

International Monetary Reform and the Less Developed Countries

1. One hesitates to add another drop to the flood of writing on international liquidity, not only for the well-known reason that almost everything worth saying has already been said by someone who has not discovered it, but more importantly because the proliferation of ideas has itself become a major obstacle to reform. Any new idea deserves serious study, which delays the day when agreement on a scheme can be reached. There is also always the hope that a new idea may split groups hitherto in agreement and thus add to delay. This is therefore a field in which he who can make one word grow where there were four before is a true benefactor of mankind.

2. In mitigation, it can be said that this discussion is confined to the implications of reform for the development prospects of the less developed countries. These are the main conclusions: (1)

Liquidity

3. (i) There is a strong case for giving the Less Developed Countries a share in any increase of unconditional liquidity. They need additional liquidity and it is not true that they are, in general, incapable of conserving it.

(ii) The best arrangements would be to allow full membership of any new scheme to any country that was able and willing to undertake its obligations. Ideally, this should consist in the creation of a new reserve asset. If this is unattainable, an extension of gold

(1) The paper owes much to Mr. W. A. B. Hopkin. The views expressed are entirely personal.

tranche facilities without gold subscription, with the minimum conditions attached, would be a second-best solution.

(iii) Proposals to expand the facilities for *conditional* liquidity available to the L.D.C.s are also useful but not a substitute for a share in additional unconditional liquidity.

The Proposal for a "Link" between Monetary Reform and the Provision of Development Finance

4. (i) The establishment of a "link" on the lines proposed in the U.N.C.T.A.D. Experts' Report (cf. paragraph 8) would in practice *probably* have the following consequences:

- (a) a larger volume of aid to the L.D.C.s;
- (b) a higher proportion of multilateral aid to the total;
- (c) a gain to advanced countries' reserves (at some cost in diversion of real resources).

The adoption of the proposal is in the interests both of the L.D.C.s and of advanced countries.

(ii) It is not true that there is any conflict between the timing of the monetary operation and that of the provision of development finance.

Monetary Reform

5. The aims of the British and American Governments in the current negotiations on the reform of the international monetary system are threefold:

- (i) The creation of additional reserve assets.
- (ii) Protection against reduction of the existing stock of reserves by conversion of reserve currencies into alternative forms.
- (iii) The provision of additional liquidity for countries outside the Group of Ten, both L.D.C.s and developed countries.

6. The main concern of this section is with aim (iii), in so far as it concerns the L.D.C.s. Measures for non-group countries might include, in order of attractiveness to them:

- (a) additional reserve assets in the same form as those created for the inner group;

(b) further unconditional liquidity by extending I.M.F. gold tranche facilities on terms of (i) automaticity, (ii) direct transferability between Central Banks, (iii) non-reconstitutability and (iv) separate account in the I.M.F. for the new rights;

(c) the earmarking of a proportion of newly created reserve units to provide further conditional liquidity for non-group countries;

(d) provision for a further tranche of the I.M.F. Compensatory Finance Scheme.

7. It is common ground that any reform of international monetary arrangements which brings about a substantial increase in liquidity is likely to benefit the L.D.C.s *indirectly*, even if they do not participate in the initial distribution of the addition to liquidity. It is a reasonable presumption that there would be fewer measures to protect balances of payments and that levels of activity in the advanced countries would be higher after a reform than they would be in the absence of the reform; and this in turn will (a) increase their imports of L.D.C. products; (b) increase the supply of industrial products; and (c) increase the flow of private investment. It may also be expected that the advanced countries would be more generous with aid than they would otherwise have been and that the proportion of untied aid would rise.

8. L.D.C.s, however, will not and should not be satisfied with these indirect benefits. They will press for and are entitled to a share in the *direct* benefits of monetary reform. Their interest in the subject found expression in the decision by U.N.C.T.A.D. to appoint a group of experts whose report (*International Monetary Issues and the Developing Countries*) was presented in November 1965.

9. The Experts argue that a reform of the international monetary system is needed which would make it more responsive to the needs of economic growth of both developed and developing countries. They say that monetary reform should go hand-in-hand with, and should facilitate, the adoption of trade and aid policies that would contribute to the removal of structural disequilibrium of developing countries. They say there is a *prima facie* case that the general level of reserves is inadequate, or in imminent prospect of becoming so. They stress that the developing countries have a legitimate and

pressing need for additional liquidity and that this should be provided in part through the expansion of reserves and in part by increasing the amount of credit facilities available from the Fund and other sources. They finally say that developing countries should be represented in the discussions leading up to monetary reform, and in the operation of the new arrangements, in accord with their interests and concerns.

10. On the basis of these general ideas, the Experts put forward proposals which have two main objectives:

(i) that L.D.C.s should have a share in any unconditional liquidity to be created; and

(ii) that the creation of additional liquidity should in some way be linked to the provision of additional resources for development. The second proposal will be discussed in the second section of this article.

11. Dr. Prebisch, in his introduction to the experts' report, emphasises that trade, aid and monetary measures must converge. The argument of the L.D.C.s starts from the assertion that they have a legitimate claim both for more liquidity and for more resources for development. The report appears at a time when the flow of international aid has not significantly increased for a number of years. The volume of aid will undoubtedly be a major question at the next U.N.C.T.A.D. and some L.D.C.s are likely to see international monetary reform and the recommendations of the experts' report as one of the means of securing an increase. They will make play with the fact that the advanced countries, or some of them at least, have laid great stress on their balance of payments difficulties as a reason for not increasing aid. They will argue that a monetary reform which relieves these balance of payments problems in some degree should enable the advanced countries to do more for them. On the principle that a bird in hand is worth two in the bush they will press that this link should be recognised in the shape of the monetary reform itself. They will argue, probably with considerable vehemence, that it would be an international scandal for the advanced countries to fix up a scheme for increasing world liquidity, keep the whole of the increased liquidity for themselves and provide no additional aid.

