3. The Balance of Payments Problem

3.1 It is a truism that the sum of the balance of payments surpluses and deficits on the current account of all countries must be zero. In other words, when there are current account surpluses (such as those run by OPEC today), there are counterpart deficits that will have been financed and which exactly equal the surpluses. This equality obtains *ex-post* in any single year's accounting; in fact, it only indicates that the surpluses will have been lent or 'recycled' to finance the deficits that actually occur.

3.2 These deficits will be diminished if the surplus countries can expand their imports either by boosting domestic activity or by allowing their rates of exchange to appreciate. But if there is no such relief to the strain on the financing mechanism, and if the mechanism is ineffective in permitting deficit countries to obtain finance from abroad, adjustment can take place only through a decline in economic activity, concentrated on the deficit countries but reacting throughout the system and bringing about an all-round curtailment of trade. The system will settle in balance at whatever level is required to balance the surpluses with the deficits that can be financed.

3.3 In the 1970s, all these three processes, the lending of surpluses, the increase of imports into the surplus countries, and a reduction in the level of economic activity, were at work. OPEC surpluses after 1973 were run down more rapidly than expected because of high imports. In 1973, total OPEC surpluses had been about $5 billion. They then shot up to $64 billion in 1974, but declined to $24 billion in 1977 and were almost zero in 1978. This decline, to a significant extent, was due to a very rapid expansion in the imports of OPEC countries.

3.4 At the same time, there was a substantial increase in bank lending to developing countries. This facilitated the financing of deficits. The developing countries' debt outstanding in the financial markets increased from over $ 30 billion in 1974 to about $ 100 billion in 1979, with the result that commercial banks' lending became the largest single component in the flow of funds. Official development assistance and the IMF played a diminishing role in financing the deficits: only about 6 per cent of the current account deficit of non-oil developing countries was financed by the IMF in 1974. It made a negative contribution, with repurchases exceeding drawings, during 1977-1979.

3.5 To the extent to which the financing mechanism did not work and imports into surplus countries did not increase, what inevitably occurred was a contraction in economic activity. This was particularly true of those developing countries which did not have sufficient resilience to increase substantially their exports or were not considered to be sufficiently creditworthy to increase their borrowings from commercial banks.

Prospects for the Early 1980s

3.6 There is a danger that, without corrective policy action, more of the adjustment to balance of payments difficulties in the 1980s will be brought about through reduction in the level of economic activity than through the on-lending of surpluses or through increases in imports of surplus countries. First, the magnitude of the problem is substantially larger now than in the past. Present projections suggest an OPEC surplus on current account of well over $ 100 billion in 1980 and a further substantial increase in 1981. Some long-term forecasts suggest a cumulative surplus for OPEC of $400 billion between 1979 and 1983 as compared with about $150 billion during 1974-1978. Second, apart from the expected persistence of surpluses, there is a real fear now being voiced by private banks that they cannot cope with the recycling problem. The banks are becoming increasingly cautious in overextending their exposure to the small group of countries which account for the bulk of the borrowings. This caution is reflected in a decline since 1977 in the rate of expansion of bank lending to developing countries. The banks are also becoming concerned about the adequacy of their capital in relation to the total size of deposits. Third, the absorptive capacity of OPEC for additional imports appears to be much less now than in the 1970s. Fourth, an important element which moderated the recessionary trend during the 1970s appears to be absent. Many of the developed countries which pursued expansionary policies then are not doing so now. This is specially true of the United States, the United Kingdom and Italy where the real and understandable concern with inflation has meant the adoption of restrictive domestic policies.

3.7 Much will depend on the policies pursued by the developed countries which will feel the main impact of higher oil prices. The combined deficit on current account of the OECD countries is expected to increase from $30 billion in 1979 to about $75 billion in 1980. This swing looks like being heavily concentrated on Germany and Japan and may continue into 1981. Both of these countries are in a strong position to run large deficits with equanimity if they so decide; but if they were to allow domestic activity to slow down or contract in an effort to reduce these deficits, or if they improved their balance of payments substantially by a highly successful export drive, a general contraction in world economic activity would be difficult to avoid.

