

Systems in Disarray

Opening Address by Jan P. Pronk, Minister for Development
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Introduction

It gives me great pleasure to welcome all of you here on the occasion of the FONDAD conference on the “Functioning of the International Monetary System and the Financing of Development”. The issues to be discussed during this conference were identified at an earlier FONDAD conference held in the Hague in 1992. FONDAD is playing an interesting and useful role in bringing together, if I may say so, preachers and practitioners in the field of international financial and monetary relations. With such an august audience, there is always the risk of carrying coal to Newcastle, or, in a more classical reference, bringing owls to Athens. I therefore prefer to take it as my role to put the discussions of today and tomorrow in a wider perspective, both historically and thematically. I will look back at the global economic debate in the seventies, consider a number of subsequent changes, and finish by reflecting upon some of the issues of the nineties.

Looking back to the seventies

My point of departure is the agenda of the 1970s, the agenda of the New International Economic Order, the NIEO. The fundamental objective of the NIEO was to bring about changes in the structure and management of the world economy to enable lasting development. It was a reaction to the failure of the prevailing system which could not solve issues like inequality, inefficiency and overexploitation. It did not aim at a supranational approach to counter the dictate of a few powerful countries and companies, but implied a search for a new world order, a new system of decision-making on an equal footing, on the basis of new principles, different from the ones agreed in the 1940s when GATT and the Bretton Woods system were constituted by a number of countries which could not be considered to represent the whole of the world's population.

The Bretton Woods system was originally conceived to promote trade and employment, rather than to simply guarantee monetary stability; this pledge is part of Article 1 of the IMF's Articles of Agreement. But many in the seventies felt, and some still feel so today, that the IMF had distorted its own mandate and in doing so had distorted real needs. The world of the late 1940s

into which the Bretton Woods system was born bore little relation to the new realities, and arguments for a new Bretton Woods were put forward. Such a new international system should:

1. fairly represent interests of all countries;
2. prevent collective deflationary domestic policies in the major industrialised countries;
3. recognise some government intervention, on the basis of mutually agreed criteria and procedures, both in international finance and in trade in goods and services;
4. increase international liquidity and relate global credit arrangements to global development capacity rather than to short-term balance of payments adjustments;
5. foster more stable exchange rates, rather than impose self-cancelling devaluation on many economies;
6. promote more stable and lower international interest rates through joint governmental intervention in financial markets; and
7. base global liquidity on a central international reserve currency, the value of which cannot be decisively influenced by the economic policy of one country alone, for example, the United States.

This last idea, the creation of an international reserve asset, I associate directly with Robert Triffin, the well known Belgian-American economist who died in Ostend, Belgium earlier this year. He correctly diagnosed the critical weakness of the Bretton Woods system and recommended the adoption of a system based on an international reserve asset. Incidentally, major intellectual battles have been fought about the specific modalities of allocating this asset, the SDR: the famous “link” debate.

Increasing concessional finance for developing countries was another major objective of the NIEO. After the developments in the early eighties, international finance became an even more urgent issue with the emergence of the debt crisis. From the NIEO point of view a global response to the international debt crisis was proposed. This response should be multilateral, long-term, concessional and integrated with a restructuring of trade relations. Concrete measures proposed at the time included: reducing and capitalising interest rates, putting ceilings on interest payments, extending maturities and grace periods to 15 and 5 years respectively, granting temporary moratoria on debt servicing, establishing an international debt reduction facility, cancelling debt of the poorest countries, and increasing concessional finance and SDRs.

What has changed?

A great number of developments have taken place since those days. Some were gradual developments, with ups and downs, but nevertheless moving in

a certain direction. Others happened suddenly. Let me sketch you the ones I consider most important. During the last decades the economies of the world integrated with each other to an ever greater extent, not only through trade, which, with very few exceptions, grew faster than output, but also through foreign investment, growing even faster. This integration was greatly helped by technological developments, nowadays allowing not only instant communication all over the world, but also instant capital movement. Some of those developments also had drawbacks. Free capital movement also meant uncontrollable capital movement, as we have found out to our dismay. These developments did not take place evenly throughout the world. Some countries profited more than others. Only a small part of foreign direct investment flows in the 1980s was directed towards developing countries, with roughly three-quarters of the latter amount going to some ten countries.

