the IMF: time for reform

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1. The challenge to international cooperation

In the last decade the case for government intervention nationally and internationally in the management of economic affairs has been gradually and inexorably lost. The philosophy which advocated economic management in the national and international common interest has been supplanted by the philosophy of market forces and belief in mechanistic monetary arrangements.

In part this has been due to declining confidence in the effectiveness of state intervention as crisis followed crisis; in part to the triumph of political rhetoric from the right. Both elements have been present in Britain and under one guise or another in many developed and developing countries. The remoteness of the state, the ineffectiveness of macro-economic planning in a turbulent and uncertain world, distrust of the bureaucracy and the resurgence of individualism at the expense of the collective cause have all contributed.

Public debate has concentrated on the role of state intervention in industry and the economy at a national level. The effects of the changing mood, however, have been most clearly obvious at the international rather than the national level. Even administrations so ideologically committed as Mrs Thatcher's have found it difficult to withdraw central government from national economic life. The state, through central and local government remains the major employer, the controller of assets in industries of strategic importance – some of which because of their age and structure would not find a ready private buyer – and the focus of social commitments so long standing as to make withdrawal politically impossible.

"International economic relations rarely influence voters, though as this pamphlet will seek to demonstrate they have had a crucial impact on their lives."

In contrast international economic management has no such roots. The ties of international economic and financial cooperation between governments are much more fragile. International economic relations rarely influence voters, though as this pamphlet will seek to demonstrate they have had a crucial impact on their lives. The result has been that governments have found it easy to stand back from the international economy. Lack of experience, knowledge and ideas of how the world economy might be controlled and developed has been matched by a growing willingness to rely on market forces to solve, however slowly and uncomfortably, the economic problems of the world. This disengagement has damaged what had been a developing process of international co-

operation and has left the world economy weak and poised on the edge of a major recession.

These developments have been matched by a growing interdependence in the world economy. Reliance of the western nations and the developing countries on OPEC oil and on a regular exchange of goods, services, raw materials and technology has increased year by year. At the same time as the sense of international collective responsibility for the economic health of the world has declined and almost vanished, trade and financial flows have grown in volume becoming progressively more important to each individual national economy.

Andrew Schonfield giving the Stevenson memorial lecture at Chatham House in November 1979 described the trend.

> "*Macro-economic policy making is increasingly in doubt and decreasingly subject to international coordination... with short term demand management so much out of fashion in so many countries it is hardly surprising that the western world has failed totally to arrive at any joint policy for tackling the severe business cycle of the 1970s – the worst that has hit them for forty years. There is a tendency for governments to say: we have sinned individually, usually by failing to control our own money supply, and now we must each make individual amends. Indeed the extremists among them take the view that control of the national money supply is a complete and better substitute for any amount of international coordination of policy*" (The edited text was published in *International Affairs*, January 1980.)

The new British ambassador in Washington, Sir Nicholas Henderson has claimed that one of Mrs Thatcher's greatest achievements has been to have made "a final decisive break with the thinking of JM

Non-oil Developing Countries. External Debt, 1973-80
(In billions of US dollars)

	1973	*1974*
Total outstanding debt of non-oil developing countries	**97.3**	**120.6**
By type of creditor		
Official creditors	**49.1**	**59.3**
a. Governments	*36.9*	*44.2*
b. International institutions	*12.2*	*15.2*
Private creditors	**48.3**	**61.2**
a. Unguaranteed debt	*21.4*	*26.0*
b. Guaranteed debt	*27.0*	*35.2*
(i) To financial institutions	*13.1*	*21.7*
(ii) Other private creditors	*13.8*	*13.5*

Source. IMF Annual Report 1981

“The instrument which Keynes helped to create in order to build a sense of international cooperation and a process of economic management – the International Monetary Fund – has been perverted over the last ten years.”

Keynes”. The break with Keynesianism and with longer standing socialist ideas on intervention, however, goes beyond the Thatcher administration and beyond Britain. It extends to the international arena where the instrument which Keynes helped to create in order to build a sense of international cooperation and a process of economic management – the International Monetary Fund – has been perverted over the last ten years. That development and its consequences along with proposals to reverse the trend are the subject of this pamphlet.

“International cooperation is an immediate need, not simply a long term ideal.”

International cooperation is an immediate need, not simply a long term ideal. After tripling in eighteen months, world oil prices levelled off in 1981, but the adverse effects of the increase are still felt. Unspent OPEC revenue from this increase was over one hundred billion dollars in 1980 alone, causing severe balance of payments problems for oil importing countries, developed and developing alike. Oil is one contributory factor to the transformation of a relatively mild cyclical down-turn in the world economy into a sustained recession

1975	*1976*	*1977*	*1978*	*1979*	*1980*
147.1	**175.6**	**216.7**	**272.7**	**322.8**	**370.1**
69.3	**81.2**	**97.8**	**117.8**	**134.8**	**155.8**
50.4	*58.5*	*68.9*	*81.6*	*92.1*	*106.0*
18.8	*22.7*	*28.9*	*36.2*	*42.8*	*49.8*
77.9	**94.4**	**118.9**	**154.9**	**188.0**	**214.3**
32.0	*37.5*	*43.1*	*51.4*	*60.7*	*68.2*
46.0	*57.0*	*75.8*	*103.5*	*127.3*	*146.1*
29.8	*39.0*	*54.3*	*73.9*	*96.1*	*112.8*
16.1	*18.0*	*21.5*	*29.6*	*31.2*	*33.3*

unprecedented since the 1930s. The deflationary policy response, coming on top of the already deflationary transfer of resources to OPEC is at least as much to blame.

In such a recession the oil importing countries of the Third World are amongst the worst sufferers. After the last round of oil price increases in 1973 their immediate problems were offset by rapid increases in their borrowing from commercial banks. The private banks offered the only source of funds which were available without the acceptance of conditions which would have transformed and destroyed the policies of economic expansion to which the developing countries were committed. The commercial banks, operating partly through the Eurodollar market, gave the Third World the opportunity to borrow in the mid 1970s but at strictly commercial interest rates and over fairly short term periods of no more than two or three years.

The box below shows the trend, and the limited role of the international institutions, including the IMF. Although these loans are now being extended into the 1980s there are growing signs that the commercial banks are not able to cope with a new round of debt financing necessitated by the latest oil price rises. There are two main reasons for this. First, a number of commercial banks have a disproportionate share of their debts in Third World countries – a share they are not anxious to increase. Secondly interest charges on existing debt coupled with the dismal prospects for world economic growth and export led development in the Third World have sharply reduced the credit worthiness of many developing countries.

The problems generated by the apparent success of the financial markets in coping with the balance of payments imbalances in the mid 1970s are now becoming obvious. Rimmer de Vries, the senior vice president of the American bank Morgan Guaranty, and the guru of the international banking community, has warned repeatedly that reliance on the commercial market to solve the new problems represents unwarranted complacency (see for instance, his speech to the Atlantic Institute for International Affairs quoted in the December 1979 issue of *World Financial Markets*)

In such an environment the rôle of the International Monetary Fund is crucial. In 1945 when the Fund was established it was conceived by Keynes and the US Treasury Secretary Dexter White as an instrument of demand management and a vital element in the process of providing an international financial environment in which growth could take place on the basis of international cooperation, leaving each nation free to decide on a political basis how to distribute and use the fruits of that growth. The aims of the founders are perhaps best spelt out in the statement of the Fund's purpose contained within the Articles of Association signed in December 1945 and quoted below. The Fund has never adequately fulfilled those aims.

The expansion of the world economy in the post war years – almost a golden age from the present standpoint is attributable in the main to reconstruction of industries and whole countries destroyed by war, increased use of resources channelled by government to finance the capital requirements of rudimentary welfare states and the rapid increase in world trade, Marshall Plan funding provided by the United States was a locomotive force in producing this growth – particularly in Europe.

Financial and currency market reform came in the late 1950s and 1960s as a consequence of this growth, and not as a contributory factor. After an initial burst of lending in 1947 the financial facilities of the International Monetary Fund lapsed into disuse and between 1949 and 1956 net

The Purpose of the IMF

The articles of agreement which brought the International Monetary Fund into being were agreed on December 27th 1945 at a meeting attended by representatives of the allied governments in Washington. Article 1 which laid out the purpose of the Fund is quoted here in full.

