deficit, and that direct foreign investment in the bauxite industry was a significant share of the total. Bauxite investment was especially important in the mid-1950s and the late 1960s, the two periods of major expansion in productive capacity.

Columns 4 and 5 provide additional indicators of the importance of external financing to the economy. Foreign investment is estimated to have financed roughly 32 per cent of total investment over the period (Column 4). The excess of imports over exports, which is made possible by external financing, amounted to 23 per cent of all imports over the entire period.

Columns 6–8 show both the growth of foreign trade and its changing composition. Foreign trade as a proportion of the GNP increased from 53 per cent to 64 per cent. Exports came to be dominated by the bauxite industry, which was non-existent up to 1950. Imports of raw materials, fuels and intermediate goods for use in the local productive system grew far more rapidly than total im-

ports, and increased their share in the total from 26 per cent to 36 per cent. Thus, local productive activity became increasingly dependent on a regular and uninterrupted supply of imports, at the same time as imports became increasingly dependent on external financing.

Columns 9–11 indicate the increasing size of the fiscal sector. Government revenues grew steadily, in association with the general economic expansion. Expenditures grew even more rapidly, and the fiscal deficit as a proportion of the total budget increased. This did not constitute a problem as local non-inflationary borrowing from the banking system, and foreign loans, were always available to finance the gap.

Finally, Columns 12–15 show real GDP performance. Real GDP growth was considerable, and much of this was associated with the rapid growth of bauxite-alumina, manufacturing and construction. It is notable that the years of largest bauxite investment (Column 3) are also those of highest GDP growth and highest growth in the construction sector. The poor performance of the agricultural sector was to underline the growing problem of social and economic inequality and unemployment, which gave rise to escalating social and political tensions towards the end of the 1960s.

In summary, then, the basis for both the economic and social contradictions of the 1970s was laid in the pattern of economic and social development of the preceding 20 years, especially the growing economic dependence and the social inequality associated with that pattern.

The period 1972–76

The proximate cause of the crisis was a sharp deterioration in the external sector ending with the complete depletion of liquid reserves. Data

Table 6 Data on capital inflows and the Jamaican economy, 1953–1972

Year	Current account deficit on balance of payments	Identified private capital inflow	Direct foreign investment in bauxite	Foreign investment as % of total investment	Foreign trade as a % of GNP	Bauxite and alumina exports as % of total exports	Imports of raw materials, fuels and intermediate goods as % of total imports
	\$M	\$M	\$M	%			
1953	-8.4			31	53.3	11.0	-
1954	-1.2			26	53.5	20.0	26.0
1955	-12.4		101 ¹	38	54.6	26.8	24.9
1956	-26.0			41	59.4	27.2	24.3
1957	-23.3	29.5		29	59.8	43.4	24.0
1958	-20.8	20.8		29	56.1	46.4	24.0
1959	-32.5	14.1	9	27	55.8	45.0	24.6
1960	-21.2	8.3		16	59.7	49.3	22.8
1961	-8.8	8.2		6	56.9	49.5	24.9
1962	-12.4	7.2		6	56.6	48.4	25.1
1963	+6.6		56	-7	57.2	42.2	24.5
1964	-31.2	3.2		25	61.3	44.5	25.6
1965	-21.8	10.2		17	56.5	47.2	26.5
1966	-30.1	46.2		20	58.2	46.5	26.1
1967	-50.6	80.2		27	57.1	49.1	25.8
1968	-86.2	107.6	380	32	62.4	48.6	25.2
1969	-103.0	90.2		35	66.2	55.5	32.7
1970	-128.3	135.3		28	71.0	65.9	31.9
1971	-95.0	108.1	117 ²	43	66.3	63.4	36.1
1972	-100.0	41.2		45	63.8	62.6	36.3
<i>Total</i>	-806.6		664 ³	Weighted ave. = 32 %			

Source: National Planning Agency ¹ Includes 1950–52, ² Includes 1973–74, ³ 1950–74, ⁴ Year beginning April 1st.

on the external sector (Table 7) show that after 1971 the current account deficit increased every single year up to 1976. The cumulative deficit for the five-year period amounted to \$965 million, of which 1975 and 1976 alone accounted for \$532 million, and this occurred at the same time as private capital inflows were declining.

The capital account.

While overall private capital inflows declined, there were also important changes in the structure (Table 8). Direct investment declined to negligible levels in 1972–74, and actually became negative in 1975 and 1976. Basically this

was due to the termination of the investment cycle in the bauxite industry in 1971, to which was added capital flight due to political factors in 1975 and 1976. The private inflows which took place, especially in 1973–75, consisted largely of commercial lending to local enterprises, much of it medium-term loans under government guarantee. This had two important implications for economic performance; one relating to the underlying growth dynamic of the economy, the other relating to the balance of payments.

The critical feature of Jamaica's high-growth experience in the '50s and '60s is that direct foreign investment in the bauxite industry

Merchandise trade deficit % of total imports	Government non-loan ⁴ revenue ⁴	Government expenditure ⁴	Real GDP	Real GDP mining and refining	Real GDP manufacturing	Real GDP construction and installation	Real GDP agriculture	Year
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	
25	30.0	30.0	Base year 1956	234.2	5.8	30.6	21.0	1953
15	34.2	34.4		260.8	11.6	33.8	22.0	1954
22	38.2	37.2		287.0	13.8	36.8	28.6	1955
27	44.8	45.6		316.8	17.2	41.4	40.2	1956
19	54.2	53.6		357.8	23.0	47.2	44.6	1957
19	58.8	60.0		366.4	30.4	47.0	42.6	1958
23	65.6	73.8		407.0	31.8	61.8	47.0	1959
17	70.2	74.6	Base year 1960	430.5	41.4	60.2	51.4	1960
10	74.4	84.8		447.5	44.8	65.0	49.0	1961
11	82.4	92.2		456.4	46.4	67.0	48.6	1962
5	84.6	98.8		467.5	46.2	72.2	48.6	1963
18	99.6	116.0		503.4	50.8	79.0	53.6	1964
17	113.2	127.4		543.8	54.6	83.0	58.2	1965
22	116.0	137.8		567.7	58.5	89.1	54.4	1966
25	132.4	155.6		589.7	60.0	91.2	56.4	1967
32	146.8	193.2		619.8	61.0	94.2	68.7	1968
33	163.6	203.3		666.1	75.8	100.3	70.1	1969
36	212.8	256.5		734.2	99.5	108.5	72.3	1970
38	244.2	310.0		774.3	106.3	117.0	73.2	1971
39	280.7	373.5	825.2	115.7	125.7	72.5	1972	

Table 7 Balance of payments summary 1968–79 (J\$ million)

Items	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
Current account balance	-86.0	-103.0	-127.2	-93.4	-117.3	-164.3	-151.8	-257.0	-275.2	-61.9	-73.5
Capital movement (net)	+117.0	+98.5	+134.1	+112.1	+59.8	+124.7	+221.1	+189.9	+41.5	+51.7	+5.4
Govt. external borrowing	+11.7	+10.3	-1.2	+4.0	+18.6	+33.4	+81.9	+112.4	+72.0	-5.4	+151.2
Identified private capital	+105.3	+88.2	+135.3	+108.1	+41.2	+91.3	+139.3	+77.0	-30.0	+57.1	-145.8*
Allocation of SDRs	-	-	+5.3	+4.7	+4.7	+4.7	-	-	-	-	-
Net errors and omissions	-6.3	-6.8	+5.4	+13.0	-9.2	+11.9	-15.2	-6.5	-6.8	-4.4	-
Overall surplus /deficit	+29.6	-11.3	+17.6	+36.4	-43.6	-27.7	+54.1	-73.6	-238.1	-14.6	-68.1

* Include net errors and omissions

Source: Bank of Jamaica Annual Reports.

formed the underlying basis of several mechanisms of expansion in the economy. It can first be noted that such investment has a

three-fold significance:

1. As a *construction* activity in the local economy.

Table 8 Details of capital inflows, 1969–77 (J\$ million)

	1969	1970	1971	1972	1973	1974	1975	1976	1977
Capital (net)	+98.5	+137.1	+160.7	+59.9	+124.5	+221.7	+189.9	+41.9	+51.7
Direct investment	+84.7	+134.5	+146.8	+21.2	+20.2	+20.6	-1.7	-0.5	-6.4
Private long term	+0.2	+3.1	+7.6	+10.8	+68.9	+101.9	+72.8	+10.0	+4.3
Private short term	+3.3	-2.3	+2.3	+9.2	+2.1	+16.1	+6.4	-37.6	+59.2
Central government	+10.3	-1.3	+4.0	+18.7	+33.3	+81.9	+112.4	+72.0	-5.4

Source: Bank of Jamaica

2. As a source of *foreign exchange cash inflows*, brought in by the companies to finance the purchase of local goods and services.
3. As investment in *new export productive capacity*, the output of which will generate additional foreign exchange inflows, and fiscal revenues, in the future.