3.8 The net oil-importing developing countries face equally difficult balance of payments problems which would be greatly intensified by any failure on the part of the developed countries to sustain activity. Higher oil prices alone may add some $24 billion to their collective import bill in 1980, compared with 1978. This comes on top of adjustments which most of the developing countries have had to make since 1973 through a sharp compression in imports, a fall in growth rates, and a substantial cut-back in development expenditure.

3.9 Estimates of the current account for the group of *net* oil-importing developing countries have been made by the IMF and show an increase in their deficit from $29 billion in 1978 to $46 billion in 1979 and a forecast of $62 billion for 1980.[1] These figures compare with a deficit of only $9 billion in 1973, a favourable year. When account is taken of official aid and capital inflows, however, these deficits disappear and the IMF calculations show a net surplus for the balance of payments as a whole of $15 billion in 1978, $9 billion in 1979 and a forecast for 1980 of $2 billion (see Table 3.1). On this showing there might seem to be very little to worry about.

3.10 The picture is, however, very different for the different sub-groups of countries making up the total. The developing countries which rank as major exporters of manufactures have run a considerable annual deficit on current account throughout the 1970s but have usually been able to cover it with something to spare through a large net inflow of capital. It is these countries which account for a large part of the oil-imports of developing countries and for most of the inflow of commercial banking funds, almost 80 per cent of private bank lending during the 1970s going to countries in this sub-group. If, as the IMF forecasts, they run a current account deficit in 1980 of $25-$30 billion this will be by no means easy to finance. It is true that most of

1. For *all* non-oil developing countries the current account deficit in 1979 is estimated at $54 billion, rising to $68 billion in 1980 and $78 billion in 1981.

TABLE 3.1
Net Oil-importing Developing Countries
Summary of Balances of Payments, 1973 and 1978-80
(billion US dollars)

	1973	1978	1979	1980
Net oil-importing countries				
Exports (f.o.b.)	71.3	158.2	195.2	235.4
Imports (f.o.b.)	–80.8	–185.1	–237.2	–291.2
Trade balance	–9.5	–26.9	–42.1	–55.8
Net services & private transfers	0.8	–1.9	–4.0	–5.9
Balance on current account	–8.7	–28.8	–46.1	–61.7
Net official transfers	3.3	5.8	8.8	9.3
Net capital inflows	13.6	38.2	46.4	54.3
Overall balance[3]	8.2	15.2	9.1	1.9
Of which :				
1. Major exporters of manufactures[1]				
Imports (f.o.b.)	–48.5	–109.6	–144.3	–179.4
Balance on current account	–4.0	–8.3	–18.0	–27.6
Net capital inflows	8.6	18.7	23.6	27.5
Overall balance[3]	5.6	11.6	8.3	2.8
2. Low-income countries[2]				
Imports (f.o.b.)	–8.3	–17.2	–20.4	–24.9
Balance on current account	–3.4	–7.3	–9.1	–10.8
Net official transfers	1.3	2.4	2.8	3.1
Net capital inflows	2.4	4.7	6.3	6.1
Overall balance[3]	0.3	–0.2	–	–1.6
3. All other countries				
Imports (f.o.b.)	–24.0	–58.1	–72.3	–86.9
Balance on current account	1.3	–13.0	–17.2	–23.4
Net capital inflows	2.5	14.7	16.5	20.7
Overall balance[3]	2.2	3.6	2.6	0.7

Source: International Monetary Fund.