A Share in the Increase of Unconditional Liquidity

12. On the proposal that the L.D.C.s should share in any increase of unconditional liquidity, three points arise for discussion:

(i) the need of the L.D.C.s for such reserves;

(ii) their ability and willingness to hold them;

(iii) their ability to meet the obligations of the scheme.

13. As regards the question of *need*, the argument that can be made in favour of the L.D.C.s is simple and strong. They suffer at least as much as the advanced countries from fluctuations in their balances of payments and they therefore have an equal or greater need of additional reserves in relation to trade. This is particularly true of countries whose exports are concentrated on a few products which are liable to price fluctuations and which form a large proportion of their production. L.D.C.s are also, by most relevant measures, typically smaller than advanced countries. Since there are economies of scale in holding reserves, reserve needs, expressed as a proportion of imports, are greater. The adjustment process is likely to work more slowly and, if speeded up, more painfully. The costs of adjustment are likely to be higher, because they are more specialised in production and do not normally export capital. Finally, the L.D.C.s have less access to credit facilities and for this reason, too, need to hold larger reserves than countries with better access to credit. The reserves of many L.D.C.s are clearly inadequate to satisfy these needs. The social costs of the alternatives to reserves will also tend to be higher than in rich countries. Industrial under-utilisation or stagnation caused by import restrictions or deflation disrupt economic development and can inflict considerable damage.

14. When we come to the *ability* and *willingness* of the L.D.C.s to hold additional reserves for periods of need, there is more room for argument. There is little evidence that actual reserves reflect needs. Professor Machlup has investigated (2) the relationship between official reserves and (i) imports, (ii) variations in foreign trade, (iii) imports and capital flows, (iv) past deficits, (v) domestic money supply and (vi) current liabilities — all of which may be thought to reflect needs. He found, perhaps not altogether surprisingly, that

(2) This *Review*, No. 78, September 1966.

no systematic relationship existed. But this is true for both poor and rich countries and is no ground for discriminatory treatment. It is often said that if the L.D.C.s were given additional reserves they would increase their overseas expenditure correspondingly so that their reserve levels would rapidly revert to what they were before the reform. This would not be true to the extent to which trade between L.D.C.s expanded. The conclusion is drawn that whatever may be the need of the L.D.C.s for greater reserves, it would be futile to give them a share in any internationally organised increase. However, the account of the behaviour of the L.D.C.s on which this argument rests does not seem to be confirmed by the facts. If it were correct, the total reserves of the L.D.C.s would be continually tending to a minimal level, and even if at certain periods (e.g. commodity prices boom) they reached a higher level, they would very rapidly fall again. In fact, the L.D.C.s as a group keep substantial reserves, even if oil producers are excluded. In total, their holdings at the end of 1964 represented 39% of their imports for the year, compared with 38% for the Ten excluding U.S.A. and 36% for the Ten excluding U.S.A., U.K., France, and Germany. However, as is shown in the Appendix Chart A 2, the ratio has on the whole been falling throughout the period 1952-1964, having started at 55% at the end of 1951. Within the group of L.D.C.s some significant changes have taken place. "A persistent fall in reserves has been characteristic for a number of countries whose reserves were relatively large at the beginning of the period...; as a percentage of imports the reserves of these countries fell very markedly. In contrast, oil producing countries as well as all other developing countries have tended to increase their reserves in absolute terms. Measured as a percentage of imports, the reserves of the oil-producing countries were higher at the end of the period than at the beginning, while those of the residual group fell only moderately" (I.M.F. Study Paper, *The Need for Reserves*, p. 10).

15. It is true that there are some L.D.C.s which have low reserves and whose propensity to spend money for development purposes is so great that they would be unlikely to retain in their reserves a large proportion of any increase in unconditional liquidity that they received. But there is no warrant in the recorded facts for regarding this in any sense as a typical or average L.D.C. behaviour. All that can reasonably be said is that if an addition is made to

L.D.C. reserves, the ultimate effect on their reserve levels will be somewhat less than the initial increment. (Even this statement must be qualified to the extent that L.D.C.s' trade with one another increases as a proportion of exports.) On the basis of past experience, however, this could equally be said of some advanced countries, and this would not be considered a sufficient reason for denying them a share in the increase of liquidity. It can also be argued that it is in the nature of unconditional liquidity that its owner may either spend or hold it. It would be difficult to show why a more rigorous condition for participation should be applied to the L.D.C.s than is contemplated for the advanced countries. It is inherent in the nature of reserves that they can be run down and so finance a higher level of expenditure than would otherwise have been possible. In those L.D.C.s where the ratio of reserves to imports has fallen, this has often been the result of the combination of an initially adequate level of reserves with a growing volume of imports. The growth of imports has not itself been specially large; it has in fact been considerably smaller, in general, than the growth of imports in advanced countries. Such a situation does not suggest a shortage of reserves due to profligacy, but rather an inability to raise reserves in the face of growing import requirements.

16. Even if it were true, as it may be in particular cases, that L.D.C.s have run down their reserves unwisely, it must be remembered that these countries are still learning and that the bitter experience of getting caught short of reserves with the disruption caused by import restrictions will have taught some of them to pursue more cautious policies in the future.