In each of the three roles, the investment triggers a series of mechanisms of expansion which together give rise to the overall process of growth. These may be identified as follows:

1. As a *construction* activity: (a) provides a direct stimulus to the expansion of output in the local construction sector; (b) provides additional demand for the output of local building materials and construction-supplying industries; (c) finances additional personal consumption expenditure by construction workers.
2. As a source of *foreign exchange cash inflows*: (a) finances additional imports of capital goods needed by local investors and the state to convert money capital into fixed investment; (b) finances additional imports of raw materials and intermediate goods needed for manufacturing, construction, transport, electricity and other services, enabling output growth in these sectors; (c) finances additional imports of consumer goods which generate additional commercial activity; (d) generates higher tax reve-

nues based on foreign trade.

3. As investment in *new export productive capacity*: (a) increases the future flow of foreign exchange earnings, leading to higher foreign trade and commercial activity; (b) increases the future flow of tax revenues, leading to greater development expenditure; (c) increases the government's *present* foreign borrowing capacity because of (a) and (b) above, giving rise to additional foreign exchange inflows through foreign loans.

By means of these (at least ten) distinct mechanisms, a chain of expansion is generated which starts with increased construction activity and embraces expanded activity in government construction, manufacturing, commercial businesses and foreign trade, with further feed-back effects on construction activity and a subsequent growth in exports. Both the growth performance *and* the state of the balance of payments appear to be healthy.

However, once the investment cycle comes to an end, a crisis can be precipitated. This is because other forms of investment and foreign exchange provision lack the all-embracing effects of bauxite investment (or any direct foreign investment in export activity). For example, public works by government stimulate the construction sector, but do not by themselves provide additional foreign exchange

cash inflows or increase export productive capacity. The expansionary effects on foreign trade, manufacturing and fiscal capacity will therefore be lacking. If government finances its own investment with foreign loans, this still does not increase export capabilities, and the burden of debt service payments increases with no corresponding growth of exports. Even if *local* private investment were to increase (which did not take place in Jamaica), this does not carry foreign exchange inflows with it. Such inflows will be required for the investment to be realized because of the high import-content of capital formation in a dependent economy.

In the Jamaican case, financial inflows to the public and private sectors not only failed to replace direct foreign investment as a means of financing the current account deficit, but also failed as a substitute engine of growth in the economy. Real GDP declined in 1974 and has been on a downward trend ever since. This was also partly due to the steep contraction in local private investment after 1974: how much of this secondary decline was due to the removal of the previous impetus from bauxite investment, and how much to political factors, it will be very difficult to determine.

However, in addition, the substitution of fi-

nancial inflows for direct foreign investment soon came to exacerbate the balance of payments problem rather than alleviate it. Jamaica's gross external debt grew from US\$143 million at the end of 1971 to US\$489 million at the end of 1976 (Table 9); 63 per cent of the increase was accounted for by commercial bank loans. Many of these were medium-term syndicated loans, and by 1975 both interest and principal payments were mounting rapidly. In 1977, payments on the government and government-guaranteed debt came to account for 22 per cent of the foreign exchange cash receipts of the Bank of Jamaica (as distinct from the declared value of exports), and the dire consequences of default on such payments became a key lever in the IMF's bargaining position vis-à-vis Jamaica.

The current account.

In examining the growth of the current account deficit we will look specifically at the IMF diagnosis of

1. Excessive consumption which pushes up imports (this would include the effects of excessive wage increases and an excessive fiscal deficit/money supply expansion).
2. Excessive wage increases, which erode competitiveness and thereby reduce exports.

Table 9 Breakdown of central government gross external debt by type of loan 1971-79 (US \$ million)

	1971	1972	1973	1974	1975	1976	1977	1978	1979
Market loans	83.4	92.8	75.9	74.6	62.3	45.9	46.6	32.3	25.0
Commercial banks	23.9	29.0	67.3	165.8	255.7	251.0	213.6	248.3	280.3
International institutions	18.1	23.3	25.4	27.7	34.5	50.2	72.2	137.0	152.3
Inter-govt.	17.5	20.7	26.3	31.5	36.4	110.4	149.8	216.6	253.4
Suppliers' credit	-	-	-	-	31.1	31.1	51.0	65.0	62.0
<i>Total</i>	142.9	165.8	194.9	299.6	420.0	488.6	533.2	699.2	773.0

Source: Bank of Jamaica

We will also take into account the alternative 'structural' explanation which ascribes the deterioration to the combined effects of import price inflation both on oil and non-oil imports and export sales declines due to the effects of the world recession in 1974/75.

Actual data on the current account deficit (Table 10) suggest a more complex picture than that implied by either explanation. First, a large part of the increase in the deficit was due to a deterioration of the deficit on services and a reduction of inflows through unrequited transfers. This was especially so in the crisis years 1975-76; in these two years, the deficit on services was actually \$204 million higher than in the previous two years, and unrequited

transfers were \$16 million lower. This accounted for the magnitude of the deterioration in the current account deficit, as the deficit on trade was actually \$3 million *less* in 1975-76 than in the previous two years. The key factors accounting for the rapidly growing deficit on services were growing investment income outflows and a sharp decline in receipts from tourism.

Secondly, in dealing with the merchandise trade component of the current account, it is notable that the actual volume of imports did *not* in fact grow during the 1972-76 period (Table 11). Only in one year (1975) out of the five was there an increase in the volume, of about 11 per cent; import volume declined by

Table 10 Balance of payments summary 1973-79 (J\$ million)

	1973	1974	1975	1976	1977	1978	1979
1. <i>Merchandise</i>	-161.2	-106.9	-144.8	-119.9	85.0	47.1	5.5
Exports (fob)	357.2	630.7	736.7	599.7	691.1	728.9	816.5
Imports (fob)	518.4	737.6	881.5	719.6	606.1	681.8	811.0
2. <i>Services (net)</i>	-27.1	-66.2	-136.0	-160.7	-134.6	-130.1	-247.1
Foreign travel	90.4	88.6	69.3	42.6	85.2	124.0	152.7
Investment income	-52.8	-61.5	-93.5	-105.1	-125.6	168.8	-270.9
Other	-64.7	-93.3	-111.8	-98.2	-94.2	-85.3	-128.9
3. <i>Goods and services (net)</i>	-188.3	-173.1	-280.8	-280.6	-49.6	-83.0	-241.6
4. <i>Unrequited transfers (net)</i>	24.0	21.3	23.8	5.4	18.2	23.4	69.0
Private	30.7	29.6	19.1	1.8	13.7	13.8	57.0
Official	-6.7	-8.3	4.7	3.6	4.5	9.6	12.0
<i>Current account balance</i>	-164.3	-151.8	-257.0	-275.2	-31.4	-59.6	-172.6
5. <i>Net capital movements</i>	124.7	221.1	189.9	41.5	51.7	8.9	35.4
Official	33.4	81.9	112.9	72.0	-5.4	162.6	64.7
Private	91.3	139.2	77.0	-28.1	57.1	153.7	-29.3*
6. <i>Total 1 through 5</i>	-39.6	69.3	-67.1	-231.3	20.3	-50.7	137.2
7. Allocation of SDRs	-	-	-	-	-	-	9.1
8. <i>Total 6 plus 7</i>	-39.6	69.3	-67.1	-231.1	20.3	-50.7	-128.1
9. Change in reserves (increase = -)	27.7	-54.1	73.6	238.1	14.6	70.5	128.1

Source: Bank of Jamaica

* Include net errors of omissions

Table 11 Price, volume and value indices of imports, 1969–78 (base year 1978=100)