1. Includes Argentina, Brazil, Republic of China (Taiwan), Greece, Hong Kong, India, Israel, Korea, Portugal, Singapore, South Africa and Yugoslavia.
2. Thirty-eight countries with a per capita income of below US $300 in 1977. India, which is also a low-income country, is included in the group of major exporters of manufactures.
3. Includes net official transfers.

them enjoy a high credit-rating in the international capital market but this does not mean that they can borrow what they choose, particularly if the economic climate continues to deteriorate. Anxiety currently being expressed about over-exposure of the banking system may well limit the additions they can make to their borrowings. There is also no guarantee that what they raise abroad for domestic investment will match their balance of payments deficit over the same period. In general, however, any residual financing difficulties experienced by countries in this sub-group should be capable of being met by recourse to the IMF through transitional facilities there and on acceptable conditions.[1]

3.11 It is otherwise with two other sub-groups: the low-income countries (with a per capita income below $300 in 1977) and an intermediate group of countries which are mainly primary producers. Their current account deficits have increased steadily and are unlikely to be financed from available sources. Moreover, the structural rigidities in their economies imply the need for substantially longer-term programme financing beyond that available through the IMF. The first of the two sub-groups is the more vulnerable. Their import volumes have scarcely grown in real terms since 1972. The real purchasing power of their exports has declined significantly. Import volumes have in these circumstances been maintained by current balance of payment deficits that are large in relation to imports – nearly 45 per cent in 1979, as compared with 15 per cent for the major exporters of manufactures and 27 per cent for 'other' net importers of oil. In contrast to these other sub-groups of countries, private bank financing of the deficits of the low-income developing countries has been largely absent, and the burden has been carried by official sources. It is not surprising, therefore, that the balance of payments out-turn for 1980, as projected by the IMF, implies a continuing stagnation in their import volumes. Even so, on this assumption there will be an increase in their 1980 current account deficit as compared with 1979 of about $1.5 billion, with another $1 billion increment projected in 1981.

3.12 While this sub-group consumes and imports significantly less oil than other sub-groups of developing countries, their total oil-import bill was roughly $ 2.5 billion in 1979 and the increment resulting from the price developments of 1979 may be around $ 2 billion. Additional finance on at least this scale will have to be found from non-commercial sources if these countries are not to fall further behind.

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1. The argument of this paragraph is not intended to apply to India which is more appropriately grouped with low-income and residual countries discussed below.

3.13 The residual category of nearly 50 other net oil-importing developing countries has a degree of resilience to external shocks intermediate between that of the low-income countries and the major exporters of manufactures. Their prospective deficit on current account shows a rise from $13 billion in 1978 to over $23 billion in 1980. While the IMF projections for their balance of payments as a whole indicate a barely positive surplus of less than $1 billion, this could readily be transformed into a deficit falling on reserves if the assumptions underlying the calculation go awry in the course of the year.

3.14 In summary, then, the 1980 picture that emerges for the net oil-importing developing countries is that while the major exporters of manufactures may be able to cope with varying degrees of difficulty within the existing sources of finance available to them, the remaining categories, namely the low-income countries and the residual category of middle-income primary producers, are likely to require additional support over at least the next two years. Certainly, all of them would require financing extending beyond the traditional time-frame of IMF facilities, though the more diversified economies among them can for the present look to the IMF through transitional facilities there on appropriate terms and conditions. For 1981, all countries would be vulnerable -- the IMF forecasts an incremental deficit of $10 billion over the 1980 figure without providing any indication of how this increment might be financed.

3.15 A broadly similar assessment was expressed to the IMF's Interim Committee by its Managing Director Mr. de Larosiere on 25 April 1980, especially with respect to the difficulties lying ahead for 1980 and the need for longer-term programme financing. Having argued that while "the outlook for 1980 with respect to the financing of balance of payments imbalances is reasonably reassuring", he went on to say that this

> "was not a reason for complacency. The expected further increase in the current account deficit of the non-oil LDCs in 1981, coupled with virtual stagnation in the volume of import growth, foreshadows a very difficult situation. Indeed, even now there are some warning signals in the financial markets: an increase in spreads, a shortening of maturities, and greater selectivity exercised by commercial banks in taking up new risks. And the signals suggest that banks might become more cautious in the recycling process as time goes by, and perhaps less active in this very essential intermediation function."[1]