17. Finally there is the question of the ability of the L.D.C.s to meet the *obligations* of full membership of a scheme. It would seem that three types of obligation may be considered, because they have been put forward in Group of Ten discussions:

- (i) what has to be done by members at the outset to get the scheme started: they must undertake to maintain the gold value of the currency put up as backing to the issue of units ("backing");
- (ii) what has to be done by members to make the scheme function successfully: they must be willing to buy the new units with their own currency at gold value, and to hold the units in a uniform proportion to gold ("acceptance");

(iii) what has to be done, over and above the technical necessities covered by (ii), to preserve confidence and goodwill while the scheme runs: they must be willing to share in a general obligation to relieve a member with an excessive holding of units, buying them with gold ("limits").

18. On "*backing*", all that members have to do is to provide their own currency for the new units and to undertake to maintain its gold value in case of liquidation, or if they were to withdraw from the scheme. This does not imply that their currency has to be generally convertible. Such a limited guarantee for a remote contingency would be within the capacity of almost all countries. Alternatively, the advanced countries could pay in more than 100 per cent for their units, thus backing the contributions of L.D.C.s. Or all countries could give a joint guarantee in case of liquidation which could be done without a slur. In any case the whole question of backing is not very real. Discussion has now moved away from the idea of a dormant fund of currencies used as "*backing*" and is concerned with an undertaking to accept the new asset in settlement of debt.

19. On "*acceptance*", the members have to be willing to buy the units with their own currency and to hold them as reserves. L.D.C.s should be willing to do both.

20. On "*limits*", the obligation on members depends on what is decided about the link with gold. Conceivably there might be *no* link with gold, in which case there would be no obligation on members under this head. But if, for example, there was provision for some kind of reshuffle, the members would have to take their share in a general obligation to relieve a member with an excessive holding of units, buying them with gold. With the possible exception of a very few countries holding minimal reserves, the L.D.C.s should be able to undertake such an obligation. Those whose reserves consist of sterling or dollars would of course have to take gold from the U.K. or the U.S.A. to meet the obligation. This might in some circumstances be awkward for the U.K. or the U.S.A., but this could hardly be considered a reason for disqualifying the L.D.C.s from membership. It is after all a praiseworthy practice of these countries not to insist on holding their reserves in gold, and we could not decently tell them that their rights as a member of the international economy are to be diminished because they do so. We

must therefore conclude that a considerable number of L.D.C.s would be both able and willing to undertake these obligations.

21. It may be argued that extension to a widespread membership would complicate operations without adding to the scheme's usefulness. This does not look defensible as a reason for excluding countries which are anxious to join and of whose ability to accept the obligations there was no reasonable doubt.

22. If one accepts these points, one is driven to the conclusion that the reasons for wishing to exclude the L.D.C.s from full membership of the scheme and a full share in its management are not technical but political. The reason for this resistance is the fear that some advanced deficit countries, in particular America and Britain, will "*gang-up*" with the less developed deficit countries in inflationary expansion. This raises the question of the management of the International Monetary Fund and the distribution of voting power in it, not the obligations of membership.

Conclusions on Sharing in Increased Unconditional Liquidity

23. There is thus a strong case for giving the L.D.C.s a share in the increase of unconditional liquidity: the L.D.C.s *need* additional liquidity and it is *not* true that they are, in general, *incapable* of conserving it. This was recognised in the Communiqué of the Ministerial Meeting of the Group of Ten of July 1966. The Ministers and Central Bank Governors state that "all countries have a legitimate interest in the adequacy of international reserves... there is agreement that deliberately created reserve assets, as and when needed, should be distributed to all members of the Fund on the basis of I.M.F. quotas or of similar objective criteria. The major countries should be ready to provide adequate financial backing through the extension of special lines of credit to the Fund or through commitments to accept and hold such reserve assets".

24. An extension of the gold tranche facilities, sometimes offered to L.D.C.s as an alternative to new asset creation, would certainly be a valuable acquisition to L.D.C.s. But it is not the same as an increase of equal value in owned reserves, as is clear from the way in which the advanced countries themselves regard the gold tranche. If this solution were chosen universally, there would at least be no objection on grounds of discriminatory treatment of outsiders.

25. In paragraph 3 other ways were mentioned in which the needs of non-group countries can be partially met. These include:

(a) an extension of the Compensatory Finance scheme for L.D.C.s suffering an unforeseen fall in export receipts;

(b) additional conditional liquidity through setting aside a proportion of newly created units for use by an international institution such as the I.M.F. to help individual countries in difficulty.

26. These are valuable proposals, but neither has the same comprehensive effect as an all-round increase in unconditional liquidity, and they are not substitutes for it.

The "Link"

27. A paradoxical situation has arisen. On the one hand, the provision of additional reserves to the L.D.C.s is inhibited, as we have seen, by the fear that the new money *will* be spent, not held. On the other hand, many donors are inhibited from giving more aid by the fear that the money will *not* be spent, or not be spent fully, on the products of the donor. We have argued that the first fear is not generally justified. If it were justified, and in those cases in which it is justified, the second fear can easily be removed: hand out the newly created reserve asset (in the form of either counterpart currencies or units) to developing countries and let them spend it on our exports, thus enabling us to earn additional reserves. But the problem of the creation of extra spending power is distinct from the problem of the creation of extra reserves.

28. In any concerted international monetary reform the creation of additional liquidity should be linked with the provision of additional capital aid to the L.D.C.s. The object of this section is to analyse the benefits and disadvantages of the proposal from the point of view of the L.D.C.s themselves and of advanced countries in need of reserves like the U.K.