Year	Indices of			Declared value of imports c.i.f. (\$'000)
	Price	Volume	Value	
1969	43.2	83.9	35.8	363,301
1970	44.4	111.3	48.2	437,839
1971	52.9	118.0	49.3	459,754
1972	52.2	124.3	54.1	489,256
1973	68.6	99.4	61.9	615,123
1974	100.0	100.0	100.0	850,781
1975	111.7	111.2	116.4	1,021,412
1976	117.8	85.4	89.1	829,785
1977	151.7	88.2	93.3	781,639
1978	219.2	84.7	143.6	1,260,011

Source: Department of Statistics

Table 12 Price, volume and value indices of domestic exports, 1969–78 (base year 1974=100)

Year	Indices of			Declared value of domestic exports f.o.b. (\$'000)
	Price	Volume	Value	
1969	46.2	69.5	30.5	206,100
1970	51.8	81.2	41.8	279,116
1971	51.0	88.4	42.3	275,203
1972	52.9	87.6	44.9	292,277
1973	56.9	93.9	52.6	347,841
1974	100.0	100.0	100.0	630,769
1975	131.0	84.5	110.6	760,889
1976	127.8	73.0	88.4	560,408
1977	133.4	80.0	104.7	672,525
1978	211.8	82.0	165.8	1,057,130

Source: Department of Statistics

20 per cent in 1973 and remained more or less at the lower level through 1974 and 1975, and then declined again by 14 per cent in 1976, the crisis year. The claim of excessive consumption, therefore, only makes sense if it is taken to mean that imports should have been made to decline in real terms by more than they actually did.

The evidence is that import price inflation was far and away the major influence pushing up the value of imports. The average price of imports increased by no less than 123 per cent over the five years, and in 1976 Jamaica paid 80 per cent more for 26 per cent less imports compared to 1971. At the same time, it is notable that average export prices increased by even more—154 per cent—than the import price index (Table 12), and the simple commodity terms of trade, far from turning against Jamaica, actually improved.

Two key factors need to be taken into account here. First, since the actual value of imports normally exceeded that of exports by a wide margin, the negative effect of a given percentage increase in import prices would

significantly outweigh the positive effect of the same percentage increase in export prices. Thus the increase in the import price index after 1971 added the equivalent of \$486 million to the value of 1971 exports. Simple terms of trade analysis should take into account the normally greater value of imports compared to exports in a dependent country.

The second factor relates to the large export shortfalls of 15.5 per cent and 27 per cent respectively in 1975 and 1976, with respect to 1974, resulting in an actual decline in the declared value of exports in the latter year. Obviously, this had a negative effect on the merchandise trade position.

The relative weight of these several factors can be assessed by reference to Table 13, which was prepared by Bonnick based on the UN methodology used for the Dell Report. Price inflation on non-oil imports was calculated as being the largest single contributor to increasing the merchandise trade deficit over the 1972–76 period. Oil price increases ranked second, but their effect was less than half that of price increases on other imports.

Table 13 Financing and some components of the current account deficit (Unit=J\$ million)

	1972	1973	1974	1975	1976	1977
<i>Contribution of cyclical factors</i>	-25.7	+131.6	+263.7	+271.0	+369.9	n.a.
Import prices	-0.8	+114.3	+293.3	+398.7	+443.9	+455.7
Export prices	-10.4	+32.1	-38.9	-231.4	-193.7	+111.8
Export volume	-14.5	-14.8	-9.3	+103.7	+119.7	+111.8
Contribution of oil prices	+5.1	+30.6	+151.4	+176.9	+199.5	n.a.
<i>Contribution of factors affecting export supply</i>						
In Jamaica	-44.7	-66.1	-262.7	-218.5	-140.9	-172.1
Abroad	-9.1	-42.4	-52.8	-86.6	-59.7	n.a.
<i>Balance of payments financing</i>	n.a.	137.8	253.9	254.8	233.4	n.a.

Source: Bonnick, G, The Balance of Payments Adjustment Process in a Developing Country—Jamaica; Report prepared for the Group of 24 (United Nations, UNDP/UNCTAD Project INT/75/015, January 2, 1979)

NB: Sign + or - indicates direction of effect on current account deficit.

The third major contributor was reductions in export volume due to cyclical factors. It is important to note the contributors in 1975 and 1976 particularly, since it was at this time that the situation moved out of the control of the Jamaican government. The net change in the contribution of the different factors to the current account deficit in 1976 with respect to 1974 is as follows:

	\$ million
Import price increases (non-oil)	+106
Oil import price increases	+48
Export volume/supply factors	+243

In other words, problems on the side of export production and sales appear to have played the key role in widening the trade deficit in 1975 and 1976, against the background of continuing import price inflation on non-oil imports, and a relatively *once-and-for-all* increase in oil import prices.

Given that shortfalls were a significant contribution, to what extent can this be ascribed to excessive wage increases? There is

no question that money wage increases were quite substantial during this period: the estimated median wage more than doubled between 1973 and 1976 (Table 14). The increase was somewhat higher in industry than in the government sector. Contracted wage increases which had averaged 21–25 per cent in 1972 and most of 1973 suddenly increased to over 40 per cent in the latter part of 1973, over 50 per cent in 1974 and over 60 per cent in 1975. These increases not only kept pace with the increases in the CPI but began to exceed them by a wide margin, and by October 1976 the real average median income of income earners in the labour force was approximately 30 per cent higher, in real terms, than in 1973 (Table 13).

The key question, however, is whether this had a significant impact on export performance. First, it is notable that wage increases occurred from a relatively low base. The actual median weekly income in October 1976 was still only \$27, compared to a national minimum wage of \$20; the increases had taken place on an average median income of \$12 in

Table 14 Jamaica: wage indicators
(Indices 1973=100)

	1973	1974	1975	1976	1977
Median wage ¹	100.0	150.1	185.7	211.9	216.6
Industrial sector ²	100.0	117.9	147.8	177.5	197.3
Central government ³	100.0	121.5	164.0	168.9	175.5
Local authorities ⁴	100.0	103.7	150.7	158.0	169.5
<i>In percentage change</i>					
Median wage	—	50.1	23.7	14.1	2.2
Industrial sector	—	17.9	25.4	20.1	11.2
Central government	12.0	21.5	35.0	3.0	3.9
Local authorities	23.1	3.7	45.3	4.8	7.3
Cost of living index	17.6	27.2	17.4	9.8	11.1

1. Median reported weekly income of income earners in the labour force
 2. Average of wage settlements in selected collective agreements
 3. Average of mean wage in 30 employment categories
 4. Average of mean wage in 11 employment categories
- Source: Department of Statistics

1973. But a broader question is how sensitive is export performance to wage rates in the context of the Jamaican economy? Jamaica's principal exports are bauxite and alumina, sugar and bananas; together these four com-

modities accounted for 83 per cent of all exports in 1973 and 1974. Bauxite and alumina alone represented 71 per cent of exports in 1974, but these exports declined in 1975 and 1976, partly because of the US recession, and partly because Jamaica lost markets to Guinea in the case of bauxite and to Australia in the case of alumina, for which the transnational aluminium companies blamed the 'uncompetitiveness' of Jamaican production costs. What they objected to, however, was not labour costs, which in any case form a relatively small proportion of their total costs, but rather the Production Levy imposed in 1974. In that year, for example, the companies paid out \$144 million on account of the Levy compared to \$55 million for local wages and salaries, and wage costs comprised 11.5 per cent only of the declared value of bauxite and alumina exports. Since 1974, the companies have pressured the Jamaican government for reduction in the Levy as the means of securing expansion of production.

Sugar and bananas are marketed under export quotas fixed with the EEC, Canada and

Table 15 Jamaica: reported median weekly income of income earners in the labour force

	1973		1974		1975		1976		1977	
	Apr.	Oct.	Apr.	Oct.	Apr.	Oct.	Apr.	Oct.	Apr.	Oct.
Average ¹ (in J\$)	11.86	12.56	16.87	19.78	22.57	22.77	24.83	26.91	26.43	26.46
Males	12.60	14.00	18.35	21.00	24.88	25.17	25.91	27.92	27.33	27.67
Females	10.70	10.30	14.56	17.87	18.96	19.11	23.15	25.34	25.02	24.56
Average ¹ (indices: 1973=100)	97.1	102.9	138.2	162.0	184.8	186.5	203.4	220.4	216.5	216.7
Males	94.7	105.3	138.0	157.9	187.1	189.2	194.8	209.9	205.5	208.0
Females	101.9	98.1	138.7	170.2	180.6	182.0	220.5	241.3	238.3	233.9
Consumer Price Index	95.0	109.5	122.4	135.4	145.1	155.5	161.1	169.3	175.9	192.4
Real income										
Average ¹	102.2	94.0	112.9	119.6	127.4	119.9	126.3	130.2	123.1	112.6
Males	99.7	96.2	112.7	116.6	128.9	121.7	120.9	124.0	116.8	108.1
Females	107.3	89.6	113.3	125.7	124.5	117.0	136.9	142.5	135.5	121.6

Source: Department of Statistics, The Labour Force, 1975, 1976. IMF

1. Weight: Males 61 per cent, females 39 per cent. Weights based on participation in the labour force

the United States, with negotiated prices denominated in foreign currency. Jamaica has failed to supply its quotas, but the problems relate to technological obsolescence in the sugar industry and organizational difficulties in both sugar and bananas. Uncompetitive wage costs were not held to be primarily responsible for supply difficulties in 1975 and 1976.