"The International Monetary Fund is established and shall operate in accordance with the following provisions:-

Article 1 Purposes

The purposes of the International Monetary Fund are

i) To promote international monetary cooperation through a permanent institution which provides for consultation and collaboration on international 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 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 the 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 full text of the Articles of Agreement was published by HMSO, Treaty Series No 21 (Cmnd 6885) 1946.

repayments into the Fund exceeded new borrowing. The Fund only caught up with the expansion in the volume of trade (and consequently of payments to be made) after the Suez crisis of 1956. The outbreak of hostilities in the Middle East caused a substantial outflow of funds from Britain and France. To cover this both countries drew substantial sums from the IMF. A new precedent was set and a sharp increase in use of the Fund's resources followed. The 1960s saw further increases in the quantity of funds utilised as currency values, in an age before floating exchange rates had become fashionale, were subjected to persistent speculative pressure.

If the Fund did not make a significant positive contribution to the world's welfare in the post war period it did help in a negative way by preventing the competitive currency devaluations which had marked the 1930s. Adjustments to exchange rates were undertaken only after a long (some would say too long) process of discussion and consultation, particularly when a major trading currency was involved. Devaluation in the 1960s was a mechanism of last resort, used to correct imbalances and

not as in the 1930s a weapon of economic warfare.

By the end of the 1960s the management of this adjustment process for various of its members states had come to be the Fund's main function. Those who claimed at that time that the Fund was fulfilling the aims of its founders ignored the two main weaknesses of the international financial system. The first of these was the failure to provide a non-inflationary means of expanding reserves in line with expanding trade – a matter of great importance to developing nations whose colonial history and economic development had not permitted any accumulation of reserve assets. The second was the failure to change the system of reliance on the US dollar as the predominant currency of international trade which had existed since the war. This reliance caused increasing problems as confidence in the old dollar parities – the exchange rates against other currencies established in the 1940s – weakened, culminating in the abandonment of convertibility from the dollar to gold in 1971 and ultimately in 1973 to the system of floating exchange rates untied to any central parity.

"The advent of floating exchange rates removed the main function the IMF had designated for itself."

The advent of floating exchange rates removed the main function the IMF had designated for itself. In the boom conditions of 1973 international economic management seemed superfluous. The balance of payments disruptions after the oil crisis, coupled with the inflationary environment of 1974/5 when world inflation rose into double figures for the first time since the war, produced a new role for the IMF, based on some of the principles previously applied only to a number of specific Third World countries which had run into debt.

For individual countries which sought IMF help the prescription was a fairly standard one. Spending, almost invariably meaning public spending, had to be limited. Private spending, whether on imports or home produced goods was considered both economically and morally preferable to spending by governments. Private investment was to be given precedence over planned investment by the public sector.

The process can be observed through the conditions imposed on numerous countries set out in formal letters of intent signed by their governments, through the minutae of IMF reports and through the speeches of IMF officials. While the policy is not in doubt its achievements are. Many officials consider that the Fund helped to limit inflation and consequently saved the world economy from currency collapse and ruin. They claim too that by forcing its clients to pursue the sort of policies which on a national scale in Britain Mrs Thatcher is now pursuing voluntarily, the IMF introduced "reality" and "stability" into a world diseased by profligate spending.

Certain facts must be set against such claims. Repeated demands for deflation, for the removal of subsidies on basic foods and for reductions in real wage levels as made by the Fund in negotiations with Turkey, Egypt, Jamaica and other countries have produced consequences clearly contrary to the commonly understood definition of stability. Food riots and other mass protests in the past three years have threatened the fragile political environment (in two of the three cases a democratic environment) which exists in the three countries. In developed and developing countries alike deflation has predictably failed to induce private sector investment. Unemployment has risen remorselessly,

doubling in the OECD countries alone. It was hardly surprising that many governments, particularly those committed to government intervention in their economies because of past failures in the private sector, and a wish to direct and plan the process of development avoided the IMF and the conditions on its loans for as long as possible. Governments of developing countries committed to growth to improve conditions for their often desperately poor citizens preferred the higher interest rates of the commercial banks to the lower rates coupled with compulsory deflation offered by the IMF. Chapters 2 and 3 tell the stories of two countries – Britain and Jamaica, both coincidentally with socialist governments, which were driven to borrowing from the Fund. The chapters set out the consequences of the conditions imposed.

2. *The IMF and Britain in 1976*

We are unlikely ever to know the full story of the International Monetary Fund's involvement in the British economy in 1976. Cabinet papers will be released six years into the next century, but few of the most important decisions were taken in Cabinet. Ministerial memoirs will give the individual experience of those elected to run the country, but who found in late 1976 that the power to do so had been removed from them. The next volume of the IMF's official history will record the event blandly, and will tell little of the story behind it.

In such circumstances the best record is likely to remain a series of articles published in the *Sunday Times* by Hugo Young and Stephen Fay later republished as a pamphlet under the title *The Day the Pound Nearly Died.*

Young and Fay trace from the summer of 1976 onwards the inexorable process of IMF intervention, beginning with the loan of 5.3 billion dollars organised through the Bank for International Settlements, one of the least stressed clauses of which ensured IMF intervention if the loan was not fully paid by December 1976.

It is clear that from the beginning of 1976 onwards, if not earlier, that the international banking community, including many British bankers, had decided that the Labour government's economic policy was wrong and that a radically different policy must be imposed. Aware of the very considerable opposition in both the Labour Party and the government to any involvement of the Fund in Britain's economic policy making they waited until June when the major standby credit initiated by the Dutch central bank in order to provide long term support for the undervalued

pound was under negotiation. While the British government welcomed such a stand-by credit as a means of securing the gradual but orderly devaluation of sterling which had become a central plank of Labour economic policy in a period when export competitiveness was crucial to manufacturing industry, the terms attached were less welcome. No immediate change of policy was demanded. Instead the Government was forced to accept that if by December 1976 Britain was unable to repay whatever she had used of the standby credit a larger, longer term loan would be sought from the Fund, with the inevitable imposition of policy changes.

The satisfaction of the international bankers with this arrangement was immediately obvious. Addressing a meeting at the University of Würzburg on 28th June 1976, Otmar Emminger – a major figure in international banking and Deputy Governor of the Deutsche Bundesbank, Europe's most powerful central bank, said:

> "*The recent international foreign exchange assistance for sterling in the form of short term credit lines totalling $5.3 billion was (designed) . . . to help restore orderly conditions on the foreign exchange markets. This did not imply a judgement whether the present exchange rate for sterling is 'appropriate' or 'inappropriate': the large collective rescue operation is in reality mainly intended to give the British government a breathing space of a few months in order to effect the requisite fundamental adjustments in domestic economic policy – slowing down wage inflation and reducing the budget deficit – without being overly disturbed by self reinforcing speculation against sterling. To the extent that the United Kingdom is unable to repay the loan out of its own resources by December 1976 it will have to fall back on its credit lines with the IMF. This ensures that if the government makes use of the loan assistance for an extended period of time it will have to accept the economic policy conditions of the IMF* (Emminger, "On the way to a new international monetary order", *American Enterprise Institute 1976.)*

The Labour government's attempt to pursued its own economic policy continued however through the autumn and Denis Healey boldly asserted in the House of Commons that the Standby Credit had "no strings attached at all". Speculation against sterling continued also, spurred in succession by high money supply figures in August and by the Labour Party Conference's decision to bring the banking sector into public ownership.

The policies adopted earlier in the year to allow a managed depreciation ranging from cuts in public expenditure to increased interest rates had insufficient time to have any real effect.

Sterling plummeted so sharply that a substantial portion of the standby credit was used up and despite extensive political and diplomatic efforts no further loans to permit repayment and avoidance of IMF involvement were forthcoming. By early November Alan Whitcombe, originally a British appointee to the Fund, had arrived discreetly *incognito* in London to begin negotiations for the loan from the Fund and for the reshaping of Labour's economic policy.