29. A form of this proposal was put forward by Mr. Maxwell Stamp in 1962. Another version has recently acquired considerably greater importance through being included among the recommendations of the U.N.C.T.A.D. expert group which reported on *International Monetary Issues and the Developing Countries*. As a possible method of implementing the proposal, and on the assump-

tion that the creation of additional liquidity takes the form of the issue by the I.M.F. of "Fund Units", they suggest that the Fund should lend the I.B.R.D. or its affiliates, in exchange for I.B.R.D. bonds, part or all of the usable counterpart currencies deposited by member countries against the issue of Fund Units. Each developed country would then have to compete for the additional orders engendered by the World Bank investments in order to retain the full addition to its reserves represented by the initial distribution of Fund Units. To the extent to which the distribution of the additional orders diverged from that of the newly created Fund Units, there would be a redistribution of the Units. The developed countries who gained from this redistribution would have done so by giving up resources to fulfil the development orders coming from the L.D.C.s.

30. *Prima facie* the adoption of such a proposal would be of considerable advantage to the L.D.C.s. They would, initially at least, obtain a substantial accretion in the flow of development aid on easy terms (it could be on easy terms since there would be no necessity for the I.M.F. to charge the I.B.R.D./I.D.A. more than a very low rate of interest on the currencies transferred). International monetary reserves are now about \$70,000 mill. An increase in international liquidity at the rate of 3% per year would imply the creation of Units at the rate of \$2,100 mill. and at the rate of 5% of \$3,500 mill. per year. If the proportion distributed via the link were to be 50%, this would produce an annual increment of between \$1,000 mill. and \$1,700 mill. in capital aid, a substantial amount in relation to the current world flow of aid.

31. Taking a wider point of view, the case for the link is that it would enable a generally agreed objective — the increase in the flow of aid to the L.D.C.s — to be achieved while safeguarding the donor countries against the danger, which most of them fear, that increased aid will damage their international liquidity position. That there is widespread fear of the effect of aid on the balance of payments is shown by the prevalence of tying. Even countries with strong reserves and persistent surpluses tie their aid (thereby increasing the inflationary pressures whose effects on their economies they continually bemoan). Any aid given via the link mechanism will carry with it a built-in guarantee, for the donor countries as a whole, against a loss of reserves. Further, the greater the extent to

which any one advanced country makes real resources available to the L.D.C.s through the link, the greater the extent to which it will share in the ultimate distribution of the newly created reserves.

32. These considerations are of particular importance to the U.K., since we have emphasized that the volume of our aid is restricted by balance of payments considerations substantially below the level which we should otherwise like to see it attain. But they are relevant to any country whose behaviour in regard to aid demonstrates a concern for balance of payments repercussions. That they are relevant to such a large part of the whole field of aid has a bearing on one argument which is often used in criticism of the link proposal, namely the assertion that monetary reform and increasing aid are logically separate objectives which can and should be separately pursued. The fact is that concern about national balances of payments, which is a symptom of a world economy suffering from liquidity shortage, is also a powerful constraint upon and inhibitor of aid policy. And from a practical point of view, though it is true that any international monetary reform which brings about a general increase in liquidity will tend to cause a liberalisation of aid policies, it is exceedingly doubtful whether this process would in a long time, or indeed ever, have the same effect on the flow of aid as would a scheme which linked the two things together right from the start. To put the same point another way round, it may be true that if a link proposal were adopted, some donors would say that the existence of this new aid channel made it unnecessary for them to go on giving so much directly and would reduce the scale of their bilateral aid. But it seems not unlikely, for practical reasons and because of the changed aspect of the balance of payments problem, that this could produce more than a fairly small offset to the direct effect of the proposal on the volume of capital aid.

33. There is another reason for expecting that the link proposal would lead to an increase in the total flow of aid. This is that it provides an automatic and unquestioned method of sharing the burden of the additional aid. It thus avoids the disputes about burden sharing which have tended to occur in international aid operations (especially I.D.A.) and which tend to make any such operations small-scale and slow-moving.

34. The adoption of a link scheme would not only increase the total flow of aid: it would also lead to a higher proportion of the

flow being channelled through the I.B.R.D. and its associates. This must be reckoned as a considerable advantage, implying better administration of the aid on average and better value in relation to the aid given — probably quite a lot better. But it would be possible to attach the links to any other aid scheme. Thus monetary reform could be linked with Supplementary Financial Measures, the scheme which proposes to insure L.D.C.s against unexpected shortfalls in export earnings, or with debt relief or with commodity support or with regional development banks.

35. It seems clear therefore that the adoption of the link proposal would bring substantial economic advantages to the L.D.C.s. We have next to consider whether, and to what extent, this gain to the L.D.C.s would be matched by a "loss" or cost to the advanced countries. It is conceivable that an advanced deficit country might find itself in the position of having to buy back its own currency from an advanced surplus country, on whose exports the currency had been spent, and so of failing to share in the liquidity gain. At the worst, the country concerned might be no better off in terms of total liquidity than it was before the reform. It could not actually *lose* reserves: though owing to the operation of the gold reshuffle (if the scheme contained such a provision) it might end up with a reduced gold holding and a balancing holding of Fund Units.