1. IMF: *World Economic Outlook and the Role of the Fund in Payments Adjustment and Financing,* page 3.

Immediate Balance of Payments Needs

3.16 It is not possible to arrive at a precise measure of the additional support required in 1980 and 1981 by the low-income and residual category of developing countries. The more aid they receive, the less it will be necessary for them to react to less favourable terms of trade in ways that involve still further impoverishment. One measure of what they might reasonably seek in aid or additional support would be the increase in their import bill for oil which in 1980 is likely to be around $ 10 billion. But this understates the strain on their balance of payments occasioned by higher oil prices, since the disruption in world markets reacts back on the demand for their exports. As shown in Table 3.1, the current account of these two sub-groups of developing countries deteriorated by $6 billion in 1979 and may deteriorate by a further $8 billion in 1980. This suggests that the IMF's estimate of the overall balance of payments for these countries may be somewhat optimistic. Given the large increase in the import bill for oil and the still larger deterioration in the current account, additional support on the scale of at least $5 billion a year, and possibly $10 billion a year, might be necessary to preserve the levels of income of two years ago.

3.17 To this must be added further aid to assist in the process of structural adjustment to higher energy prices. Unless the additional aid on balance of payments grounds is to continue indefinitely, or its discontinuance is to plunge the poorer countries into just those depths of poverty which it was designed to avoid, a beginning will have to be made with longer-term adjustments in the economy to the change in the terms of trade and the balance of payments. These may be such as to effect economies in the use of imported oil or make for an expansion of exports or a curtailment of imports in other ways. They are not likely to be accomplished without investment and the funds required may have to come to a large extent from foreign aid. Thus the immediate need for balance of payments support shades into the need to bring about structural adjustments to a balance of payments problem that has become more acute, and this in turn leads on to the need for other long-term structural change in the interests of economic development. To set on foot projects that help to reduce a continuing balance of payments deficit requires longer-term programme finance, extending over the period of gestation of the projects, than is needed in situations where the deficit can be expected to reverse itself in, say, three to five years.

3.18 Against this background we have considered what action might be taken to ease the problems of the developing countries and so contribute to greater stability in international trade and economic activity generally. Since it would be unrealistic to expect an increase in imports into the surplus

(OPEC) countries in the short-run or the injection of an expansionary bias in developed countries gripped with inflation, that leaves only one area of effective policy action. It is to find ways to provide additional financing mechanisms, both through commercial banks and through governmental channels, to meet deficits in order to sustain economic activity on acceptable terms.

3.19 Over the next year or two it will not be easy to add to those mechanisms in ways that provide balance of payments support of the order of $5-$10 billion (additional to the aid and capital inflows already assumed in paragraph 3.16). There is scope for additional bilateral aid and for a larger element of grant or interest subsidy in the aid supplied. Substantial additional help may come from the OPEC Special Fund. It should be possible for the IBRD to make fuller use of programme lending to those countries even within the limits to which its operations have hitherto been confined. It should also be possible for the IMF to establish a new facility, along the lines suggested below, which would lend to the poorer developing countries on first credit tranche conditions. But for the least developed countries and some other lower income countries whose debt situation is already serious, resort to the IMF except on very favourable terms offers little help. Many of these countries cannot afford to incur additional debt even on Third Window terms (i.e. 4 per cent interest and 25 years maturity) and need grants or soft IDA-type financing. For some of them it will be necessary to reschedule their debts. For nearly all of them the need is for a special programme of increased bilateral and multilateral assistance for the next few years, and efforts should be directed urgently to arrangements for this purpose.