"The Fund's involvement had been carefully orchestrated by a group of international central bankers"

The most noteworthy element of the story to this point was not that the IMF had become involved but that the Fund's in-

volvement had been carefully orchestrated by a group of international central bankers able to act independently of the Fund's decision-making process and to use the Fund as a means of forcing Britain to pursue policies which the British electorate had twice rejected two years earlier. The group consisted among others of Ed Yeo, the American under-secretary for monetary affairs – a temporary civil servant working in the US Treasury between periods at commercial banks in Pittsburgh and Chicago – Karl Otto Poehl, an official then and now of the Bundesbank, Arthur Burns, Chairman of the US Federal Reserve Board, and Jacques de Larosiere, a Belgian Central banker later to become Managing Director of the IMF. The involvement of the two senior British Treasury civil servants, Sir Douglas Wass and Sir David Mitchell remains unclear.

On arriving in Britain Alan Whitcombe and his team of IMF staff met a Labour Cabinet which had already moved a long way towards embracing a policy of deflation as the only solution to Britain's problems. Few ministers could offer a detailed alternative to the policy demanded by Whitcombe. In the event much of the ground had been cut from under their feet by earlier government decisions to cut £1 billion from public expenditure in July and to increase employers' National Insurance contributions as well as raising interest rates. The combination of these policies dampened any remaining enthusiasm in the private sector for new investment in British industry. By November 1976 the British government had already implicity accepted the argument that reducing inflation and stabilising the currency must take precedence over policies designed to promote economic growth.

Once that argument has been accepted, the swallowing of the IMF medicine which took the form of immediate cuts of £3 billion in public expenditure and a series of other deflationary measures was less difficult. One or two ministers and man officials who shared the view expressed a year earlier by Roy Jenkins that public expenditure in excess of 60 per cent of Gross Domestic Product constituted a significant threat to the democratic way of life in this country clearly viewed IMF intervention with something little short of relief.

"The illusion that IMF intervention came in the nick of time and saved Britain from either international bankruptcy or an "Eastern European" siege economy is widespread."

The illusion that IMF intervention came in the nick of time and saved Britain from either international bankruptcy or an "Eastern European" siege economy is widespread. Many are convinced that the IMF successfully managed the British economy, restoring the health of sterling, which rose from a low of $1.55 in October 1976 to $2.00 in 1979, and reducing inflation from its 1976 peak of over 20 per cent to just over 8 per cent in 1978.

The reality is very different. The revival of sterling in 1977 and 1978 was due to a combination of factors – the gradual increase in North Sea oil production which promised by 1980 to give Britain near self sufficiency in oil, and second the deterioration of international confidence in the dollar as the Carter administration failed to impose restrictions on oil imports and as US inflation rates rose. It was the strengthening of sterling coupled with phases I and II of incomes policy and falling real oil and commodity prices on world markets which produced the sharp improvement in inflation.

Neither the exchange rate of sterling against the dollar nor the inflation rate are reliable indicators of economic health. Behind the superficial improvement British industry continued to decline. The exchange rate by the end of 1978 was considerably overvalued, seriously harming Britain's competitiveness abroad. The long term trend of rising imports continued and the combined threat to both domestic and foreign markets deterred investment. In pursuit of the new holy grail of monetary policy, interest rates were kept high. Government intervention to supplement investment was strictly limited by the controls on public expenditure imposed by the IMF. It would be unjust to attribute the consequences of Mrs Thatcher's policies since May 1979 to the IMF. She has pursued with conviction the sort of policies which the Labour government sought to avoid, and the effects of which they sought to minimise between 1976 and 1979. IMF intervention, however, did both set the intellectual climate for deflation and contributed to the current level of unemployment by forcing on a Labour cabinet narrow and restrictive policies which could not include positive intervention in British industry when it was most needed.

3. The Jamaican Experience

At the end of March 1980 Michael Manley, leader of the People's National Party and Prime Minister of Jamaica since October 1972 announced that his government was ceasing its negotiations with the International Monetary Fund. The conditions the Fund was trying to impose on his government in exchange for its financial support were in Manley's words "simply too onerous".

In Jamaica's shaky political and economic condition it was a brave and risky act – the full consequences of which have still to be realised. Private foreign investors, not surprisingly, were slow to rush to the aid of a left wing government which rejected the apparent prudence of IMF guidance. Unemployment was high and social stability insecure. Clearly Manley's decision to end discussions with the Fund was not taken lightly. To understand the decision and to appreciate the importance of Manley's stand against the conditions imposed by the IMF for its loans to the poorest and most vulnerable developing countries it is necessary to appreciate the long and tortuous history of those discussions and Jamaica's experience at the hands of the IMF.

Between 1972 and 1976 the PNP government's policies produced major changes in the Jamaican economy along lines proposed

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for many years by radical and socialist development economists. In a very unequal society, wealth and economic power were redistributed and fundamental reforms of the economic system were begun. Measures of nationalization in the bauxite industry – an integral part of the international aluminium trade – and the introduction of a form of worker cooperative in the sugar industry were attempts to introduce Jamaican control to industries and factories accustomed to being passive players in games controlled in the international markets. Land reform offered property, often for the very first time, to individual Jamaicans. Welfare provisions were introduced. Manley's government made a sustained attempt to fulfil the promises on which it had been elected in 1972.

Three factors hampered its success and eventually brought Jamaica to the door of the International Monetary Fund for urgent financial assistance in 1977. First, the quadrupling of oil prices in 1973/4 which hit a country totally dependent on imported oil for its industry and commerce, whose balance of payments could not for long sustain the oil burden. Jamaica's oil bill rose from $73 million (the equivalent of 11 per cent of its imports) in 1973 to $195 million (21 per cent) in 1974. Secondly, the general state of the world economy – itself partly due to oil disruption – wth slow trade growth, high inflation and intermittent collapse of commodity markets vital for Jamaican exports. Thirdly, the lack of international trust in an openly socialist regime compounded in terms of resources available to the government, by the exodus of many of Jamaica's previously all powerful affluent middle class who in Manley's words "illegally took with them millions of dollars of the wealth of Jamaica".

By 1977 Jamaica had a severe foreign exchange crisis and the government with the greatest reluctance took the decision to turn to the IMF as the only remaining possible source of help.

“Jamaica’s government and the Fund reached agreement in July 1977 on a standby credit to provide up to $75 million. Even for this relatively small facility IMF conditions were harsh.”

Jamaica's government and the Fund reached agreement in July 1977 on a standby credit to provide up to $75 million. Even for this relatively small facility IMF conditions were harsh. A large reduction in government expenditure was demanded and targets were set for specific economic indicators including public sector borrowing and currency reserves. Jamaica made only one drawing on the standby credit of $22 million. The remainder of the credit was suspended when, by December 1977 it became apparent that the country had failed to meet one of the minor target figures – that for Net Domestic Assets of the Bank of Jamaica – by a margin of 2.6 per cent. Manley in retrospect is kind about individual officials of the IMF who he says were simply following rules. It is difficult though for any outside observer to credit the judgement of an official prepared to suspend a nation's vitally needed access to credit because of a failure to meet by less than 3 per cent a target figure in a category considered important only by the

most ardent of monetarists. One suspects that a nation of greater strategic importance than Jamaica or one which was not a black, socialist and often outspoken democracy, would have been treated better. For instance, even from the limited amount of information available, it is clear that General Pinochet's military dictatorship in Chile was treated with exceptional generosity in the period after the 1973 coup. (*Evidence of the help given to the military government after Allende's death was published in* The Observer *13th July 1980.*)

In the early months of 1978 Jamaica's problems worsened. Sugar production was falling sharply and banana exports, another crucial element in the Jamaican balance of payments dropped in quantity and value. The problems of the agricultural sector which Jamaican governments have never been able to finance adequately were compounded by harsh weather conditions.

Jamaica turned again to the Fund, which insisted, during protracted negotiations, on drastic new terms and conditions to accompany a three year extended credit facility. Jamaica's long standing dual exchange rate system which carried one rate for imports of essential commodities such as food and oil and a second, lower rate for all other transactions was unified and a further 15 per cent devaluation imposed. The net effect was to raise the unit cost of food and oil, the least flexible elements of any country's consumption, by over 60 per cent at a stroke. Price controls imposed earlier by Manley as a way of maintaining the spending power of ordinary Jamaicans had to be lifted and the government was compelled by the Fund to offer a wide range of incentives to private investors. Central to the programme was a rigid incomes policy, imposed as the cost of imported goods soared. In a move typical of IMF actions in developing countries, subsidies on basic foodstuffs were to be withdrawn.