The only category of exports which are sold on conditions approximating to a free market is exports of so-called 'non-traditional' manufactured and agricultural goods, chiefly to the Caricom market. However the principal cost element in such exports is not wages at all, but rather the costs of imported inputs. A survey taken in 1977 showed imported raw material costs as representing 39 per cent of the gross value of production of selected manufacturing activities, while wages represented 21 per cent of the gross value of manufacturing production in 1978. Also, 'non-traditional' exports account for less than 20 per cent of total exports. In any case, the reductions in export sales of 1975-76 were not registered for these commodities, but rather in the 'traditional' products of bauxite and alumina and sugar.

Fiscal performance

Government expenditure grew at an extremely high rate, averaging 32 per cent per annum in the five financial years from 1972/73 to 1976/77 (Table 16). Capital expenditure grew at a slightly higher rate than current expenditure and increased its share from 23 per cent to 30 per cent. A great part of this increase was to finance salvage operations and loans to private sector enterprises and payments for government takeovers of public utilities, etc. But current expenditure also grew at a high rate to finance the great expansion of social programmes being undertaken, as well as wage increases of public sector employees (the me-

dian wage in the government sector increased by 58-68 per cent between 1973 and 1976). In addition, the effects of borrowing began to be felt, as debt service payments absorbed 21 per cent of a much enlarged budget in 1976/77, compared to 9 per cent in 1971/72.

Revenue growth, which averaged 22 per cent per annum over the five years, did not match the huge expansion of budget expenditure. Basically, this was due to the sluggishness of economic activity, especially after 1973. Personal income taxes proved to be the most buoyant of the tax categories, because of the substantial increase in money incomes, but corporate income tax payments were virtually stagnant and actually declined in 1974/75. The government introduced additional indirect taxation, especially consumption duty, and also resorted to increasing transfers from the Capital Development Fund into which the bauxite Production Levy was paid. This helped to contain the problem in 1974/75 and 1975/76, but in 1976/77 the situation appeared to become completely out of control. Expenditure increased by \$225 million while revenue actually declined, and the deficit grew to J\$524 million, approximately 42 per cent of total expenditure. At the same time, external commercial lending dried up completely, and the government was forced to finance \$271 million of the deficit through money creation by the Central Bank.

Evidently, a greater degree of fiscal discipline was required in 1976/77. The budget had become basically unviable, and the large increases in expenditure against a background of shrinking revenues only increased the severity of the adjustment that would be necessary in the future. The growth of expenditure was partly due to deliberate Keynesian inspired fiscal expansion, the effect of inflation on recurrent expenditure, lack of strict financial ac-

Table 16 Central government fiscal data 1972/73–1979/80 (J\$million)

	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79*	1979/80**
Total expenditure	359.7	443.1	750.6	940.0	1,164.9	1,187.7	1,752.1	1,852.3
Total revenue	292.3	347.7	563.5	661.8	654.4	674.5	1,049.0	1,102.3
Deficit	66.8	95.4	187.1	278.2	510.5	513.2	703.1	750.0
Current expenditure	263.2	340.2	493.2	614.1	758.0	832.8	1,139.1	1,266.3
Rate of growth (%)	25.2	29.3	45.0	24.5	23.4	9.9	36.8	11.1
Per cent total expen. (%)	73.1	76.7	65.7	65.3	65.0	70.1	65.0	68.3
Capital expenditure	96.5	102.9	257.4	325.9	406.9	354.9	613.0	586.0
Rate of growth (%)	12.1	6.6	150.1	26.6	24.9	-12.8	72.7	-4.4
Per cent total expen. (%)	26.8	23.2	34.2	34.6	34.9	29.8	35.0	31.6
Tax revenue: total	252.9	322.2	394.5	477.5	484.8	487.9	750.5	823.4
Non tax revenue	25.1	25.5	38.0	38.2	41.9	41.7	26.7	41.1
CDF transfers	—	—	—	70.6	80.0	110.0	268.0	232.5
Tax revenue:								
rate of growth (%)	11.3	27.4	22.4	21.0	1.5	0.6	53.8	9.7
Total expenditure (per cent GDP)	23.0	23.6	31.7	35.3	42.0	37.6	44.6	43.7
Total revenue	19.0	19.5	24.9	26.0	25.6	22.5	27.9	26.0
Deficit	-3.5	-4.3	-5.5	-9.6	-15.0	-13.4	-18.7	17.7
<i>Financing</i>								
External borrowing	19.1	53.9	55.2	99.4	83.2	21.1	247.6	135.8
Domestic non-bank	41.4	27.4	76.8	77.6	114.5	254.7	104.9	256.2
Bank of Jamaica	11.9	38.4	32.9	93.0	271.5	69.8	100.0	293.2
Domestic commercial banks	—	20.3	10.3	21.9	54.4	159.6	60.6	65.0

Source: Ministry of Finance; Bank of Jamaica; IMF

*Provisional outturn

**Preliminary outturn

countability in the state bureaucracy and political pressures. Contradictions within the ruling PNP led to a tendency to alleviate the social effects of the crisis by increased expenditure, rather than tackling the underlying structural problems, and the political pressures of an election year contributed to the failure to control public expenditure. However, it is not completely clear that fiscal expansion was the root cause of the deterioration in the balance of payments, or that fiscal restraint in 1976/77 would have prevented the crisis. In 1976, import volume fell by 14 per cent and value by 13 per cent. Perhaps imports would have fallen even more if fiscal expansion had not occurred, although this by itself would not have

prevented the other developments which were the principal causes of the deterioration.

Macroeconomic indicators

Real GDP began to stagnate after 1972 (Table 17). The level remained about the same for the years 1972–74 and declined significantly in 1975–76. This was due to declines in real output in the bauxite-alumina sector and in manufacturing, to which was added a sharp decline in the construction sector due to a fall in investment activity in 1976. The consumption/GDP ratio increased to 92 per cent in 1976 from 83 per cent in 1974; but this was *not* due to any increase in real consumption. The ratio increased because real GDP and real invest-

Table 17 Macroeconomic indicators, 1974–78 (constant prices)

	1974	1975	1976	1977	1978
<i>Indexes</i>					
GDP	100	97.4	89.3	87.6	86.1
Consumption	100	99.5	99.8	98.2	92.3
Private	100	100.3	99.7	97.7	89.8
Government	100	96.1	99.9	100.5	102.6
Investment	100.0	103.6	71.9	49.5	49.9
<i>Ratios</i>					
GDP	100	100	100	100	100
Consumption	82.4	84.0	92.1	92.5	88.3
Private	65.4	67.3	73.1	73.0	68.2
Government	17.0	16.7	19.0	19.5	20.1
Investment	21.1	22.4	16.9	11.9	12.2

Source: National Planning Agency

ment declined more sharply than real consumption, especially in 1976.

Conclusions on the 1972–76 period

The most striking observation to emerge from the above review is the critical importance of the years 1975 and 1976—especially 1976—in precipitating the crisis. Whereas the termination of the bauxite investment cycle did bring to an end the high-growth phase of the economy, this by itself did not generate the acute foreign exchange crisis. Import price increases, for both oil and especially non-oil commodities, did put intense pressure on the balance of payments, but the bauxite Production Levy of 1974 went a long way towards covering increased import costs. In fact, exchange reserves actually increased in 1974. Moreover, import prices did not increase so markedly after 1974 as to explain the sudden deterioration in the foreign exchange situation in the next two years.