3.20 In the longer run, other financing mechanisms could be devised. The large OPEC surpluses open up new possibilities. They create the danger of massive exchange instability, but the provision of satisfactory assets to remove this danger could take place in ways making it easier to engage in longer-term borrowing in order to effect structural adjustments in the developing countries. The crux of the problem from the OPEC point of view is that higher oil revenues will increase the OPEC holdings of foreign exchange by a large amount in relation to their existing stock of foreign exchange. In the single year 1980, the banks are expected to receive a flow of funds from OPEC countries ranging from $30 billion to $50 billion compared with the stock of $87 billion that OPEC had placed with them by the middle of 1979. There are serious doubts whether the markets are capable of handling such a large and sudden increment in the existing stock, without causing exchange rate instability. Funds are likely to move rapidly from one asset to another as depositors seek to diversify the composition of their reserve portfolios.

3.21 If this situation is to be avoided, policy action directed towards achieving the following objectives is now necessary:

(a) the prevention of potential exchange rate instability by ensuring that sufficiently attractive long-term reserve assets are available to OPEC countries;

(b) the establishment of a mechanism or mechanisms to facilitate larger flows of commercial funds to net oil-importing developing countries; and

(c) an increase in the availability of official sources of financing for countries which are not in a position to borrow from the commercial banks.

3.22 The policy action we suggest could be taken in a series of steps in financial intermediation, which would aim to provide funds both for balance of payments support and for the financing of structural adjustments to balance of payments difficulties. This action would necessarily take some time but could result in more satisfactory and longer-term arrangements than those that can be contrived with existing financing mechanisms.

3.23 First, comes the need to provide facilities to diversify the reserves of oil producers through off-market transactions with central banks. Alternatively, the same results could be achieved through a negotiated dollar Substitution Account within the IMF. If the IMF does not operate such an account there is all the more need for it to take advantage of other mechanisms of reserve diversification in order to 'recycle' the funds that can come to it via central banks. Second, the negotiating sequence that we propose would leave central banks in possession of dollars that could be re-lent to developing countries on longer-term within a suitable financing framework. The third step is the establishment of a mechanism that would put such re-lending on a genuinely long-term basis for programme financing purposes. This mechanism would build on the framework of central bank cooperation through the negotiation of guarantee arrangements between governments. Bonds would be floated against these guarantees and included in these issues would be bonds issued to subscribers of funds derived from off-market diversification arrangements. Finally, this mechanism could be given permanent institutional form by converting the guarantees into the callable capital (in the sense of a system of 'limited and several guarantees') of a lending institution such as the World Development Fund proposed by the Brandt Commission.

3.24 In so far as they meet both programme and project financing needs, proposals along these lines are developed in Appendix 1 and seem to us to merit consideration. We content ourselves here with an outline of those features of the proposals that seem to us crucial.

Reserve Diversification

3.25 The first step would consist in providing facilities for off-market reserve diversification by oil producers in order to reduce exchange rate instability caused by switches of their reserve assets between currencies while preventing unwanted changes in the money supply of the countries affected. In practice, these facilities would have to be such as to allow oil producers to unload dollars without undue disturbance to dollar exchange rates and receive in return assets denominated in some preferred currency. The off-market transactions involved would require to be negotiated among the central banks of the countries concerned and would, in the first instance, have the effect of creating a tier of secondary reserve assets for the participating central banks.

3.26 Such a negotiating sequence might proceed, illustratively, as follows: the Saudi Arabian Monetary Authority (SAMA) would sell the dollars received for its oil to the German Bundesbank in exchange for securities denominated in Deutsche Mark. These securities would represent secondary reserve assets for the SAMA whose terms as regards interest rate, maturity, etc. would be negotiated at somewhat *below* market rates, to reflect some sharing of the exchange risk being borne by the Bundesbank in selling Deutsche Mark securities for dollars.