The Jamaican government, forced by the IMF to take the consequences of policies it did not want and did not believe in, implemented the programme reluctantly but fully. The effect was to worsen economic and social conditions in Jamaican dramatically. Government spending cuts generated recession and unemployment. Domestic demand fell, causing problems for the manufacturing sector which, far from generating new investment, began to cut back existing levels. These factors plus the high rate of inflation, running in the post devaluation period at over 40 per cent, so reduced confidence in Jamaica among the private commercial bankers who had been he main source of external funds in 1975 that rescheduling of debts became much more difficult.

Flood damage in the summer of 1979 which impelled higher public spending as well as hitting export earnings coincided with the new wave of oil price increases and a resurgence of inflation in the world economy as a whole. The rise in interest rates alone added $30 million to Jamaica's interest payments on foreign commercial loans.

"Manley refused to accept the IMF's demand that his government should deepen that poverty by its own actions."

In such a situation it was hardly surprising that the IMF's performance targets were not met. What is surprising to those unfamiliar with the Fund is that the response was not an acceptance that external circumstances had driven the Jamaican government off the course laid down in 1978, but rather a renewed assault by IMF officials

on Jamaican public expenditure. Cuts would have hit directly at the mass of Jamaicans. Public spending is a vital safeguard for living standards on an island which far from being the tropical paradise of the travel posters is a agricultural economy beset by intermittent hurricanes and floods. Only brief upturns in world commodity markets have relieved the country's poverty. After three months of negotiation at the end of March 1980, Manley refused to accept the IMF's demand that his government should deepen that poverty by its own actions. At the end of three years of imposed policies unemployment had reached 30 per cent of the working age population and was as high as 50 per cent among school leavers. Wage rates in real terms had fallen by 45 per cent in one year after smaller falls in 1977 and 1978.

Public uncertainty, a sense of insecurity provoked not least by a violent election campaign and a widespread perception that Jamaica would be unlikely to prosper alone without outside support, led to Manley's defeat in the October 1980 General Election. His successor, Edward Seaga has pursued a very different policy, welcoming foreign, especially American private investment, encouraging the private rather than public sector plans for development and ending some programmes of income and land redistribution. Both the IMF and the commercial banks have found the new philosophy attractive and loans have been granted on significantly more favourable terms than were offered to Manley's government. Unemployment, though is higher than ever and living standards for most Jamaicans have fallen. Hopes of an equitable process of development have been dashed.

Jamaica is of course richer in resources and skills than many developing countries. Those countries when confronted by IMF demands have had no power to resist and

"What is necessary is a reform of the policies of the IMF so that international support can be given on reasonable and acceptable terms without a requirement to conform to a particular set of economic and social policies."

no option of even attempting to go it alone. They have of necessity been required to conform. For those countries and probably for Jamaica too survival without internatonal support is not feasible. What is necessary is a reform of the policies of the IMF so that international support can be given on reasonable and acceptable terms without a requirement to conform to a particular set of economic and social policies. Jamaica's experience has been spelt out in detail because it is typical of the Fund's treatment of developing countries who are forced to its door by circumstances beyond their control. The Brandt report in its section on the IMF sums up the situation:

"the credit conditions of the IMF normally presume that balance of payments problems are a result of too much domestic demand and can be solved by balancing the budget, curbing the money supply, cutting subsidies and setting a realistic exchange rate. Sometimes these measures are appropriate and have been effective. But in many cases these measures reduce domestic consumption without improving investment; productive capacity sometimes falls even more sharply than consumption. This is because many developing countries with deficits have a shortage of food or of basic consumer goods or cannot readily shift resources in line with their new needs. Indeed the Fund's insis-

tence on drastic measures, often within the time framework of only one year, has tended to impose unnecessary and unacceptable political burdens on the poorest, on occasion leading to IMF riots and even to the downfall of governments".

4. A future for the Fund

In view of the IMF's record over the last decade not just in Britain and Jamaica but in dozens of countries, including the world's poorest, it is scarcely surprising that the demand for radical reform of the Fund has grown more insistent over recent years.

At the Dag Hammarskjold Foundation conference held in July 1980 in Arusha, Tanzania delegates from twenty countries, mainly in the Third World but including sympathetic developed nations such as Sweden concluded that the Fund had lost its legitimacy and must be replaced by a new world monetary body. They called for a special United Nations conference on Money and Finance and for a new currency unit. Plans to co-ordinate Third World action for the Annual Meeting of the Fund were abandoned as a valueless waste of time in the face of implacable resistance to change among countries, including Britain, which hold an overwhelming majority of the voting power at Fund meetings. The conference demonstrated the depth of disillusionment with the Fund as currently constituted.

The case set out in this pamphlet is that the policies adopted by governments at the IMF's behest, and the IMF's own philosophy over most of the past decade have run directly contrary to the real needs of the world economy. The world's population, a third of which lives and dies in conditions of absolute poverty, requires an organised, planned and coordinated expansion of that economy. Such expansion is required to cope with both the unused capacity of capital and labour and blatantly unfulfilled demand.

Uncoordinated and selfish expansion undertaken on a competitive, nationalistic basis would be inadequate and possibly damaging. The IMF is the obvious agency to take on the required role of coordination and planning. The Brandt Commission has put forward one outline model of how such a system might work and how economic prosperity might cease to be the preserve of the rich developed nations alone. The Commission's proposal is for a world development agency combining the World Bank and the International Monetary Fund.

Such a proposal amounts to a reconstitution of the Fund and a rewriting of its

terms of reference. Successive Managing Directors of the Fund, including Jacques de Larosiere, have rejected the notion that the Fund is a Development Bank or should in any way become one. This official view ignores the reality of much of the IMF's current work and the practical effects of its policies. The involvement of Third World countries in the world economy through the process of industrialization, agricultural modernization and trade had inevitably increased the amount of time devoted in the IMF to development issues. Third World countries almost by definition do not have the currency reserves or economic strength to survive sudden adverse changes in their terms of trade such as oil price rises unaided. Resort to currency depreciation as a means of adjustment carries inflationary risks. Their ability to borrow and the speed of their resort to the IMF is conditioned by the strength of their development prospects.

This pamphlet accepts that a gradual integration of the Fund and the World Bank is a desirable objective for those dissatisfied with the present system. Integration would in the long run combine the financial strength of the Fund with the Bank, which is expert in development matters but badly starved of funds because of the reluctance of the US, especially under the present administration, to accept a deeper involvement. By building on established institutions it would avoid the need to attempt a new beginning which in the present climate of international mistrust could conceivably disintegrate and leave an anarchic and chaotic situation in world financial markets, from which only the strong would benefit.

This paper is not an analysis of the history and work of the World Bank. That is a topic for professional development economists. The existing literature, however, suggests that the recent work of the World Bank in funding project development has been reasonably successful where circumstances have permitted but has been consistently hampered by the economic instability of the Third World countries as well as by the Bank's own lack of funds for new and adventurous schemes such as its proposed energy affiliate. It is clear that successful development requires both the project finance, planning and management which the World Bank can provide and a climate of financial and economic order, which the IMF should assist in creating. It is important while concentrating on the financial and monetary policies of the Fund as this pamphlet does to consider the issue as an integrated whole in which successful development and financial confidence are mutually essential.

The proposals that follow unashamedly advocate the evolution of the IMF's role as a development agency as well as an institution of financial regulation. During the 1970s interdependence became a fashionable word in economic jargon, signifying the extent to which almost for the first time events outside the developed, OECD economies could affect the prosperity of those economies. The linking of the concept of interdependence to successive oil crises created the impression that interdependence necessarily has adverse consequences for Britain and similar industrialized countries, and in consequence should be avoided or limited as much as possible. Only recently has a different concept of interdependence recognizing the benefits which can flow from economic co-operation and integration been advanced.

Encouraging development of Third World economies – not just by industrialization but primarily by rural and agricultural and social development along paths suitable to and chosen by the countries concerned is not just an act of charity. Nor is it simply a reflection of a moral and political commit-

ment to redistribution of the world's wealth and power, though as socialists we should not underestimate the need for such a commitment. Rational and progressive development improving food supply and indigenous energy production as well as increasing industrial output and trade is vital if the relationship between developed and developing countries is to be co-operative and free from the continual conflict over scarce resources which the present system is encouraging. Co-operation can bring benefits as well as reducing risks. The needs of the world's poor are enormous. Housing, sanitation, basic communications (railways rather than motorways), basic agricultural and energy technology and skilled teachers at many levels from the most basic teaching of literacy upwards could be traded. The option of a positive and creative alternative to becoming the nation of arms salesmen which Mrs Thatcher's government appears to favour does exist.