36. As far as the U.K. is concerned, if we are uncompetitive and suspicion is cast on sterling, no reform of international liquidity can, by itself, remedy this situation. In actual fact, there is a reasonable expectation that the adoption of the proposal would enable the U.K. to gain more reserves than it would gain if there were no link. Past experience suggests that in the competition for meeting the import requirements of the L.D.C.s financed by additional capital aid, the U.K. should do well. The estimated addition to U.K. exports arising out of I.D.A. expenditure has considerably exceeded in value the U.K. subscription to I.D.A. Moreover, it would be possible for the U.K. to make a special effort to gain a big share of the new development orders, by suitable home demand policy and in other ways. We should be presented with an opportunity to strengthen our overseas position by much more than we could do if the new Units were simply distributed direct to the participating members in proportion to their subscriptions. Of course we

would not get this advantage for nothing; we would have to make the necessary real resources available.

37. Some of the advanced countries, notably the Continental European countries, might not find the effect of the proposal so much to their taste as we should. They would see it as facing them with the prospect of increased pressure of demand on their economies, already over-employed and suffering from inflation. They could avoid this only by not taking any share in the new development orders, and if they did this they would not gain any of the additional liquidity created through the link. It is clear that it would not be reasonable for a country to support the proposal unless it was prepared to make an additional transfer of real resources in favour of the L.D.C.s. If it is so prepared, however, it should also be willing to take action to reduce domestic demand to the extent necessary to prevent an overloading of the economy. Clearly the proposal has no chance of being adopted unless there is a sufficient number of countries, who, like the U.K., are willing to make a greater real transfer to the L.D.C.s so long as their balances of payments and reserve positions do not suffer thereby. If this is the case, then the difficulty about inflationary pressure is not insuperable. And the need to *earn* reserves, in exchange for real resources, should provide a safeguard against excessive expansion of reserve assets and should appeal to those concerned by the inflationary dangers of reform.

38. Another criticism of the link proposal is that it would reduce the quality of the "backing" for the newly created reserve units. Under the proposal the backing would consist of long-term I.B.R.D. bonds, which it is said would not be as attractive to participating countries as the currencies of the inner group countries which is the alternative. However, as the U.N.C.T.A.D. Experts point out, the question of the quality of the backing would arise only in the event of the liquidation or partial liquidation of Fund Units. This is a fairly remote contingency, and it seems somewhat irrational for a country which is willing in effect to invest money in the scheme at a low or zero rate of interest to take fright because of a small chance of getting less than 100% of its money back on liquidation. The real return on investment in a monetary reform scheme lies in the liberating effect on economic policy and international trade all over the world. The quality of the backing is not, or at least should

not be, more than a minor consideration in choosing between one type of scheme and another.

39. A different objection which has been made to the link proposal is related to the time pattern of the two operations which it is desired to link. This point is stated as follows by the Ossola Report:

"From the point of view of international monetary management, full flexibility of decision is called for as to whether assets should be created or not. From the point of view of development, on the other hand, planning both by donors and by recipients requires firm commitments over considerable periods. This would introduce an inflexibility into the monetary aspects of the scheme and thus impair the monetary quality of the asset".

As was stated in paragraph 32, this criticism may apply to the Stamp proposal but has little substance as applied to the Experts' proposal. Under their scheme the new reserve asset would be created according to the estimated needs of the world economy, not according to development needs. A proportion of these newly created units, or of the currencies furnished as backing for them, would be put at the disposal of the I.B.R.D. and the size and timing of this provision would be designed to meet the needs of development policy. It should be possible to achieve quite a satisfactory degree of continuity from the point of view of I.B.R.D. planning; indeed, the situation with "link" finance might well be an improvement on the types of finance available to the I.B.R.D. at the moment.

40. It is a common objection to the link that liquidity and aid are entirely separate problems which cannot and should not be packaged together. If a group of industrial countries — the argument runs — wish to give each other credit, there is no reason why they should not be entitled to create the necessary instruments for themselves without linking this scheme with the provision of real resources to L.D.C.s. The reply to this argument (given by Professor Machlup) is that the creation of new liquidity, whether by additional drawing rights or by new assets, presents a saving compared with the acquisition of gold. When new gold deposits were discovered, those who wished to acquire gold had to give up real resources. The introduction of international "paper" money amounts to a technical invention which saves resources. It is sensible that this

saving should accrue to those most in need, the L.D.C.s, and that richer countries should have to earn at least part of it.

41. It may be argued that the attempt to forge a link between reserve creation and aid reduces the chances of achieving an effective monetary reform and of increasing bilateral and multilateral aid in more conventional ways. This raises problems of strategy. Even if the link were to reduce other flows of aid, the total is likely to be larger and of better quality. Monetary reform is more important than the link, and insistence on the link need not ultimately be made a condition of agreement. Favouring the link therefore need not reduce the chances of success of monetary reform and an increase in conventional forms of aid.

42. From this discussion of the probable consequences of adopting the "link" proposal the following conclusions emerge:

(1) The adoption of the proposal would in practice *probably* result in:

(a) a larger total volume of aid to the L.D.C.s;

(b) a higher proportion of aid channelled through the I.B.R.D. and its associates;

(c) a gain to reserves, at some cost in diversion of resources to aid from domestic use if full employment prevails.

(2) It is not true that there is any necessary conflict between the timing of the monetary operation and that of the provision of development finance.

43. The proposal thus offers an opportunity of giving a substantial encouragement to the development of the L.D.C.s while guaranteeing the donor countries against any ill effects on their balance of payments positions. It would also offer advanced deficit countries an opportunity to strengthen their reserve positions by making a special effort to fill the development orders which the scheme would generate.