Another long-term development concerns the industrialisation that took place in developing countries. At the same time, great differences among developing countries have become visible. While long ago developing countries might have been aptly, if not completely truthfully, described as commodity-dependent countries, today the picture is radically different. For low and middle income economies the share of manufactures in total exports doubled from 25-30 per cent in 1965 to 50-55 per cent in 1990, only for Sub-Saharan Africa this share remained stagnant at 7 per cent.

Change and differentiation accelerated in the 1980s under the pressure of circumstances like debts, low commodity prices, severe imbalances, adjustment or lack of it, but also because of the example set by a number of newly industrialising economies. The old paradigm of import substitution shifted towards a new paradigm of world market orientation.

At the same time that developing countries are turning outward, the rich countries hesitate. Vested interests and lack of dynamism lead to a less open attitude vis-à-vis foreign competitors. Non-tariff protectionism practised by the rich countries has been increasing more or less continuously throughout the 1980s despite the Uruguay Round. The very fact that this Round has not yet been completed is not only caused by the complexity of the issues involved, but owes much to this mind set. As a reaction to increasing integration of economies and concomitant competition pressures, global free trade is under threat and regionalism is on the increase.

In the field of international monetary and financial relations we have seen the debt problem come and, to a certain extent, go. We have seen upheavals in foreign exchange markets. International economic coordination is not all that it should be. And it seems we still do not know how to deal with one of the factors involved, viz. the uncontrolled movement of capital.

On a different front, we have recently seen major events in Central and Eastern Europe. While here, too, the process has been a long one in the sense

of pressures building up, the actual developments, and especially their speed, took all of us by surprise. From one day to the next, a role model for development disappeared. There is no longer a contest between the communist and the capitalist development models. We are all looking now for the optimal mix between market and state, as a pragmatic question. From an economic point of view, the transformation in the former communist countries can also be seen as a more extreme, and possibly more unstable, version of the structural transformation taking place in developing countries.

From a political point of view, these changes are even more impressive. The contradictions that have dominated world politics, and economics, for decades have disappeared. The consequences of this are manifold. Old conflicts in and between developing countries, related to, blown up but also controlled by the East-West confrontation, faded away. New conflicts, often already smouldering for a long time, have erupted, unimpeded now by greater interests, intent upon putting limits to the damage.

In fact, new conflicts have turned out to be much more prevalent than could be foreseen at the time when the Iron Curtain was lifted. We see these conflicts, in different forms, at various places in the world, on all continents. There is a cruel paradox involved here. The greatest threat to mankind in the last decades – nuclear annihilation – has receded and the major powers involved are no longer antagonists. The potential for worldwide cooperation has never been so great. But somehow we are very hesitant to act. We are not sure of our objectives. Our words are not matched by our actions. Or, as *The Economist* put it recently in relation to the UN system: heart of gold, limbs of clay.

Altogether, the New International Economic Order, as pursued in the past, indeed seems a thing of the past. For political reasons, the rich countries were always very reluctant to pursue it at the time, among other things because it would diminish their control of international institutions. And, from an economic point of view, although the objectives of the New International Economic Order may remain valid, its instruments are mostly outmoded now. Traditional commodity agreements are no longer considered viable. Delinking from the world economy is no longer pursued by developing countries. Transnational companies making use of new technologies in information and communication as well as in production itself can quickly adapt their behaviour to any uncoordinated public decision or regulation in the field of trade and finance. Preferential treatment for exports from developing countries is less relevant nowadays for various reasons: industrialisation in developing countries has become a fact of life and does not require preferences but competition and equal access. Developing countries' economies are much more diversified today, import tariffs in rich countries have decreased and have often been replaced by other forms of

protection, and, most important of all, many developing countries have become competitive. In a perverse way, the pervasiveness of non-tariff barriers bears testimony to that.