Together the IMF and the World Bank can help to begin and sustain such constructive development. For it is the IMF which remains the critical element it will require a reform not just of policy and philosophy but also of structure and organization.

"Control must rest in decisions made by national governments, not in the palatial halls of the central banks."

Control must rest in decisions made by national governments, not in the palatial halls of the central banks. The mystique of international finance which proclaims itself an area for bankers alone in which politicians and laymen alike meddle to the peril of us all, must be swept away. The failure of the IMF to provide the right solution after a decade of dislocation in international financial affairs and continuing poverty in more than a third of the world is not a failure of economic ideas, but an institutional and political failure to implement the ideas which exist.

5. *An agenda for reform*

There is no magic wand which can transform the international monetary scene overnight. The issues are too complex, national interests too diverse and short term pressures too strong for change to come suddenly. The Fabian process of gradual determined reform, with a clear end in view is probably the only one which has a chance of success. This chapter lays out an agenda for reform covering a range of inter-related issues and

problems. The solutions offered are original only in the sense that the concept of international finance pioneered at the end of the war – as a system of international co-operation dedicated to prosperity for all rather than simply to the maintenance of the existing order – has been so neglected that even a mere restatement of that concept seems new and original. To unearth and quote from the statement of the Fund's purposes signed in 1945 is an act of economic archaeology.

Even a full return to the original purposes of the Fund is not, however, now sufficient. The balance of economic power has shifted considerably over the years away from the Anglo-Saxon world to the mainland of Northern Europe, Japan, the Arab countries of the Persian Gulf and increasingly to newly industrializing countries in the Third World led by Brazil, Mexico, South Korea and a handful of others.

A programme of reform for the IMF must not only reflect the shifts which have already taken place but must allow and encourage economic development elsewhere. The reforms proposed here are designed to shift the balance of economic power still further – to the many countries who to date have enjoyed neither the fruits of colonial power, nor the rewards of a scarce natural resource. A fully effective international monetary system will not simply ensure the smooth running of world financial markets and the world economy as it now exists. It must also form an integral part of policy for redistribution, for the relief of absolute poverty and for the establishment of a new and equitable international economic order. The Fund cannot be morally and politically neutral since a commitment to the maintenance of the *status quo* is itself far from neutral. This strategic view of the Fund underlies and is inseparable from the proposals on the technical aspects of the Fund's work which follow.

Fixed and Floating Exchange Rates

At the centre of any discussion of international finance lies the question of exchange rates between the currencies of individual nations and the process of adjustment to those parities. Before the 1970s a succession of crises in the foreign exchange markets had indicated to the public in Britain and elsewhere the difficulty and complexity of the process involved in adjusting parities, particularly when a reserve currency in which other nations held their assets was involved. Exchange rates came to assume a symbolic importance in political affairs which made their objective management all the more difficult. Politicians and pundits, not all on the jingoistic right, proclaimed the sterling devaluation of 1967 as a damaging blow to British pride, symbolizing the fall from imperial splendour.

In view of the furore provoked by what was essentially a belated technical adjustment to reflect new patterns of world trade and competitiveness it was scarcely surprising that the move to floating exchange rates in the early 1970s was widely welcomed as restoring sanity and leaving to the currency markers what politicans had been unable to achieve. The warmest welcome came not unnaturally from the Selsdon men of the British Conservative Party and their counterparts around the

world who shared an unquestioning belief in the efficacy and superiority of the free market.

Experience over the intervening years has tempered the enthusiasm of all but the most ardent advocates of floating. By 1978 the vast majority of IMF member states had abandoned any reliance they had placed on the currency markets and pegged their exchange rates either to the currency in which most of their trade was invoiced – in the majority of cases the dollar – or to a basket of currencies such as the Special Drawing Right. Only a minority of countries in the non-communist world have floating currencies – that is less than 1 in 4 of the 140 members of the IMF. By mid 1981 eight of these had a 'snake' arrangement in the shape of the European currency agreement and five adjusted their exchange rates in response to a fixed set of economic indicators. More than 100 pegged their currencies for reasons, in the words of Otmar Emminger, "not dissimilar to those prevailing in the Bretton Woods system". National currencies were thereby able to maintain constant or stable relationships with the currencies of major trading partners and to avoid much of the speculative pressure, and consequent drain on investment and trading confidence, which floating far from eliminating had encouraged.

"Sterling, for instance, rose on the news of Prince Charles' engagement – an excessive tribute even to the charms of Lady Diana Spencer."

The world's major currencies, however, have been unable to avoid the floating system. Sterling, the dollar and to a lesser extent the Deutschmark and other currencies used in international trade have fluctuated in value from day to day in response to the latest economic headlines, to sudden shifts in confidence and even as a consequence of events unrelated to economic or industrial developments. Sterling, for instance, rose on the news of Prince Charles' engagement – an excessive tribute even to the charms of Lady Diana Spencer. Such shifts are a boon to speculators and a burden to industrialists and exporters.

Much academic time has been devoted to analysis of the reasons for the failure in the early 1970s of the fixed but adjustable exchange rate system created at Bretton Woods. There is no consensus view. Europeans blame the breakdown on the reliance on the dollar which allowed the United States to settle its payments deficits with the outside world simply by creating more dollars and giving the Americans, in De Gaulle's words "the exorbitant privilege of running a deficit without tears". Americans themselves tended to argue that the dollar, as the key link between the system and gold was unable to adjust its own parity which as a result of inflation and the devaluation of other currencies had become substantially overvalued.

These were certainly contributory elements but at the heart of the matter lay the question of reserves which meant, especially for the countries of the developing world, dollars alone since gold reserves were the preserve of a minority of states in the developing world. The failure to expand international liquidity in the 1960s in line with expanding world trade and to create new reserves in SDR's left the dollar exposed and vulnerable.

It was this which stimulated the move to floating exchange rates after a series of huge American deficits at the beginning of the 1970s. The change came almost by accident in response to waves of speculative pressure and not as the result of a coordinated attempt to reform either the process of adjusting exchange rates or the

international financial system as a whole.

Any expectation that floating rates would produce a smooth adjustment of currency value to reflect underlying changes in competitiveness have been cruelly frustrated. Short term shifts of confidence and speculation have produced changes which in a number of instances have run directly contrary to the direction which trade competitiveness would dictate.

Traders have been forced to hold greater amounts of currency as insurance against sudden movements in the exchange rate, Smaller traders whose margins have been squeezed, suffer more than the large multinational companies which have been able to switch large volumes of funds between currencies on a day-to-day basis. Some multinationals have become so skilled in this manipulation of the market that the Treasurer's department has become a profit centre in its own right.

In an age of high inflation rates, widely divergent between countries, the restoration of fixed rates, desirable though they might be for those engaged in trade, is not feasible. Rates would not be sustainable over a long enough period to prevent speculation against de- or revaluations. In any case some degree of flexibility is desirable, not least to allow the system to adapt over time to shifts in economic activity.

A number of countries by tying their currency to a basket of the currencies of their trading partners may be beginning to find a new and better solution which offers a combination of stability with flexibility with changes less sharp, and more predictable. A technical adjustment mechanism of this nature which responded on a regular basis to inflation rate differentials and trade balances would remove some of the misplaced emotion surrounding exchange rates. The establishment of trade and competitiveness at the heart of the system will ensure that economic realities will override purely speculative pressures in the foreign exchange markets.

Such a permanent reform, however, is not achievable in isolation. Currencies will continue to fluctuate wildly unless the system of international reserves is reformed and the increasing reliance of the whole system on a single national currency, the dollar, is eliminated. The supervision of that reform should be a priority for the IMF in the 1980s.