The deterioration was rather the result of a number of adverse developments operating with combined effect, namely:

1. Export volume declines in 1975–76.
2. Export price falls in 1976.
3. The fall in tourist receipts in 1976.
4. Big increases in service payments, especially investment income, in 1975 and 1976.
5. The net outflows on private capital account in 1976.
6. The cessation of commercial bank lending to the government in 1976.

There is little evidence to support the IMF diagnosis of excessive wage increases and excessive consumption. While significant wage increases were occurring, the volume of imports was actually falling, and the performance of Jamaica's principal exports of tourism, debt service and the capital account cannot be ascribed in any significant degree to wage movements. Private and government consumption fell in real terms after 1974, and the consumption ratio increased only because of the contraction in investment activity resulting from adverse private sector reaction to the government's policies and from capital flight.

The alternative structural analysis has more validity than the IMF diagnosis, but still provides only a partial explanation. Termination of the bauxite investment cycle, import price inflation, export short-falls and export price reductions were important *contributory* factors to the weakness of the economy after 1972. But—except for export reductions—they did not precipitate the crisis of 1975. The key elements were the behaviour of tourism, service payments, and capital flows.

In fact, analysis of the factors underlying the adverse developments of 1976 leads to the conclusion that political elements played a major part. The suspension of direct foreign investment and the flight of capital were largely results of domestic political developments. The 1975–76 winter tourist season was a disas-

ter because of the widespread violence and bad press that Jamaica was receiving, as a result of the destabilization campaign, and bauxite production declined largely as a result of retaliation by the transnational companies against the Production Levy. Jamaica then became a poor credit risk to the commercial banks, since exports and tourism were floundering and the government was under extreme domestic pressure. Local and foreign hostility towards the government's political and economic programmes appear, therefore, to have played a critical role in bringing Jamaica to its economic knees at the end of 1976.

Economic performance 1977-79

The effectiveness of prescription is another way of assessing the correctness of the diagnosis. Thus performance of the Jamaican economy under the IMF programmes in 1977 and 1978 should give further indications of the effectiveness and appropriateness of IMF economics. In Table 18 we have shown *policy indicators*, i.e. those macroeconomic variables which were changed as a result of the IMF policies, and *performance indicators*, i.e. those variables which the policy changes were meant to influence in a favourable direction.

Table 18 Macroeconomic indicators under IMF programmes

	Before		After		
	1975	1976	1977	1978	1979
<i>Policy indicators</i>					
Average exchange rate: (per cent change)	-	-	-11.1	-33.0	-5.4
Consumer price index: (per cent change, Dec.-Dec.)	+15.7	+8.1	+14.1	+49.4	+19.8
Average real median weekly income: (per cent change, Oct.-Oct.)	+15.1	+18.1	-1.6	-25.9	-
Cost adjusted exchange rate (December 1970=100)	125.0	128.3	133.7	96.4	94.0
Compensation of employees/national income: (per cent)	61.5	63.9	63.5	61.1	-
Operating surplus/national income: (per cent)	30.9	29.2	32.8	37.3	-
Real government expenditure, ¹ index (excluding debt service)	100	114	104	118	101
Fiscal deficit/GDP, ¹ per cent (excluding debt service)	8.4	14.6	10.5	8.0	6.5
Money supply (M ₂): per cent change	+17.3	+6.9	+13.2	+18.2	+10.0
Bank credit to public sector: per cent change	+76.3	+81.3	+37.6	+37.1	+12.5
Bank credit to private sector: per cent change	+24.2	+5.0	-5.4	+19.3	+15.3
<i>Performance indicators</i>					
Real GDP: per cent change	-2.6	-8.3	-2.0	-1.7	-2.2
Exports (f.o.b.) in US \$: per cent change	+16.8	-18.6	+15.2	+5.4	+10.4
Imports (f.o.b.) in US \$ per cent change (cif)	+19.5	-18.4	-15.8	+12.4	+9.8
Balance of merchandise trade: change in US \$ million (f.o.b.)	-41.7	+27.4	+225.4	-41.7	+9.5
Balance of payments: change in US \$ million	+127.7	-164.1	+233.5	-64.5	-78.6
Real consumption: per cent change	-0.5	+0.3	-1.5	-6.0	-
Private	+0.3	-0.5	-2.0	-8.0	-
Government	-3.8	+3.9	+0.5	+1.4	-
Real gross fixed investment: per cent change	+3.6	-30.6	-31.1	+0.8	-
Unemployment rate: per cent (October)	20.9	24.2	23.8	26.0	31.1

¹ Fiscal year beginning April 1

- Not available

Source: National Planning Agency

The policy indicators show the drastic changes brought about by the IMF programmes. Real wages were cut by perhaps as much as 35 per cent in 1978 alone. External 'competitiveness' was fully restored by the end of 1978. Government expenditure and the fiscal deficit in relation to the GDP were cut sharply. The growth of bank credit was contained. International cost adjustment and demand management were therefore, in large measure, successfully accomplished.

The same cannot be said about the performance of external trade and payments and overall production, the improvement of which was allegedly the underlying objective of the programme. The value of imports contracted in 1977 as a result of tight import restrictions, but expanded in 1978 as the restrictions were liberalized. Export growth was substantial in 1977 as the bauxite-alumina industry picked up but, in terms of foreign currency, there was hardly any growth at all in 1978. Thus deficit on the balance of trade and payments narrowed significantly in 1977, but widened again in 1978. Inflows of capital from the IMF and from the refinancing operations of the commercial banks allowed imports to be licensed more freely and financed a larger deficit on trade and payments, but the exchange rate and demand management measures have shown virtually no effects on the performance of merchandise trade. These trends have continued into 1979.

This is not surprising, as previous analysis has shown that the majority of Jamaica's exports are marketed under conditions which make the level of export sales quite insensitive of the exchange rate. In the case of bauxite-alumina, the devaluations have had a perverse effect, in that the companies now bring in a smaller amount of foreign exchange in order to finance the purchase of local goods and ser-

vices, especially the payment of wages and salaries. The savings to the companies amounted to approximately \$30 million in 1978 or 5 per cent of the central bank's foreign exchange cash receipts in the previous year. In the case of sugar and bananas, the production problems inhibiting export performance have remained. Manufacturing exports have shown some buoyancy since the devaluations, but since their share in total exports is less than 10 per cent and their estimated import content is 65 per cent, even a relatively high rate of growth has little dent on overall export performance.

On the side of imports, there has been no evidence of substitution of domestic for imported commodities as a result of the price effects of the devaluations. Some substitution of domestic for imported foodstuffs probably did take place, and domestic agricultural output increased by a total of nearly 50 per cent over the two years, but this was thought to be more the result of the import restrictions and recurrent shortages of imported food, together with the effects of good weather. The absence of significant substitution effects is not surprising, since the supply rigidities and the technological dependency of the Jamaican economy on imported raw materials are well known. Any effect on imports, therefore, occurred through income effects of price increases resulting in lower real consumption. The devaluations have achieved this through the price mechanism, rather than through a process of physical rationing which had been proposed early in 1977.

Another major disappointment in the programme so far is the failure of the investment rate to recover. While labour income has contracted and operating surpluses increased as planned, these surpluses have not been converted into capital formation. In real terms, the

investment/GDP ratio remained stagnant at about 12 per cent in 1978. This is partly the result of a foreign exchange constraint, as capital goods imports would be needed to convert financial capital into real capital. However, there is no evidence of significant pent-up demand for capital goods or of plans for investment projects on a significant scale. The general picture is of a private sector which has adopted a 'wait and see' attitude. This attitude has spilled over to the international commercial banks, which in September 1979 decided that the time was not propitious to proceed with arrangements for a \$700 million package for refinancing and incremental lending to Jamaica.

After over two years of IMF agreement, including 18 months of a programme designed and strongly endorsed by the Fund, the economic prospects for Jamaica continue to look grim. GDP has continued to decline in 1977 and 1978, and into 1979. Export growth continues to be sluggish, with the bauxite companies still pressing for substantial levy reductions in order to restore 'competitiveness'. Import costs continue to escalate under the impact of a fresh round of OPEC price in-

creases and accelerating inflation in the western countries. While the Fund appears willing to contribute even more resources once again, doubts will persist about the viability of the path to economic recovery which is being advocated. Prime Minister Manley clearly stated Jamaica's dilemma in an address to the Board of Governors of the Inter-American Development Bank in May 1979:

... If the country holds to its determination to work for a more just society, with all that this entails in terms of serious policies, it may find that the incremental inflows arising from private foreign investment do not materialize. In this event, it will find economic growth extremely difficult of attainment and may, indeed, find that growth to be inconsistent with the maintenance of an open society. If it is committed to such a society, it may face a political catastrophe.