Looking ahead in the nineties

Considering the changes that have taken place, a pervasive feature of the nineties is lack of order and, therefore, lack of stability in international relations. Regionalism is a deviation of the postwar economic order, characterised by non-discriminatory multilateralism. In the financial sphere, uncontrolled capital flows easily destabilise economies, whereas the Bretton Woods system originally regulated these flows in order to assist orderly exchange arrangements. In the political sphere, domestic instability in many countries destroys the perspective for development, and there is no international order to take care of this in a systematic way.

I will now consider some issues in international economic relations in the nineties and their relation to the need for more stability and orderliness in the framework governing those relations. The objective of stability is not to stifle dynamic developments, but to provide a transparent and predictable international enabling environment for relations between countries, without major inequities and inefficiencies. The pursuit of this sort of stability is probably comparable to the pursuit of the Holy Grail in the sense that it is not fully attainable, but it is nevertheless worth trying. The difference is that in the case of pursuing stability, one need not completely achieve the goal to reap some of the advantages. My point of departure will be the interests of developing countries, but with the perspective of mutual advantage for all parties involved.

Trade

In trade relations, I start from the notion of ever more integrating economies. I think it is imperative that developing countries take part in this process as much as they can. As I said, preferential treatment of exports is no longer a useful instrument for many developing countries. The best “preferential” treatment would be for rich countries to abstain from the application of all sorts of grey-area protectionist measures, which mostly do not comply with the spirit if not the letter of GATT rules. Moreover, this protectionism is completely inconsistent with other policies vis-à-vis developing countries. Recent calculations from the World Bank tell us for example that trade barriers applied against Bangladesh cost that country roughly one billion dollars in lost exports. That is equal to almost half of the official development assistance provided to Bangladesh. Corresponding figures – lost exports as a

consequence of trade barriers in OECD countries – for Jamaica are half a billion dollars (equivalent to almost 3 times ODA for that country) and for Pakistan 1.5 billion dollars (equivalent to 1.25 ODA for Pakistan).

Traditional preferential treatment was meant to promote export competitiveness and industrialisation in developing countries. Nowadays the emphasis is on sustainability of development. To the extent that preferences still make a difference, it would probably be more appropriate to tie preferential treatment to eco-friendly forms of production in developing countries. That way it could serve a different but more useful purpose. It would serve as an incentive for developing countries not to follow the same environment-intensive development path that the rich countries have followed in the past.

Commodity agreements are a traditional instrument in the field of trade. And as in the case of preferential treatment, their usefulness in the traditional sense seems to have passed. On the other hand, one might think about new applications for commodity agreements. Some forms of commodity production are detrimental to the environment. For reasons of competitiveness, countries are often reluctant or unable to take appropriate care of this aspect. It would therefore be useful to link commodity agreements to sustainable production of commodities. These agreements, if coupled with exclusive access to importers' markets for participating exporting countries, would serve as an incentive for sustainable production methods by deterring free riding.

Of course, changing the focus of commodity agreements is not to deny that dependence on commodities still poses a problem for a number of developing countries, especially in Africa. Unstable and mostly structurally low prices are a hallmark of commodity markets in the nineties. Compensatory financing is the immediate remedy, but diversification remains the obvious long-term answer. A stronger link between these two would be welcome.

Finance

Let me now turn to recent developments in the financial and monetary sphere, and more specifically: the SDR issue, the international debt issue, and the issue of the financing requirements of development.