Reserves

It is all too easy in the present environment of world economic stagnation to forget that economic growth and the spread of industrialization outside Europe and North America have combined to generate exceptional growth in world trade in manufactured goods in the years since the Second World War. Increasing volumes of trade in raw materials as well as manufactured goods have been matched by a rapid expansion in international financial transactions. The requirements at both public and private level for foreign currency reserves has grown proportionately. Sadly the International Monetary Fund has consistently failed to respond to this requirement, and international liquidity has expanded erratically and iniquitously. World trade, the international economy and many of the IMF's member states have suffered as a result.

The nature and distribution of international liquidity has long been a matter of contention. Keynes and Dexter White in debating the creation of the Fund during the war years disagreed fundamentally. American economic power ensured that White's proposals, which based international liquidity on the reserves already in the possession of member states, were incorporated into the IMF Treaty. Keynes'

more radical system of creating new reserves and distributing them in the form of credit to states whose economic history had not permitted accumulation was abandoned in the face of American hostility.

World trade growth made international liquidity an issue of central concern in the 1950s and 60s. Under the International Monetary System operated by the world's central banks there was no opportunity for any central authority to control the creation of liquid assets. No mechanism existed by which the volume of assets held by central banks as monetary reserves could be regulated. Because of the strong central position of the dollar, countries tended to accumulate reserves in dollars instead of gold and in preference to any other currency. Additions to international liquidity were therefore dictated by the United States balance of payments position from year to year, and by decisions of individual countries on the question of retaining dollars or converting them into gold. A US balance of payments deficit generated new liquidity, but in a manner unrelated to worldwide trading patterns and the needs of individual nations. Fluctuations in the stocks of gold used for monetary purposes were equally erratic. Private demand for gold, non-monetary gold consumption, Russian gold sales and fluctuations in production all contributed to the uncertainty.

The absence of an internationally managed reserve asset increased pressure on the dollar to the point in the early 1970s when the system cracked under the strain.

Such a reserve currency is still needed and its absence remains one of the main contributory factors to the periodic instability and insecurity of the world's financial markets. Steady growth of world liquidity to match the growth of world trade is vital over the long term. The sufferers under the present system are the developing countries whose recent industrialization, high import requirements and need for borrowed capital have not allowed them to accumulate adequate reserves to sustain their economies through difficulties for any length of time. This rather than any fundamental economic mismanagement is the cause of so many abandoned development plans.

Special Drawing Rights

The IMF's only significant step towards a managed expansion of international liquidity to date has been the creation in the mid 1960s of Special Drawing Rights (the SDR). The SDR falls far short of the concept of an international reserve asset which the world economy requires. Its creation, however, marked a significant victory for those seeking to reform the system.

After their formal creation in July 1969 ten billion SDR's were allocated among Fund members during the following three years. Further allocations have taken place at intervals since. All have been small scale and even taken cumulatively have done almost nothing to reduce the burden on the dollar, which continues to be the world's overwhelming reserve currency and the denominator of almost all trade. Indeed over the last decade the dollar has grown in importance as the move away from convertibility of dollars to gold has allowed US payments deficits to be funded in dollars while denying US creditors the opportunity to dispose of their dollar holdings. The oil producing countries, the fastest growing group of nations in the world over the last decade have relied predominantly on dollars for their external transactions.

By 1980 the reserves of IMF members were made up of foreign exchange holdings (49 per cent) and gold valued at market prices (43 per cent) with the remainder

accounted for by the individual reserve positions of IMF member states with the Fund itself. Only 3 per cent was held in SDRs. A few nations with extensive gold reserves have gained dramatically from escalations in the world gold price during the last few years. As the Brandt Commission Report notes the benefit of those price increases has gone to the industrialized and not the developing countries.

A radical change of policy is clearly necessary if the international monetary system is not to limp along from one crisis of exhausted reserves to the next. To date the only proposal to emerge from the Fund itself has the notion of a substitution account which would exchange unwanted dollars held by central banks around the world for IMF generated Special Drawing Rights. Opposition from all sides to various proposals for funding the substitution account has prevented any progress being made. Even if funding could be found, substitution can offer at best only a marginal contribution to solving the reserves problem.

Substitution, however, financed and guaranteed would benefit only those countries already holding surplus dollars. Deficit countries, the countries for whom reform of the international monetary system should be designed would have gained nothing. The disproportionate attention given to the notion of substitution over the last few years has distracted effort from other more wide-ranging proposals of reform.

Attention should instead be directed to the creation of a new system of reserve allocation controlled by the IMF and building on the role of the SDR.

Reserves and Development Aid – A Desirable Link

The concept of a scheme which links the creation of SDRs to development aid has been a major point of contention between the members of the IMF for the last decade and a half. Since the acceptance of the principle of SDRs in the mid 60s, the developing countries, individually or collectively through various groupings have argued that the allocation of SDRs should be biased in favour of developing countries, as evidence of the commitment of the world's already rich nations to aid and redistribution. Over the years, however, the various proposals of mechanisms whereby this might be achieved have met with a stone wall resistance.

The three main mechanisms proposed have been, (i) a reweighting of quotas in favour of LDCs so that SDRs are allocated on the basis of new quota levels, (ii) a direct allocation of SDRs to the world bank and regional development banks for redistribution by those agencies or (iii) a voluntary donation by developed countries of their SDR allocation either to development agencies or direct to LDCs. Industrialized countries have consistently opposed each scheme.

Their objection has been to the general principle of linking the establishment of a new reserve asset to any transfer of resources. In their view international liquidity creation and development aid should remain independent of one another because of the different economic objectives the two involve. Their resistance prevented the Committee of Twenty, set up in 1971 with the aim of reforming the Fund from within, reaching any agreement on the issue. In the absence of agreement SDRs have continued to be allocated in proportion to the existing quotas of IMF member states. Those with the largest quotas are allocated the greatest amount of SDRs and the existing iniquitous and inefficient distribution of reserves is not only perpetuated but worsened.

There is a clear answer to the case that the economic objectives of reserve creation and development aid are in conflict. Redistribution of reserves, through whatever mechanism, will help dozens of LDCs to avoid periodic balance of payment crises and the disruption of international trading and financial stability which these entail. Allocation of SDR reserves to those countries which lack adequate resources of their own would give greater flexibility and would allow countries in difficulties caused by events beyond their control to respond in a more considered and planned manner than they are able to at present.

The establishment of a link between the creation of reserves in the form of SDRs and a pattern of distribution which worked in favour of the developing countries of the Third World offers Britain and other developed countries in the IMF a viable means of fulfilling long standing but so far rather empty commitments to the cause of economic justice. A link established in this way would go further and would enhance the role of the SDR itself, if only because Third World nations are more likely to draw on, and to make use of their new SDR reserves.

Over the years there has been a slow but steady extension of the role of the SDR. A number of official international agencies, in addition to the IMF, have made the SDR their unit of account. IMF loans are now denominated in SDRs. Since 1974 the value of the SDR has not been tied to the dollar alone but to a 'basket' of the sixteen most important currencies of IMF member countries. This 'basket' has been simplified in the past year. The use of SDRs between nation states has begun to develop and direct transfers are now quite common, though still on a small scale. There is a modest Eurobond market in SDR denominated bonds.

If SDRs are to become a full scale reserve currency further development of their role will be necessary. Interest rates payable on SDRs will have to rise from the present level (an average of 80 per cent of short term market rates in the US, Britain, West Germany, France and Japan) to a figure fully matching market rates. A secondary market, making SDRs a fully tradeable reserve asset, will be necessary. Internationally traded commodities such as oil and non-fuel minerals could then be priced in SDRs.

Conditionality

The proposals set out so far in this chapter if enacted by the IMF and its member states will help to provide some stability and to introduce some element of redistribution into the international financial system. But they will not solve all the world's economic problems overnight.

Even a major reallocation of reserves will still leave large numbers of countries, developed and developing with intermittent balance of payments problems. For developing countries which depend on export revenue from a narrow range of products and raw materials, a cyclical downturn and a collapse in world commodity market prices can be devastating. Coffee prices for instance fell by 50 per cent between 1977 and 1980, sugar by 80 per cent between 1974 and 1978 and copper by 60 per cent over the same period. Limited price support schemes and compensation have not been enough to prevent dramatic year to year swings in the foreign earnings of countries like Zaire and Jamaica, and of major sectors in other economies. The construction of commodity price control schemes and buffer stocks is outside the scope of this pamphlet and has in any case been fully discussed in articles by Lord Kaldor and others. Even the full implementation

of such schemes will not eliminate balance of payments problems caused by crop failure, natural disaster, or by bad economic planning by inexperienced governments. In addition dependence on imported oil and other energy resources is growing in the developing world leaving nations vulnerable to a sudden increase in oil or fuel prices. Soaring import bills, rather than economic mismanagement or collapsing commodity earnings, have been the primary cause of balance of payments crises in the 1970s.