3.27 The circuit would be completed by the Bundesbank investing the dollars so acquired in the United States in dollar-denominated bonds on terms negotiated *above* market rates, thus permitting the Bundesbank to share some of the remaining exchange risk with the United States. This type of negotiating sequence has a precedent in the two-year Roosa bonds negotiated in the middle 1960s to relieve pressure on the US dollar. Indeed, this process has already been set in train as a result of recent transactions between the Bundesbank and the SAMA and projected similar transactions involving the latter and the Bank of Japan. The issue of securities by the Bundesbank, however, has so far been limited to amounts required towards financing the Federal Republic's budget deficit without any rise in domestic interest rates. If there were a willingness to extend further the reserve role of the Deutsche Mark, then one could envisage additional transactions between the Bundesbank and the SAMA that would lead to the Bundesbank investing the dollars so acquired in the United States and completing the sequence previously described.

3.28 The principal innovative feature of this type of negotiating sequence is that it can enable monies to be lent to developing countries as well. For the dollars which find a home in the United States at the end of the negotiating circuit could be re-lent to developing countries within, of course, a framework of suitable terms and conditions for financing their deficits. Specifically, the Federal Reserve Board which would have received the dollars would make them available to the IMF against IMF obligations denominated preferably in SDRs or in dollars, somewhat in the manner in which finance was obtained for the IMF's 'oil' facility in the 1970s. As in the 1970s, the need to await the development of mechanisms described below for longer-term financing of deficits would mean that the amounts to be re-lent to developing countries within the framework of traditional IMF facilities would have to be on a broadly similar basis of conditionality to that of the 'oil' facility – viz. first credit tranche. Action to enable recycling via the IMF would constitute the second step in the series we recommend. Given the amounts requiring to be negotiated for reserve diversification purposes in the early 1980s, this form of re-lending could be the nucleus of a 'massive recycling process'.

3.29 In principle the same results in terms of both diversification and recycling can be achieved through a negotiated dollar Substitution Account within the IMF. This is simpler because it avoids a multiplicity of bilateral transactions among the central banks concerned. The case for such a Substitution Account has been urged by the Witteveen Group of Thirty.[1] But it has to be recognised that, considering the time it will take to put the Substitution Account into place, and granted the likely strength of desire for diversification of currency reserves, cooperation among central banks will be required. The case for such cooperation is further strengthened by the postponement within the IMF of the Substitution Account issue at the recent Hamburg meeting of the IMF Interim Committee. Indeed, the Witteveen Group has referred to one such form of central bank cooperation as 'the foreign currency substitution channel', in terms which make it virtually equivalent to the negotiating sequence which we have described, with the difference that in their formulation no explicit provision is made for re-lending and recycling the amount to the developing countries.[2]

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1. The Reserve Assets Study Group of the Group of Thirty: *Reserve Assets and A Substitution Account: Towards a Less Unstable International Monetary System,* February 1980, page 10.

2. See ibid., page 18: "An alternative or complementary approach to the balance of payments channel is the foreign currency substitution channel. Problems posed by the relative lack of development of surplus countries' capital markets might also, to some extent, be avoided by this approach

continued

3.30 The advantage of adopting the route of negotiated off-market reserve diversification is that transfers to developing countries can be grafted on to the meeting of urgently felt central bank needs on which rapid action is bound to result, in response to market pressures. In the short-run, however, since the securities that will have to be negotiated among central banks are in the nature of secondary reserve assets, they are likely to be of a relatively short-term nature. The negotiation of terms which involves a sharing-out of the exchange risk between three or more parties will not be an easy matter. There may not be much room for manoeuvre, initially, therefore, regarding the maturity for re-lending the amounts to developing countries. Hence the short-run plausibility of the suggestion that the IMF become the intermediary for channelling these funds to developing countries.

3.31 A clear distinction will have to be drawn between funds disbursed through the existing facilities of the IMF to meet immediate needs for financing of balance of payments deficits and those earmarked for some new and longer-term 'oil' or structural change mechanism still to be set up. There is a need for resources for both purposes.