On the other hand, if it dismantles the assault upon social injustice, it will doubtless recover a 'good' reputation as a locus for foreign investment. The incremental flows may resume, but at an internal price of social betrayal including a return to the path of growing social inequality. Once again, the likely outcome, in an open society, is political catastrophe ...

5 Socio-Political Consequences of IMF Economics

There were a number of predictable consequences of the sharp decline in the standard of living of the Jamaican population associated with the IMF programmes. One immediate result was a marked increase in labour unrest and work stoppages due to causes *other than* wage disputes. This may appear to be surprising, but the fragmentation of the trade union movement in Jamaica, the degree of inter-union rivalry and the fact that the two

major unions are affiliated to the two major political parties seem to have inhibited any national collective action against the IMF incomes policy by the trade union movement as a whole. In addition, Prime Minister Manley, a former trade unionist himself, engaged in continuous rounds of discussions and consultations with the trade union leadership on the reasons for the adoption of the IMF programme. This had the effect of communicating

to the unions that the alternative to the IMF programme would be widespread unemployment, acute shortages and virtual economic collapse. The unions publicly rejected the wage guidelines both in 1978 and 1979, but in practice they have accommodated to them in large measure. At the same time, work stoppages caused by inter-union rivalry and local grievances have increased, attesting to the growing irritability, disgruntlement and disaffection of wage earners.

Another effect has been an up-swing in emigration of professional personnel and skilled workers. The tendency for professional middle-class emigration had begun in 1975 as a result of the panic and hysteria provoked in response to the government's policies. Although relative calm returned in 1977, the number of high-level professionals emigrating to the United States and Canada in that year actually doubled, showing the effects of economic as distinct from political conditions.

The quality and scope of the social services have deteriorated at an accelerating rate, especially since the 1978 programme. Budget cuts, the loss of skilled manpower and the demoralization of those remaining, have taken a heavy toll. The 1979/80 budget instituted a reduction of recurrent expenditure of 12 per cent in real terms. The Ministry of Education's proposal to reduce the intake into High Schools in September 1979 was abandoned under public pressure, but it has laid off a number of teachers who were in temporary employment. The intake of the Jamaica Youth Corps, an employment and skill-training programme for school leavers, was cut from 10,000 to 2,000 in 1979. The health services are in a state of virtual collapse and in September 1979 the two largest hospitals in the country were closed, due to the combined effects of machinery breakdown, lack of medical per-

sonnel, shortages of drugs and industrial action.

In the economy, the relative size of the government sector has been reduced. Further state incursions into productive activity have been more or less prohibited. The proposal to extend the coverage of the State Trading Corporation into other basic imported materials was abandoned in early 1978 as part of the IMF agreement. State enterprises are kept on a tight rein by means of a ceiling on commercial bank credit to them, and the public utilities have been required to raise their rates in order to cover 30 per cent of capital expenditure through internal surpluses. Many public utilities, especially electricity and urban bus transport, have also shown big reductions in the efficiency of their operations because of the combined effects of maintenance problems and industrial action.

The impact of the IMF programmes on class attitudes and class alliances can be analysed with reference to the classes and groups shown in Figure 1.

The PNP's campaign for the 1972 election emphasized anti-mismanagement, anti-inequality, anti-corruption and participatory democracy. On that basis, it secured significant

Figure 1 Class attitudes and alliances

Capitalist class	Comprador capitalists Nationalist capitalists
Managerial bourgeoisie	Private managerial bourgeoisie State managerial bourgeoisie
Petty bourgeoisie	Small business Small farmers Professionals
Proletariat	Workers Cultivators Own account workers Unemployed
Lumpen proletariat	

support from all classes. In office, it emphasized egalitarianism and anti-imperialism, and from 1975 anti-capitalism as well. In doing so it lost support amongst national capitalists and the professional middle class, but strengthened its position with workers, unemployed and

cultivators, including the women and youth in these classes (Figure 2).

Virulent anti-communism, and qualified pro-imperialism, have always been basic elements of the JLP's ideological and political line. These were intensified in 1975 and 1976 as

Figure 2 Ideological effects of IMF programme

	<i>Before IMF</i>	<i>After IMF</i>
<i>Characteristics of PNP's 'Democratic socialism'</i>		
Anti-imperialism	Positive response from all sectors except comprador capitalists.	Down-played: decline in anti-imperialist sentiment; except for anti-IMF position of left.
Anti-capitalism	Positive response from workers and unemployed. Negative response from comprador and national capitalists, small businessmen. Anxiety among middle class, small farmers, cultivators.	Down-played: mixed economy and role of private sector emphasized, decline of anti-capitalist sentiment and growth of anti-government feeling.
Egalitarianism	Positive response from workers, unemployed, small farmers, cultivators. Negative from business sectors and professionals.	Down-played; desirability increasingly called into question.
Participatory democracy	Positive response from all sectors.	Remains, but not as important now as bread-and-butter issues.
<i>Characteristics of JLP's 'Nationalism'</i>		
Anti-communism	Positive response from comprador and national capitalists, professionals. Moderate appeal to small businessmen and small farmers. Indifference from workers, unemployed.	Greater response from petty bourgeoisie and workers who blame socialism for declining living standards.
Pro-imperialism	Positive response from comprador capitalists. Moderately to strongly negative from others.	As above; foreign capital seen as means of restoring 'prosperity'.
Anti-'economic mismanagement'	Positive response from comprador and national capitalists. Indifference from other sectors.	Growing response from all classes, national capitalists.
Anti-'corruption'	Indifference from all sectors.	Growing response from all classes.
Social harmony (Anti-'class politics')	Positive response from comprador and national capitalists, and professional middle class. Indifference from other sectors.	Growing response from small businessmen; workers, unemployed and small farmers still relatively indifferent.

the PNP went further to the left, and the charge of economic mismanagement was added as the economic situation deteriorated. This evoked a response from comprador and national capitalists, and professionals, but other sectors overwhelmingly rejected the line in the 1976 election. However, under the pressure of austerity and the apparent ideological zig-zags of the PNP under the IMF programme, disillusionment has set in. Political polls show a steady decline in support for the PNP after 1976, with the JLP overtaking them in June 1978, one month after the announcement of the second IMF agreement (Table 19).

The effects of the programme on class alignments and attitudes are depicted in Figure 3. An extrapolation of the trends emerging after the IMF agreements shows that the JLP would have a clear advantage in an election held under those conditions. More specifically, the comprador capitalists will continue to give their full and undivided support to the JLP. The nationalist capitalists would continue to support the PNP, although with less vigour, if reasonable protection against imports and competition with foreign capital continues. The private managerial bourgeoisie would continue to be ardent supporters of the JLP for ideological reasons, and because of abhorrence of regulations. This class has managed to maintain its standard of living despite inflation

and import restrictions. A poll taken in late 1978 revealed that 84 per cent of the people in 'high income areas' support the JLP. The state managerial bourgeoisie would be split. Those who work with the PNP for ideological reasons or who by association would be fired if the JLP became the government would actively support the PNP. Some, under the strain of a reduced standard of living or out of frustration with the indecisiveness of the political directorate, may line up with the JLP.

The self-employed professionals, since the PNP's proclamation of Democratic Socialism, have consistently supported the JLP. This group will be a very important factor in the quality of the JLP's election campaign. Small business persons, despite being the beneficiaries of several programmes, will probably be split. Some who would suffer by competition with big capital and foreign capital would stick with the PNP. Those whose activities are more comprador in nature would gravitate towards the comprador capitalist camp. Small farmers whose consciousness derives from preoccupation with ownership and the preservation of ownership of land, may return to the JLP fold.