The IMF has failed miserably to respond to the problems which such crises bring in a creative way. Attempts to recycle funds from the OPEC countries which have acquired a sudden surplus have twice ended in failure. The Commodity Compensation Facility – in principle an excellent scheme – has not been expanded to meet the scale of the problem. Countries in difficulty have come to rely more and more on the commercial banks. The debts of the non-oil exporting developing countries rose by 600 per cent between 1974 and 1980, with rising interest rates imposing a further burden in the later years. Despite the generally lower rates of interest on IMF loans, the bulk of the increased debt has been with commercial banks. IMF money has been scorned firstly because loans have generally been offered only on a short term basis, allowing little margin for medium term planning of economic recovery by the governments concerned, and more importantly because the IMF has imposed rigid conditions on borrowers while the commercial banks have in general lent money on a strictly risk related basis. In 1978, when the Fund should have been contributing to an orderly expansion it actually withdrew money from the world economy by allowing repayments to exceed new loans. Since 1979, during a period when concessional finance could have cushioned the impact of oil prices and recession, the Fund has switched back to lending on strict conditions, and away from the softer loan policy begun for some borrowers under various special facilities in the mid 1970s.

The conditions attached to IMF loans and guarantees have a depressing uniformity. Most of the IMF teams visiting countries in difficulties have taken the view that productive capacity is beyond the scope of their concern. This has led to a strong emphasis on contraction of imports to achieve a satisfactory balance of payments position rather than the expansion of exports. The Fund will generally attempt to influence macro economic aggregates rather than conditions in particular sectors or industries. A credit squeeze, a reduction in public spending, especially spending on subsidies which distort the market pricing of consumer goods, and an adjustment of currency values are typical IMF policies for dealing with balance of payments problems. Longer term stability is seen as the product of untrammelled market forces, a reduction of state involvement in the economy, incentives to private investment including tax relief and the removal of restrictions on capital flows.

Such conditions have an undisputed impact both on growth and on the distribution of income – often in a direction directly contrary to the policies of democraticaly elected governments. In developing countries in particular they can also have the effect of undermining attempts at industrial development and increasing the country's reliance on raw materials.

Though some adjustment of any economy in critical balance of payments difficulties is necessary, the rigid nature of conditionality as imposed by the IMF is not the most appropriate means of securing that adjustment.

Primarily the Fund must accept that the

problems of different developing countries have different causes and demand specific remedies. The collapse of a commodity market is likely to be temporary and full scale deflation of a national economy is not the appropriate solution. Mismanagement of debt repayment may be the result of lack of indigenous banking skills. Oil price rises may have the same effect in superficial terms as an overlarge import bill for luxury consumer goods but the method of correction should be very different.

Above all the Fund should accept that growth is an alternative to contraction as a means of solving imbalances of trade. Such a change in philosophy will inevitably involve the IMF in judgements about the prospects for particular industries and sectors, as exporters as well as suppliers of the home market. It will involve a longer term view of the economy concerned, and a willingness to lend on a longer term basis to give investment an adequate period in which to show results. In view of the adverse effects of repeated contractions of any economy, not just on the economy concerned but on other trading nations, ordered growth is clearly the preferable alternative.

Growth cannot be left to private sector alone. Planned development to meet the needs of the country concerned is difficult to reconcile with the IMF's unquestioning faith in private sector enterprise. A re-created IMF must stress the necessity of well managed public sector involvement and of controls over markets which are so easily distorted by speculation and by concentrations of economic power.

A new definition of conditionality along these lines, particularly if some control of trade and restructuring of industry is involved in the process of global economic management will inevitably involve some sacrifice of strictly national sovereignty. The thrust of this pamphlet has been that such a shift in sovereignty is desirable and overdue. Before the role of the Fund is changed and extended, however, some reform of the way in which it is run is necessary.

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6. Reform and political control

"There is scarcely any enduringly successful experience of an international body which has fulfilled the hopes of its progenitors. Either an institution has become diverted to the instrument of a limited group or else it has been a puppet – sawdust through which the breath of life does not blow" (JM Keynes, at the inaugural meeting of the IMF in Savannah in 1946.

As Michael Manley has stressed on numerous occasions, most recently at the Special Session of the United Nations in New York in June 1980 the problem of the IMF is one of political control rather than of economic theory. The Fund is remote from political events, unaffected by the consequences of its own actions and policies and almost immune to political influence. Its directors and its staff are professional bankers and Treasury officials brought up on the preachings of monetary and financial orthodoxy which characterise their institutions and are resistant to all proposals which threaten to change the established order.

In individual countries central banks and Treasuries are at least nominally politically accountable and subject to a potential if underused process of political scrutiny. In the IMF any scrutiny or control is remote and so delayed as to give appointed officials considerable power in their own right. Officials are appointed, usually on the basis of seniority within their national Treasury, Finance Ministry or central bank and then serve for a substantial period on the Fund's executive and operational committees. In most cases they survive changes of government in their country, even very radical changes. In Britain for instance their appointment and their tenure of office is the responsibility of the civil service rather than the government of the day.

As the day-to-day controllers of the IMF's decision making process, appointed officials naturally carry more influence over those decisions than frantically busy Chancellors and Finance Ministers who meet for two or three days a quarter to discuss an agenda which the officials themselves have determined. Appointed officials can of course be instructed on how to act and vote. Few politicians, however, have any interest in, or knowledge of the technicalities of international finance, technicalities which are unavoidable in any debate on reform. The importance of knowing how the IMF works and how it could work is commonly only perceived when the moment of crisis has been reached, as the Labour Cabinet discovered in 1976.

A programme of reform would require not only substantial knowledge but also the commitment of a large amount of time and energy to the cause of persuading other countries to accept specific proposals. Few Chancellors or Finance Ministers have such knowledge or time. Those preoccupied with domestic problems or uninterested in international economies like Sir Geoffrey Howe tend to rely on the advice of officials, strengthening still further the influence of central banks and Treasuries on the Fund.

Expert official advice can make an important contribution to the IMF, and continuity can be of great value. Political direction, however, is vital if the Fund is to regain its positive role. As the Keynes papers show, Keynes himself argued consistently that the executive directors of the Fund should not be professionalized staff but political appointments preferably of active politicians supported by their own independent advisers. The weight of Treasury business means that an addition in terms of additional meetings and active involvement to the existing burden of the Chancellor would be infeasible and undesirable.

The alternative, which would build on proposals made by Judith Hart, and by many others with experience in the field over recent years is the appointment at senior level within the Cabinet of a Minister of International Economic Relations with responsibility not just for controlling Britain's actions within the IMF but also with overall responsibility for the overseas development administration, currently sub-

sumed in the Foreign Office, and for trade questions.

A restructuring of the Whitehall or Cabinet bureaucracy is not of course a guarantee that problems will be solved as Mr Heath found to his cost after 1970. A clearly responsible minister would however at least ensure that the issue received the attention it deserved and that a channel existed through which reform of the international economic system could be directed.

Institutional changes are also necessary within the Fund itself. Change must begin by shifting the balance of power within the Fund which at present is overwhelmingly dominated by the United States. The weight of US influence in the Fund has consistently hampered constructive efforts and proposals for change, through a mixture of self interest and indifference. In the 1960s it was widely suggested that the US was using the Fund to impose on other, poorer nations a degree of financial orthodoxy and sacrifice it was unwilling to accept in relation to its own economy and that rejection of reform reflected a desire to maintain this position. As Susan Strange, one of the most emminent academics in the field wrote

> *"Without it ever being stated in so many words, the Fund's operational decisions made its resources available neither to those in greatest need, nor yet to those with the best record of good behaviour in keeping the rules but paradoxically to those members whose financial difficulties were most likely to jeopardise the stability of the International Monetary System"* ("IMF Monetary Managers" in Cox and Jacobson *'The Anatomy of Influence: Decision making in International Organizations*, Yale 1973).