Brighton

PAUL STREETEN

APPENDIX A

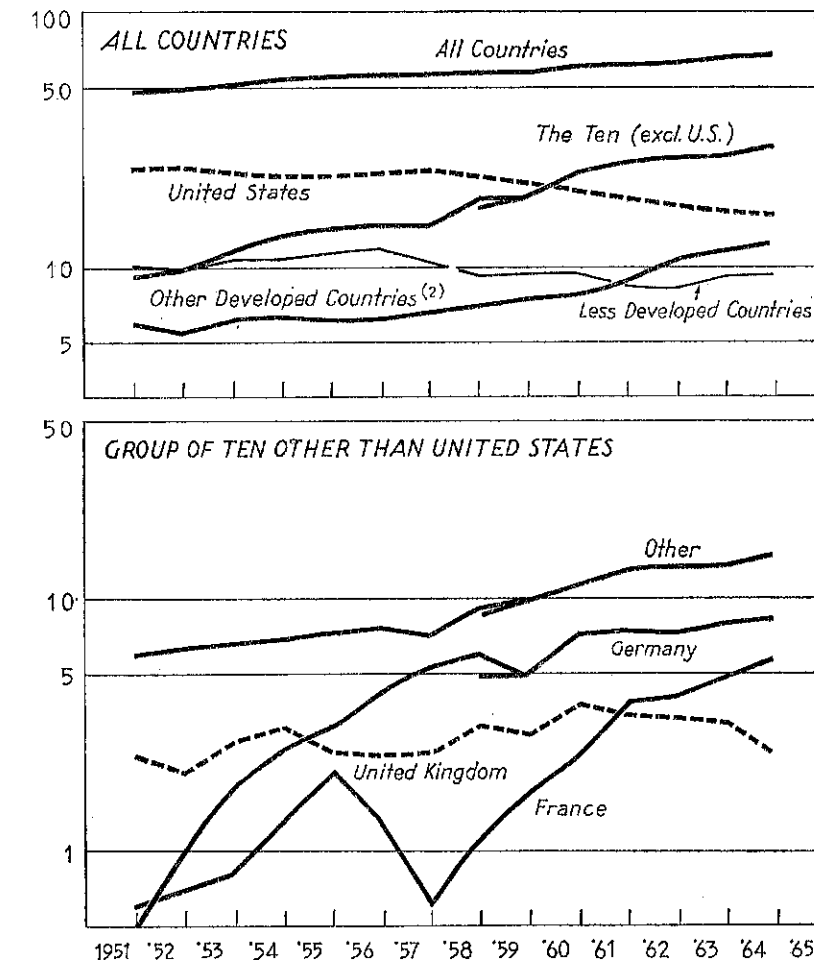
LIQUID RESERVES AND IMPORTS

An I.M.F. study "The Need for Reserves S.M./66/9" comes to the following conclusions.

(1) During the period 1951-64 the absolute level of reserves held by L.D.C.s remained stable. (See Chart A1).

LEVEL OF INTERNATIONAL RESERVES (1) 1951-64
(In billions of U.S. dollars)

CHART A 1



(1) Gold and Foreign Exchange Holdings plus Reserve Position in Fund at end of year.

(2) Other Europe, Australia, New Zealand, South Africa, Israel and Turkey.

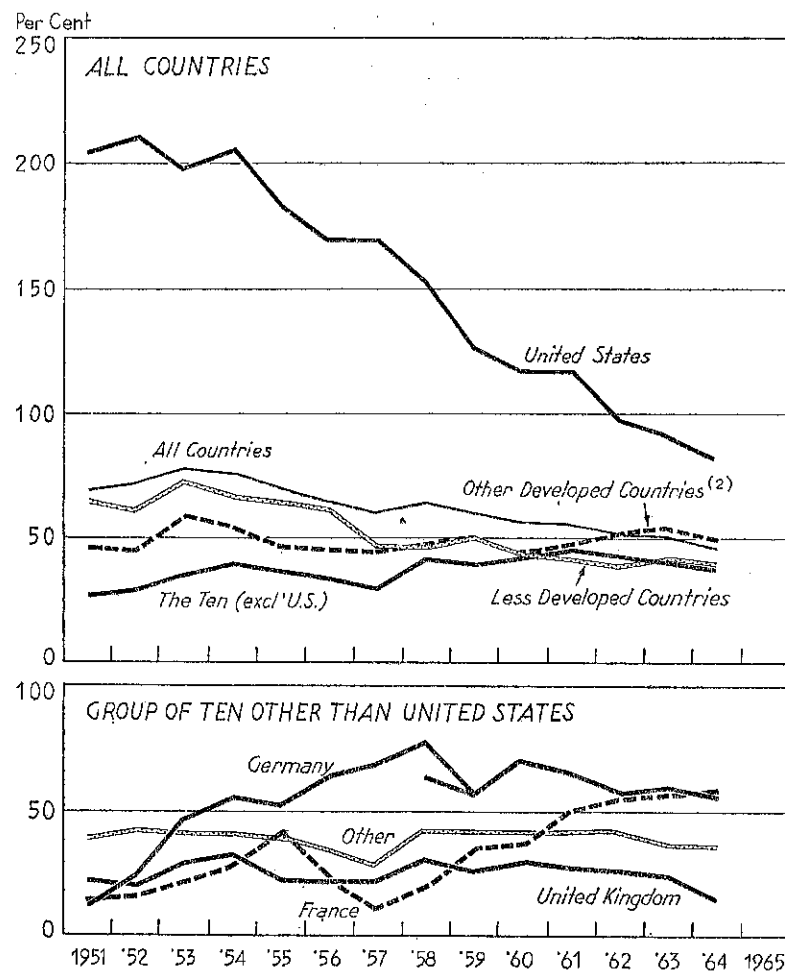
Source: IMF, *The Need for Reserves* (1966).