The cultivators, many of whom were among the 34,319 people receiving plots from the distribution of 62,639 acres under the Land Lease programme, along with the workers

Table 19 Standing of the political parties, 1976-79

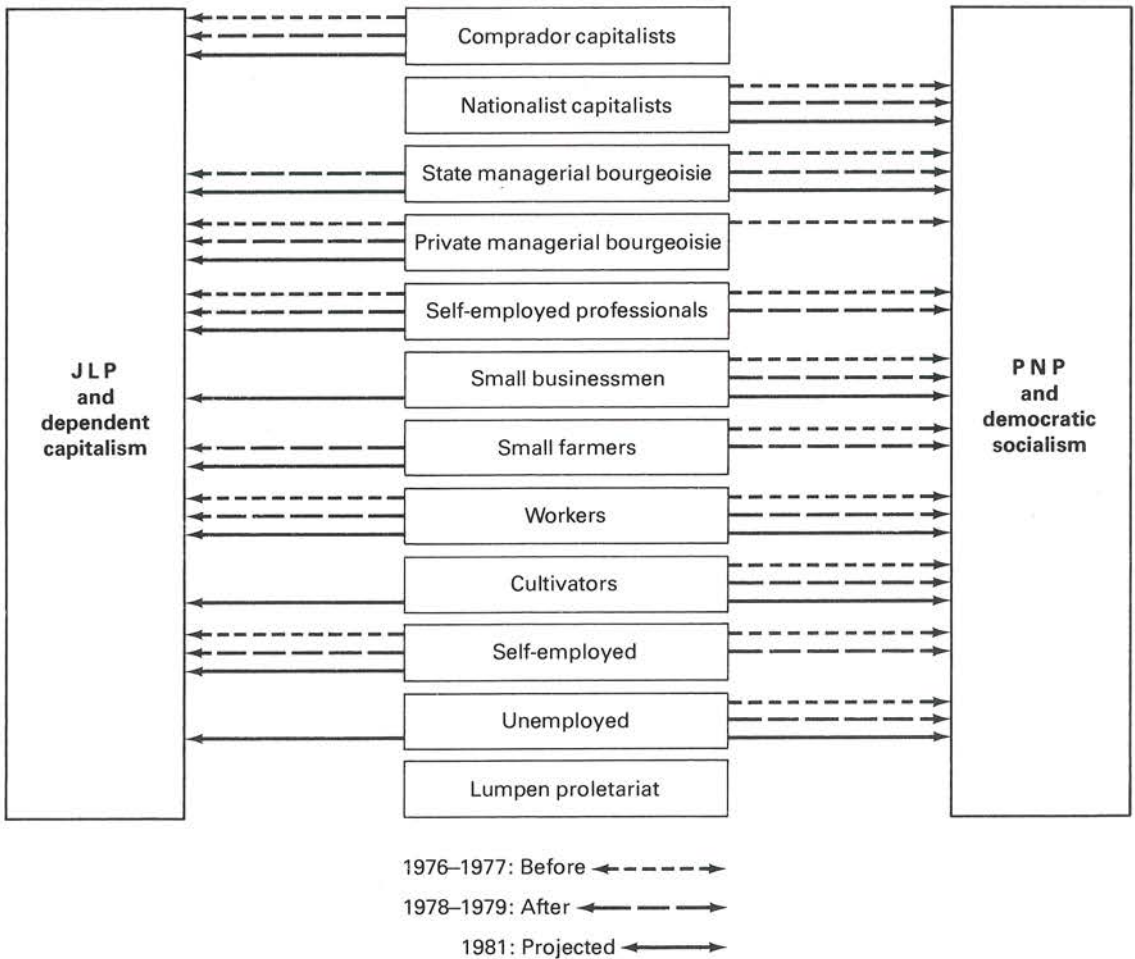
	Oct. 1976	Nov. 1977	March 1978	June 1978	Nov. 1978	March 1979	July 1979	Sept 1979
PNP	48 %	39 %	33 %	28%	29%	32%	34%	37 %*
JLP	37 %	36 %	32 %	32 %	33 %	36 %	40 %	47 %
WPJ	15 %	—	—	—	—	2 %	3 %	—
Uncommitted	15 %	25 %	35 %	40 %	38 %	30 %	23 %	16 %

* Includes WPJ support

NB: The question asked was 'If an election were called tomorrow which party would you vote for?'

Source: Poll conducted by Dr Carl Stone, for *The Daily Gleaner*

Figure 3 Effects of the PNP programme on class alignments and attitudes



have been bearing the brunt of the effects of the IMF measures, e.g. high prices for imported food, machetes, chicken feed, transport and seeds. Two factors will decide which party receives most votes from this class. First, although 60 per cent of them blame the government for the economic situation, the effect of this may be diluted due to the political apathy

and physical dispersal of this class. Secondly, there is still a tremendous demand for land which, despite the budget cuts, the PNP through the state could make available to this class and the unemployed.

The support of the workers would be split between both parties. Many workers will opt for the JLP because of the IMF-imposed wage

guidelines, the horrendous increase in the cost of living, and the state's inability to alleviate this pressure by subsidies or increased social services. The PNP will retain some support among the workers because of its past record, e.g. free education, minimum wage. Some state workers will support the PNP because their jobs will be in jeopardy if the JLP becomes the government. Both the JLP and Jamaica Manufacturers Association leaders have called for what the latter calls a 'cutback of the non-productive people in the over-loaded Government bureaucracy'.

The unemployed will be split depending on purely subjective evaluation of which party is more likely to be able to alleviate their desperate circumstances. The PNP should continue to have strong support from the unem-

ployed youth given the state's efforts, in the last few years, to provide economic and social programmes. The lumpen proletariat will tend towards the highest bidder, which is likely to be the JLP.

The PNP rejection of further IMF assistance and decision to hold an early election on the issue of economic policy and direction, will have changed some of the attitudes and tendencies discussed in the above scenario. Other issues will also doubtless enter the election campaign and influence voter behaviour. However, the IMF programmes clearly contributed to dissolving the class alliance which formed the basis of the PNP's political support, discrediting the governments record of performance and undermining its moral authority.

6 Conclusion

Jamaica's IMF experience throws three critical issues into sharp relief. First, how appropriate is the standard kit of analytical tools used by IMF staff in diagnosing the causes of the payments deficits of Third World countries like Jamaica? Second, how helpful are the resulting economic policy measures in treating these payments deficits and promoting external balance and economic growth? Third, are the IMF prescriptions technically and politically 'neutral' and, if not, are certain political repercussions not an intrinsic consequence of Fund 'stabilization' programmes?

The analytical methodology of the IMF was to study the trend in money wages, credit expansion and the fiscal deficit, and certain other variables which provide *a priori* evidence of 'distortion' such as the extent of subsidies on basic goods and the deficits of public enter-

prises. These analytical procedures led to the conclusion that the variables studied are 'not right', i.e. that wages are too high, credit expansion has been excessive, the fiscal deficit is too large, and so on.

The method was unscientific in two senses. In the first place, it failed to identify all the possible sources of payments disequilibria and to rank their importance through empirical investigation. Secondly, the method does not attempt to distinguish the underlying causes of the disequilibria from their effects, or from those aspects that appear as monetary manifestations of developments in the real economy. For example, a sharp increase in credit expansion and the fiscal deficit may merely be a reflection of a sudden decline in fiscal revenues and foreign inflows due to problems being experienced in the external sector.

However, by merely juxtaposing the expansion in credit with the balance of payments deficit, a specious argument can be made that the second is a consequence of the first. Much of the Fund's economic analysis consists precisely of such methods, which one could find amusing from the intellectual standpoint were it not that so much damage has been caused by the imposition of policy measures which assume the validity of the diagnosis.

These measures involved devaluation; credit contraction; reduction of the fiscal deficit by increasing taxes, cutting expenditure and removing subsidies; and reducing the deficits of state enterprises by raising their rate structures. Complementary measures invariably included actions to stimulate private sector activity and encourage foreign investment, and to restrict the role of the public sector and of state intervention in the economy. The underlying logic was to reduce real wages and deflate the economy so that import demand is compressed, while seeking to increase exports and capital inflows by improving the competitiveness of the economy and raising the rate of profit. However, if the diagnosis is off target, then the measures may merely result in costs without benefits: a severe reduction in living standards is imposed without the returns of external equilibrium and economic growth. This is precisely what happened in the Jamaican case.*

The issue becomes particularly acute in the present conditions of oil importing Third World countries like Jamaica which are, in addition, undertaking domestic structural changes which arouse the opposition of vested

interests, both internal and international. In these circumstances, the country and the government have to cope with two sets of factors. The first—pressures caused by oil price increases, rising international inflation and unstable export markets—are a direct result of the crisis in the world capitalist system. The second—the drying up of domestic and foreign private investment and a flight of capital as the government seeks to alter the traditional relations of economic, social and political power—are essentially the economic expressions of internal class conflict. The loss of foreign exchange reserves that result from the joint impact of both sets of factors brings the country up against the 'need' for IMF assistance at a relatively early stage.