Regarding the Special Drawing Rights, it looks as if this has become more of a political issue than an economic one. SDRs were introduced in the seventies, not as a sole reserve unit as suggested by Triffin, but rather as an additional form of liquidity. The last SDR allocations took place more than ten years ago. They have never been linked to developing country needs. In the past, critics of this idea said that this link would impair the development of the use of the SDR, and would result in over-allocation of SDRs beyond

the true liquidity needs of the system. A new aspect in the SDR debate is the emergence of new countries which strengthens the argument for a considerable liquidity increase and SDR-allocation. Only recently, Mr. Camdessus, managing director of the IMF, pointed out the low reserve position of especially the small low income countries and the former Soviet Union countries and advocated a new allocation of SDRs. Lack of reserves in these countries can only be compensated by lowering imports. This lack of reserves leads therefore to an artificial and unwanted brake on international trade. An increase in the reserves may enable the world to make a better use of the available production capacity, which is presently underutilised, without risking the danger of fuelling global inflation. The world requires growth and trade and therefore more liquidity. The creation of SDRs, well planned, on the basis of a study of the need, in adequate annual instalments and fairly distributed, could be a very useful instrument in a policy to better integrate trade and finance.

The problem of international debt has changed considerably in nature. The actual debt crisis of the eighties, from a global point of view dominated by the Latin American share with its predominantly commercial nature, has been neutralised, without endangering the international banking community and the stability of the international monetary system. In the Paris Club, ways have been found to start dealing with official government-to-government debt of the poorest countries. Since the last time I addressed a conference organised by FONDAD in 1990, we have seen some developments in this field, including the proposal by myself and my colleague Wim Kok in September 1990 to completely cancel the debt of the poorest countries. This was not acceptable to other creditors, but it may have helped to catalyse the decisionmaking process in the Paris Club. The adoption of Enhanced Toronto Terms (50% write off) by most creditor countries is a step in the right direction. Recently Lawrence Summers, who left the World Bank to serve in President Clinton's administration at the US Treasury, announced that his department has proposed to the U.S. Congress to participate in debt relief along the lines of Enhanced Toronto Terms for many countries. I consider the increasing consensus on these terms as a positive development.

However, the problem of debt in Africa is far from over. Commercial debt may not be such a large part of total debt. IDA debt reduction operations may have helped in a number of African countries to eliminate parts of this commercial debt. Bilateral official debt may be dealt with in the Paris Club on increasingly concessional terms. However, debts owed to the multilateral international financial institutions seem to be increasing in weight and size. Relatively little research is done on the issue of multilateral arrears and debt service. The multilateral financial institutions have not been forceful and creative development agents in this respect. Of course, it would be too easy to

say that they should simply reduce the debt owed to them. Their position is very different from all other creditors. However, continuing the present attitude of benign neglect is no way out of the debt trap.

The financing requirements of developing countries have been calculated under different assumptions by several researchers and institutions. These calculations, although they have severe limitations, do offer some indication regarding orders of magnitude. I would like to mention some model-based findings in this field by Mr. Robert Lensink, of Groningen University. For Sub-Saharan Africa he finds, in a base line scenario, that funding to the amount of US\$ 30 billion is needed to maintain present per capita GDP growth rates. Given only minor private flows and projected official flows of some US\$ 11 billion there remains a financing gap of US\$ 18 billion!! Another finding in this scenario is that Sub-Saharan Africa would not regain creditworthiness until at least the year 2000. Given these figures, a thorough examination of means available to increase official flows to these countries seems called for.

In the seventies the G-24 countries, in their debates with the Bretton Woods institutions and the G-10 countries, did manage to increase available IMF resources likely to favour developing countries: the Extended Fund Facility, the Special Oil Facility, the enlarged access policy in general and the establishment of the Trust Fund are examples of this. Additional mechanisms have been developed since, like the (Enhanced) Structural Adjustment Facility and, most recently, the Systemic Transformation Facility. I did refer already to the issue of SDRs above and here I would only like to add that the Compensatory and Contingency Financing Facility for developing countries in my opinion has not been fully exploited.