(2) However, the ratio of L.D.C. reserves to imports fell from about 55 per cent in the earlier decade to below 40 per cent in 1964. (See Chart A2).

(3) Within the broad group of L.D.C.s a number of significant changes have taken place. (See Table A).

RESERVES AS PERCENTAGE OF IMPORTS (1) 1951-64

CHART A.2



(1) Gold and Foreign Exchange Holdings plus Reserve Position in Fund at end of year related to imports during the year.

(2) Other Europe, Australia, New Zealand, South Africa, Israel and Turkey.

APPENDIX B

Alternatives to the Link

The Stamp plan consists in issuing international certificates to L.D.C.s, which can spend these for development purposes in countries that express their willingness to accept them. The initiative for the creation of this money can lie either with the international agency giving aid, or with the agencies or countries concerned with the need for additional reserves. The objection to the former solution is that the creation of international reserves should be guided by other considerations than the need for aid.

The Scitovsky Proposal

The Scitovsky proposal (*Requirements of an International Reserve System*, Essays in International Finance No. 49 International Finance Section, Princeton University, 1965 pp. 10-13) meets this objection by shifting the initiative of reserve creation to deficit countries in need of additional reserves and ready to surrender real resources for aid. A deficit country in need of reserves makes a budgetary appropriation for grants-in-aid to L.D.C.s and hands over this grant to the I.M.F. in the form of its national currency or government debt. The I.M.F. issues international currency against the security of this country's currency or debt and makes it available to I.D.A. I.D.A. gives it to an L.D.C. for the purpose of financing development imports. The L.D.C. receiving the money can spend it *only* in the country against whose currency or debt it was issued; but once in this country's hands, it becomes unrestricted international liquidity, spendable and acceptable anywhere. In other words, the L.D.C. receives a tied grant (to which not the same objections apply as to a tied loan): the deficit country receives additional external reserves, but only in exchange for real resources. This proviso prevents reserves from being too easily acquired. To link the creation of international money to the financing of development would follow a respectable tradition: on the national level deposit money was created against bank credit that helped to finance industrial development.

Taxes and Subsidies

There can be no objection to tying grants. If, however, loans are to be given rather than grants, tying is objectionable and against the rules of I.D.A. An alternative to tying, which would nevertheless permit deficit countries to earn reserves and surplus countries to avoid the impact of inflationary pressures, would be to impose indirect taxes on the aid-financed exports of surplus countries and to give subsidies to the aid-financed exports of deficit countries. Such a system would permit otherwise non-competitive deficit countries to earn reserves in exchange for real resources, while insulating surplus countries with adequate reserves unwilling to suffer inflationary pressures against aid-generated demand.

TABLE A

COUNTRIES RESERVES AS PERCENTAGE OF IMPORTS 1951-1964 (*)