The paradox is that in such a country these developments are manifested in even sharper form in the variables that are the subject of IMF analysis, and strengthen the apparent justification for the IMF measures. Thus, for example, the flight of capital becomes the evidence of 'lack of confidence' in the currency, which means that the currency is overvalued and provides the justification for devaluation. Similarly, the drying up of private investment reduces economic activity which in turn reduces fiscal revenues, while at the same time generating social and political pressures for greater government spending. This leads to a big increase in the fiscal deficit, which provides evidence of the 'need' for higher taxes and expenditure cuts. In other words, the greater the degree of domestic and international opposition to the government's reforms, the more acute are the 'economic imbalances' and 'government mismanagement' revealed by the IMF's 'technical' analysis, and the more violent the 'adjustment' that is seen to be necessary.

While the adjustment failed to cure the eco-

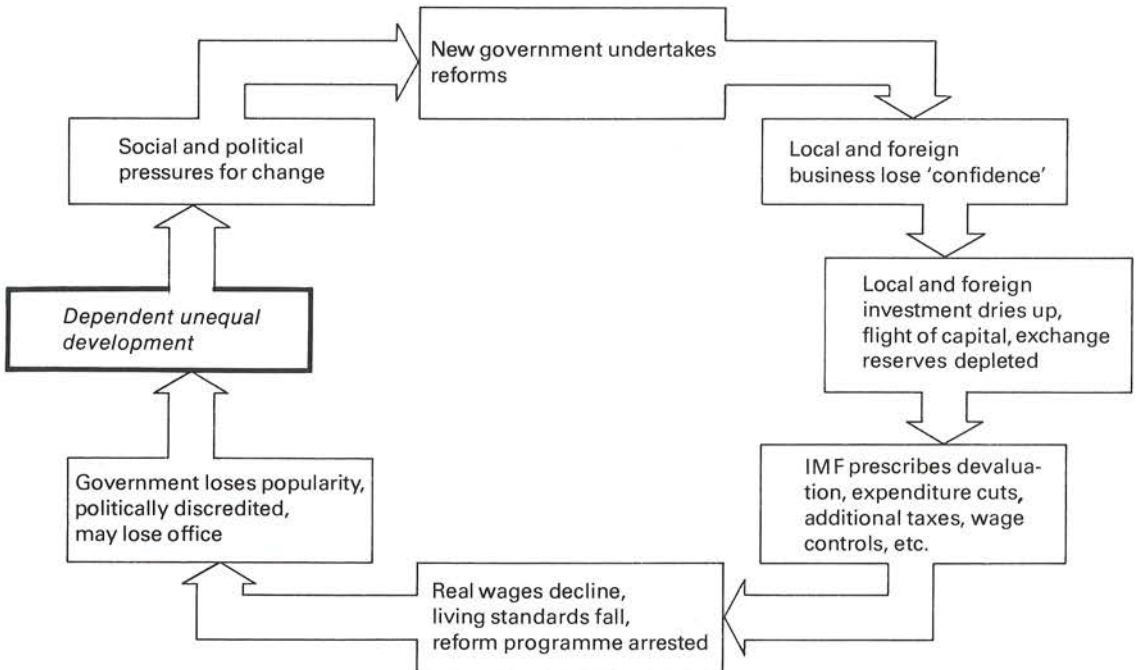
* This is not to suggest that *some* of the IMF measures may not be useful as *supporting* elements in the economic programme; rather it is to question the appropriateness of the entire package as the basis for a programme.

conomic illness it is supposed to treat, it had very definite and pervasive political results. The sharp decline in living standards and the arrest of the process of reforms could not but erode the popularity of the government and turn key elements in the supportive alliance of classes into a disillusioned and eventually hostile position. What was even more damaging was the loss of its moral authority, for the government, in order to justify the IMF stabilization programme, had virtually to acknowledge that it was guilty of economic mismanagement in its previous policies. In other words, *the government had to discredit itself, and the process of reforms it initiated*, in the eyes of the local and international public. In addition, the measures aimed at increasing the profitability and the

role of the private sector objectively had the effect of strengthening those very social forces which opposed the attempts at changing the traditional power relations in the society. The logical end result of this would be the removal of the government and its replacement by one not tainted by previous 'mismanagement', fully committed to the tenets of IMF economics, and sure of the 'confidence' of local and foreign business (Figure 4).

In Jamaica, growing awareness of this among informed opinion within the country and within the ruling PNP eventually led to a situation where the government decided to cease further attempts at an accommodation with the IMF. Should the opposition JLP win the forthcoming election, it could be said that

Figure 4 Role of IMF in restoring dependent development

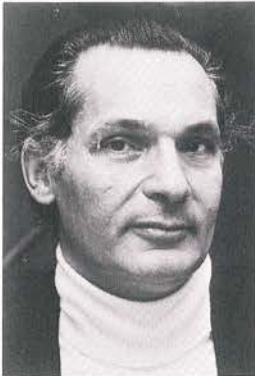


the IMF had succeeded in manipulating the Jamaican political process to re-establish the political conditions in which the previous model of dependent, unequal capitalist development may function. If the PNP is re-elected, then Jamaica will become a test case of the willingness and responsiveness of the international community to deal with the payments deficits of Third World countries in a manner supportive of domestic reforms aimed at securing greater national economic sovereignty and social equality.

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Notes on Contributors



Ismail-Sabri Abdalla is a graduate from the universities of Cairo and Paris. He taught at Alexandria and Cairo universities while involved in active radical politics. During the Nasser period, he served as adviser to the President, participated in development efforts, went to prison and returned again to his developmental and political activities. He was Chief Editor of the State Publishing House and then Director of the Institute of National Planning. From 1971 to 75 Ismail-Sabri Abdalla was a member of the Egyptian cabinet in charge of planning, while keeping the directorship of the Institute of National Planning. Devoting much of his time to the cause of the Third World, *inter alia* as Chairman of the Third World Forum, he remains involved politically as member of the leadership of the opposition left-wing party. He has published books and articles in Arabic, French and English.



Richard Leighton Bernal was born in Jamaica in 1949. He holds degrees of B. Sc (Economics) from the University of the West Indies, 1971, and M.A. (Economics) from the New School for Social Research and is currently completing a Ph.D dissertation for submission at the New School. Since October, 1979, he has been Lecturer in the Economics Department, University of the West Indies in Jamaica and a consultant to the National Planning Agency. Previous appointments include research posts in the Monetary Studies Programme of the Institute of Social and Economic Research, U.W.I. (1972-74), in the Research Department of the Bank of Jamaica (1971-72 and 1974-75) and in the National Planning Agency.



Norman Paul Girvan was born in Jamaica in 1941. He holds degrees of B.Sc. (Economics) from the University of the West Indies, 1962, and Ph.D. (Economics) from the London School of Economics, 1966. Since 1977, he has been Chief Technical Director of the National Planning Agency of the Government of Jamaica. He was formerly Coordinator, Caribbean Technology Policy Project of the University of the West Indies and the University of Guyana (1975-77); Senior Research Fellow, U. N. African Institute for Economic Development and Planning, Senegal (1973-1975); and Lecturer and Senior Lecturer in Economics at the U.W.I. in Jamaica (1966-1973).



Wesley George Hughes was born in Jamaica in 1953. He holds a B.Sc. (Economics) from the University of the West Indies, 1977, and recently completed studies for M.Sc. (Economics) also at the U.W.I. He is employed by the National Planning Agency (Jamaica) since 1977 as an Assistant Planner in the Macro-economics Division. He is also part time tutor in economics and Caribbean economic problems at the U.W.I.



Justinian F. Rweyemamu, former Head of the Department of Economics and Dean of the Faculty of Arts and Social Sciences at the University of Dar es Salaam, served as Principal Secretary in the Ministry of Economic Affairs and Development Planning and as Assistant to the President for Economic Affairs in the Government of Tanzania. He was on the staff of the Brandt Commission and is presently with the Office of the Director-General for Development and International Economic Cooperation at the United Nations in New York.

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