Let me reiterate here what I said three weeks ago at a Seminar on Structural Adjustment held here in The Hague: as a politician I am inclined to foresee that, in future, bilateral donors will be less and less inclined to provide external resources in order to finance development in developing countries. This should serve as an additional incentive to the Bretton Woods institutions to attempt to meet the financing needs of those countries in particular who are not likely to regain creditworthiness in the near future. Regarding financing, let me add that I am not looking for grand initiatives. Rather, as a famous American senator (Everett Dirksen) used to say: a billion here, a billion there, and pretty soon we're talkin' real money.

Transition

A new item on the agenda of the nineties is of course the economies in transition of the former communist countries in Eastern Europe and the former Soviet Union. An important aspect of this painful transformation is

the speed of the adjustment process: big bang versus planned, orderly transition. There are economic, political and social aspects involved in this process. Even in Poland, with many elements of the big bang approach, the process is under great political pressure. Are there lessons to be learned from transition experiences in developing countries that are useful for the former communist countries? I believe so. The UNCTAD study on International Monetary and Financial Issues for the nineties looks at the so-called Southern Cone experiments in liberalisation in the late seventies and the early eighties and arrives at the following four conclusions:

- the transitional period is long and difficult to manage, and the state has a crucial role in sequencing trade liberalisation, decontrolling capital accounts and liberalising the financial system;
- the transition is a painful one with social costs associated and this requires the government to take political constraints into consideration;
- during transition there will be a reduced availability of credit;
- the state has a crucial role in regulating the economy: especially the financial system must be tightly supervised.

At the Annual Conference on Development Economics of the World Bank, 1993, it was pointed out that the successful gradual economic liberalisation undertaken by China since the late seventies started out by liberalising agriculture first, followed some years later by light industry, together providing for fast development of rural areas. Also, international trade was only gradually liberalised through special economic zones. This may provide valuable lessons for those Eastern European countries that opted instead for the Big Bang approach. Of course, there are also differences to be taken into account, such as the state and the structure of the economy.

Let me end with a word on globalisation, i.e. the increasingly transnational character of economic and financial processes. Some of these processes are getting more and more outside the scope of national authorities, while they may have a great impact on the position and functioning of national economies. The most important actor involved in globalisation is the transnational company. Globalisation implies increasing competition. Competition among transnational firms is at the same time competition among regulatory systems of nations. Both types of competition imply great risks of increasing friction between countries or groups of countries. We must contain those frictions before they start to overwhelm us. In other words, the Uruguay Round should finally be brought to an end, to allow us to tackle the important issues of the nineties: trade and competition, trade and investment, trade and the environment. And on exchange rates and capital flows, we must come to grips with the impossible triangle of unstable exchange rates, lack of coordination of economic policies and free capital flows. Policy coordination and a strong surveillance role for the IMF seem to

me crucial to improve the functioning of the international monetary system and to prevent monetary adjustments taking place with the severity we witnessed in the EMS only recently.

Policy coordination and a strong surveillance role of the IMF: What does it mean? It means a return to a situation whereby there would be no longer a distinction between macroeconomic coordination, on the one hand, and exchange rate coordination, on the other. It means that the IMF would again be seen as the beginning of a world central bank, with powers vis-à-vis transnational commercial banks as well as vis-à-vis countries in deficit – not only the small ones – and countries in surplus. It means an IMF which would control a sizeable percentage of world liquidity, not only a slight percentage of world's imports but – say – something closer to the White proposal in the early forties (and we know that this was much less than the proposal by Keynes). It means an IMF which would help reinstall global monetary discipline as against speculative private capital destabilising economies. It means a system which would not only concentrate on poor countries with only a small position of the world liquidity but on all actors, in order to contribute to the most important target of any market economy: full employment. It means building systems and procedures which fit into a global civil society.

In such a global civil society we need equity but also order and stability. Of course it is very difficult, when you are in the middle of tumultuous changes, to be aware of the direction and magnitude of the forces involved. It is only too easy to cling to old values and perceptions. However, we should try to be creative, because the times have changed. The nineties are a decade of transformation, not only for individual countries, but also for the international order, be it economic or political, within which they operate. If we just stick to the answers of the eighties we are bound to fail.