| | Reserves as Percentage of Imports | | | | | | | | | | | | | |
|---|-----------------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| | 1951 | 1952 | 1953 | 1954 | 1955 | 1956 | 1957 | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 |
| <i>Major Oil Exporters</i> | 60 | 64 | 67 | 55 | 64 | 80 | 75 | 64 | 52 | 49 | 50 | 51 | 76 | 67 |
| Iran | 81 | 112 | 111 | 84 | 69 | 67 | 59 | 44 | 37 | 30 | 30 | 42 | 47 | 39 |
| Iraq | 80 | 75 | 94 | 114 | 108 | 111 | 77 | 94 | 91 | 66 | 53 | 53 | 92 | 60 |
| Kuwait | ... | ... | ... | ... | ... | ... | ... | ... | ... | 30 | 34 | 34 | 34 | 34 |
| Libya | ... | ... | ... | ... | ... | ... | ... | 56 | 67 | 51 | 58 | 47 | 51 | 59 |
| Saudi Arabia | ... | ... | ... | ... | ... | ... | ... | ... | 69 | 79 | 92 | 87 | 161 | 172 |
| Venezuela | 50 | 52 | 53 | 47 | 51 | 76 | 78 | 66 | 46 | 51 | 53 | 53 | 78 | 72 |
| <i>Countries with Initial High Reserves</i> | 75 | 65 | 96 | 88 | 86 | 73 | 46 | 43 | 44 | 38 | 32 | 26 | 26 | 22 |
| Argentina | 35 | 36 | 67 | 54 | 39 | 34 | 22 | 10 | 28 | 42 | 26 | 8 | 28 | 14 |
| Brazil | 26 | 26 | 46 | 30 | 38 | 50 | 32 | 34 | 27 | 24 | 32 | 26 | 21 | 29 |
| Ceylon | 67 | 46 | 34 | 58 | 69 | 69 | 49 | 34 | 34 | 25 | 25 | 24 | 24 | 12 |
| Ghana | 209 | 204 | 198 | 258 | 216 | 194 | 160 | 190 | 137 | 107 | 48 | 63 | 35 | 38 |
| India | 108 | 106 | 154 | 144 | 133 | 85 | 42 | 39 | 41 | 29 | 29 | 22 | 24 | 19 |
| Pakistan | 98 | 41 | 79 | 78 | 103 | 76 | 59 | 54 | 86 | 48 | 43 | 38 | 35 | 24 |
| Sudan | 198 | 105 | 122 | 122 | 109 | 148 | 62 | 52 | 80 | 91 | 64 | 57 | 35 | 26 |
| U.A.R. | 143 | 114 | 136 | 152 | 117 | 94 | 85 | 64 | 47 | 40 | 29 | 30 | 24 | 23 |
| <i>Other Less Developed</i> | 49 | 52 | 52 | 47 | 44 | 44 | 38 | 41 | 53 | 47 | 45 | 44 | 44 | 42 |
| Bolivia | 35 | 27 | 32 | 16 | 9 | 1 | 7 | 9 | 11 | 10 | 10 | 4 | 10 | 23 |
| Chile | 18 | 20 | 20 | 16 | 23 | 23 | 12 | 15 | 31 | 20 | 12 | 13 | 13 | 15 |
| Colombia | 33 | 40 | 37 | 38 | 20 | 20 | 30 | 40 | 52 | 34 | 27 | 18 | 21 | 21 |
| Costa Rica | 16 | 24 | 26 | 21 | 24 | 14 | 13 | 21 | 15 | 12 | 6 | 12 | 13 | 14 |
| Dominican Republic | 36 | 31 | 29 | 39 | 32 | 32 | 35 | 32 | 31 | 26 | 11 | 14 | 23 | 19 |
| Ecuador | 52 | 64 | 53 | 33 | 31 | 31 | 36 | 26 | 44 | 35 | 36 | 44 | 40 | 40 |
| El Salvador | 70 | 65 | 61 | 52 | 42 | 37 | 37 | 37 | 38 | 27 | 22 | 21 | 29 | 28 |
| Guatemala | 51 | 58 | 53 | 47 | 53 | 51 | 51 | 33 | 33 | 39 | 41 | 35 | 34 | 30 |
| Honduras | 40 | 35 | 37 | 41 | 32 | 27 | 20 | 13 | 17 | 18 | 17 | 16 | 13 | 20 |
| Jamaica | ... | ... | 38 | 39 | 33 | 29 | 29 | 40 | 37 | 32 | 36 | 33 | 40 | 34 |
| Mexico | 36 | 35 | 31 | 26 | 50 | 48 | 41 | 35 | 45 | 37 | 36 | 37 | 44 | 39 |
| Nicaragua | 25 | 32 | 33 | 21 | 20 | 10 | 14 | 10 | 18 | 17 | 19 | 19 | 29 | 28 |
| Panama | 66 | 62 | 63 | 58 | 48 | 48 | 25 | 44 | 35 | 27 | 18 | 18 | 18 | 8 |
| Peru | 24 | 22 | 19 | 26 | 19 | 19 | 9 | 8 | 19 | 28 | 84 | 22 | 24 | 28 |
| Uruguay | 86 | 135 | 191 | 122 | 103 | 102 | 77 | 186 | 109 | 56 | 101 | 92 | 112 | 96 |
| Jordan | 59 | 50 | 50 | 61 | 47 | 60 | 52 | 48 | 40 | 38 | 44 | 45 | 41 | 55 |
| Lebanon | 31 | 31 | 39 | 44 | 40 | 38 | 40 | 51 | 48 | 44 | 48 | 58 | 53 | 59 |
| Syria | 14 | 22 | 35 | 28 | 27 | 35 | 37 | 24 | 28 | 21 | 16 | 18 | 16 | 17 |
| Burma | 111 | 115 | 119 | 61 | 53 | 61 | 31 | 58 | 63 | 50 | 55 | 76 | 80 | 79 |
| China, Republic | 56 | 39 | 43 | 28 | 43 | 54 | 63 | 54 | 53 | 39 | 42 | 38 | 63 | 69 |
| Korea | 19 | 39 | 32 | 44 | 28 | 26 | 26 | 39 | 48 | 46 | 66 | 40 | 24 | 34 |
| Malaysia | 66 | 78 | 80 | 99 | 97 | 92 | 85 | 93 | 117 | 112 | 118 | 114 | 111 | 109 |
| Philippines | 46 | 51 | 49 | 39 | 26 | 28 | 10 | 15 | 16 | 19 | 8 | 11 | 16 | 14 |
| Thailand | 133 | 115 | 93 | 91 | 90 | 87 | 79 | 79 | 75 | 82 | 94 | 96 | 94 | 99 |
| Viet-Nam | ... | ... | ... | ... | 48 | 61 | 48 | 69 | 76 | 90 | 69 | 58 | 61 | 47 |
| Ethiopia | ... | ... | ... | ... | ... | ... | ... | ... | ... | ... | ... | 64 | 45 | 50 |
| Morocco | ... | ... | ... | ... | ... | ... | ... | 32 | 43 | 50 | 41 | 40 | 25 | 12 |
| Nigeria | ... | ... | ... | ... | ... | ... | ... | ... | 99 | 74 | 59 | 56 | 43 | 36 |
| Tunisia | ... | ... | ... | ... | ... | ... | ... | 31 | 56 | 45 | 35 | 29 | 28 | 13 |
| <i>Total Less Developed</i> | 64 | 60 | 72 | 66 | 64 | 61 | 47 | 46 | 50 | 44 | 41 | 38 | 42 | 39 |
| <i>Grand Total</i> | 67 | 69 | 74 | 73 | 66 | 62 | 57 | 62 | 58 | 55 | 54 | 51 | 50 | 46 |
| <i>Memorandum Item</i> | | | | | | | | | | | | | | |
| The Ten (excluding U.S., U.K., France, and Germany) | 39 | 42 | 41 | 41 | 40 | 34 | 28 | 42 | 42 | 41 | 42 | 41 | 36 | 36 |
| The Ten (excluding U.S.) | 27 | 30 | 36 | 40 | 37 | 34 | 30 | 42 | 40 | 43 | 45 | 43 | 40 | 38 |

(*) Gold and Foreign Exchange Holdings plus Reserve Position in IMF at end of year, related to imports during the year.