Since the early 1970s American interest in the Fund has been more limited and American policy has been characterized by a mixture of indifference and resistance to change. Both seem likely to be intensified under the new administration which took three months even to nominate a representative and which opened the 1981 Annual Meeting of the Fund with demands for a tighter and more restrictive lending policy. The attitudes of the "Group of One" as America is known within the IMF are crucial because the distribution of voting power in the Fund allows them to be imposed whatever the attitudes of the "Group of Twenty-Four", the developing countries and their allies or the other members of the "Group of Ten" industrialized countries.

For many years the policy of the Fund's Executive Board has been to avoid open votes. The absence of a formal vote, however, does not mean that the process of counting heads does not take place. In the IMF the process of counting is a very special one indeed. Each member has a basic vote plus additional votes proportionate to their deposits with the Fund. The effect of this part of the system alone is to reinforce the existing order. The current distribution of voting power is set out in the box below.

Power in the IMF

It is impossible for developing countries who form the overwhelming majority of members to change the Fund's policies. Unity within the developing country grouping is difficult enough to attain. The present voting system ensures that even when attained it is valueless in face of a distribution of votes based on economic power built up over decades of industrialization. If the IMF is to become an institution for the whole world, and not just an instrument sustaining the existing balance of economic wealth and power, the distribution of votes must be much more equal, reflecting perhaps a new formula based on a variety of economic and social measures.

Voting Power in the IMF

With the exception of the six "leading" members of the Fund, and, for political reasons, the Republic of China, IMF member countries are grouped mostly by region into small voting blocs. The figures below show the distribution of voting power on April 30th 1981.

Country/group	*Total votes*	*Percentage of Fund total*
United States	*126,325*	*20.01*
United Kingdom	*44,125*	*6,99*
West Germany	*32,590*	*5.16*
France	*29,035*	*4.60*
Japan	*25,135*	*3.98*
Saudi Arabia	*10,651*	*1.69*
China	*18,250*	*2.89*
Black Africa (2 groups, 39 countries)	*34,741*	*5.50*
Middle East/North Africa (2 groups, 21 countries)	*41,249*	*6.53*
South East Asia (9 countries)	*20,124*	*3.19*
South Asia (India, Bangladesh, Sri Lanka)	*21,990*	*3.40*

Even a totally united group of developing countries representing roughly three quarters of the population of IMF member states could muster no more than 35 per cent of total votes.

As well as the distribution of votes the system of special majorities, imposed repeatedly over the years and now covering dozens of different categories of decision must be challenged. Special majorities almost without exception reinforce the position of the United States within the Fund. The list of categories for which more than a simple majority vote is required is wide ranging and deceptively technical. The main categories include,

	majority needed (per cent)
Adjustment of quotas	85
Transfer of proceeds of gold sales to investment account	85
Distribution from general reserve	70
Allocation or cancellation of Special Drawing Rights	85

The technical labels are misleading. All major elements which will require change in any significant reform of the IMF from adjustment to quotas to SDR interest rates are covered by regulations which require a 70 per cent majority or more.

The intention and the effect is clear. At present no major change relating to the central activities of the Fund is possible without the positive approval of the US Treasury and the Federal Reserve Bank.

Although Britain cannot of course reform the voting system of the fund alone it can lead the debate and build upon the existing pressure for change. The United States could of course remain oblivious to such pressure particularly under the current administration. The political pendulum, however, swings as strongly in the US as in Europe and it is important that rational reform proposals, supported by a group of developed as well as developing countries are in place when a regime with a more liberal, internationalist outlook takes office in Washington.

Ultimately, however, it is the threat of the Fund disintegrating with a severe adverse impact on the interests of the United States which will put the greatest pressure on the US to accept constructive proposals for reform. A realistic American government is likely to prefer a reduced, though still major, role in a reformed IMF to a completely dominant role in a divided and impotent institution.

Any attempt to reduce the US to the status of any other single Fund member would of course be unrealistic. In terms of trade, investment flows and industrial output the United States remains predominant in the world economy.

One solution to the problem of voting power in the Fund would be the abandonment of unequal quotas and special majority categories in favour of a veto system as operated in the United Nations. In international fora acceptance under present conditions of straightforward majority voting is sadly infeasible. A veto allows the major actors on the international stage to halt developments which they cannot condone but forces them (unlike the present IMF voting system) to justify each and every such veto.

A new voting system which gave veto power to each of a number of groups of countries would contribute to the pursuit, as a matter of consistent policy of a consensus on the measures needed to achieve and sustain common prosperity. The oil producing countries of OPEC, the developing countries of Africa and Asia and the organized groupings in Latin America and South East Asia would all, for the first time have direct influence on the Fund's policies.

Voting power would thus be disentangled from the quotas governing contributions, which would remain as no more than a measure of inputs to the Fund's resources. As suggested in chapter five new reserves would be distributed in relation in need, rather than in relation to existing assets in using an inverted quota formula.

7. Conclusion

Of all the international institutions created in the wake of the second world war the IMF is easily the most powerful. As the last Labour government learnt in 1976 the Fund is not a remote, wordy debating society whose resolutions can be ignored. The IMF's status, as lender of last resort has given it effective political power, power which can be used in a variety of ways producing sharply different results.

In the recent past as this pamphlet has argued that power has been used in ways detrimental to the international economy.

The response should not be one of "unilateralism" (a word borrowed by Harold Lever to characterize the tendency to use the criteria of short term national self interest in financial matters) but a renewed effort to re-establish the vision of the Fund which existed at the end of the Second World War.

On an international scale in the developed world where unemployment averages 10 per cent but more still in the Third World the need for an institution to plan and coordinate the process of reviving the international economy is now especially strong. Although many commentators, particularly those outside the Party have interpreted Labour's economic strategy as isolationist and nationalistic, it is clear that the success of that strategy is dependent not just on reviving the British economy but on the growth of world markets and an orderly expansion of our trade. Such an expansion will be impossible to achieve if the world economy remains stagnant.

There is a second, more defensive reason for the next Labour government to give some priority to reform of the international financial system. Our strategy demands large scale public expenditure financed by borrowing. Investment of the sort envisaged in successive outlines of Labour's economic programme will take several years to reach fruition, years during which the demands for immediate measures to reduce unemployment, restore real wages cut by the present Tory government and re-establish all manner of social expenditure, will be loud and insistent.

In such circumstances resort to the IMF funding is far from inconceivable particularly if declining oil reserves in the North Sea set a limit on Britain's creditworthiness in commercial capital markets. Unless some reform of the Fund has taken place we may again find ourselves forced to abandon policy commitments at the behest of the Fund.

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the IMF: time for reform

Over the last decade the International Monetary Fund has become the object of public political controversy. In Britain it carries the blame or credit for changing the direction of the Labour government in 1976. In Jamaica the years of wrangling between the Fund and the socialist government of Michael Manley ended in Manley's defeat in a violent election. The Fund's policies and philosophy of deflationary orthodoxy have been criticised not just by borrowers forced to accept its terms but also by those concerned that the Fund has failed to fulfil its potential by playing only a negative part in the management of the international economy.

The pamphlet sets out practical proposals for changing the direction and policies of the IMF. The underlying proposition is the need to revive the concept of economic management on an international scale which was inherent in the original construction of the IMF and which has since been eroded. The urgency of reform is stressed, and the dangers for all - from the poorest Third World country to a future British government committed to a policy of intervention, high public spending and borrowing – if the IMF is left unreformed.

young fabian group

The Young Fabian Group exists to give socialists not over 30 years of age an opportunity to carry out research, discussion and propaganda. It aims to help its members publish the results of their research, and so make a more effective contribution to the work of the Labour movement. It therefore welcomes all those who have a thoughtful and radical approach to political matters.

The group is autonomous, electing its own committee. It co-operates closely with the Fabian Society which gives financial and clerical help. But the group is responsible for its own policy and activity, subject to the constitutional rule that it can have no declared political policy beyond that implied by its commitment to democratic socialism.

The group publishes pamphlets written by its members, arranges fortnightly meetings in London, and holds day and weekend schools.

Enquiries about membership should be sent to the Secretary, Young Fabian Group, 11 Dartmouth Street, London SW1H 9BN; telephone 01-222 8877.

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