3.32 The resources available for the IMF's current facilities comprise about $10 billion worth of lendable currencies and another $10 billion from the Supplementary Financing Facility (the Witteveen facility), of which more than half will have been committed under ongoing negotiations. Although the high degree of conditionality attached to existing IMF facilities, in particular the Supplementary Financing Facility, inhibits recourse to them, increasing calls are likely to be made on these facilities by the developed countries and the first sub-group of developing countries (the major exporters

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2. *Continued*
which allows for diversificaton outside the markets. For example, the strong currency countries could issue obligations in their own currencies in exchange for dollar claims on the United States. The advantage would be that they could thereby arguably sterilise the domestic monetary effects of foreign currency inflows before they actually occurred; that such techniques would be independent of the state of the countries' domestic financial markets; and that if the claims were in the form of long-term placements with central banks, they could be less volatile than short-term capital inflows. This approach might be considered analogous to a swap, with one leg of it in longer-term assets. However, strong currency countries would under this proposal have to accept further accumulations of dollar reserves and presumably the resultant exchange risk, unless bilateral arrangements are agreed between participating countries to share the exchange risk or the strong currency countries deposited newly-acquired dollar reserves in the Substitution Account."

of manufactures) discussed above. If the IMF's existing resources prove inadequate they could readily be supplemented, especially since the relatively short-term nature of the assets intitially generated in the course of off-market diversification transactions make them a permissible and attractive form of replenishment of IMF resources.

3.33 The Minister of Development Cooperation of the Netherlands has recently proposed that

> "In concrete terms, the IMF could use funds drawn from the capital market to finance the balance of payments deficits of the oil-importing developing countries on a medium-term or long-term basis. Short-term financing would be pointless in view of the structural nature of the deficits. . . . So my first proposal is to establish a new mode of operation by having the IMF borrow on the capital market to finance the deficits of the oil-importing developing countries."[1]

From one point of view this is a highly attractive proposal and has the great merit of simplicity. However, a genuine question arises as to how far recycling through the IMF to developing countries could be sustained over a period of years on a sufficiently longer-term basis in line with the structural nature of the deficits requiring to be financed. It is one thing for the IMF to venture occasionally into longer-term territory as in the case of the Extended Fund Facility, where the revolving nature of the fund as a whole can still be maintained by virtue of the fact that the vast bulk of the disbursements are for relatively short periods. It becomes, however, a totally different matter if a substantial proportion of IMF resources were to be lent on longer-term. This would court the risk, against which the IMF has been repeatedly cautioned, of transforming itself too far in the direction of a development institution. For this reason we regard the Minister's proposal as essentially transitional. Instead we suggest a procedure whereby governments, as distinct from central banks, take the initiative in establishing a mechanism for re-lending the proceeds of off-market diversification on a genuinely longer-term basis. This is the third and crucial step in the series we recommend.

Long-term Programme Lending

3.34 The opportunity which is within reach of governments as distinct from central banks (and which could be grasped by them almost *pari passu* with off-market reserve diversification negotiations among central banks), consists

1. J. de Koning: *The Right to Existence and to Development* (address to the Independent Commission on International Development Issues, The Hague, 17 May 1980).

simply of implementing what is perhaps the key recommendation of the Brandt Commission, formulated as follows:

> "We have shown how the 1980s will inevitably see massive increases in the deficits and debts of the developing countries. Further studies are badly needed of the range of those debts and deficits by 1985 and of the resources – both private and public – potentially available to meet them. *But it is already apparent that special measures are needed. The industrialised and the oil-exporting countries should reach agreement on their respective additional roles and additional lending capacities, both directly by each and in the form of jointly shared guarantees.* Given the new sense of the interdependence affecting all parties, it is essential that these two groups of countries join forces to transform this potential crisis into a new opportunity for cooperation – in the common interest".[1]

The existence of a framework of central bank cooperation, which would have the effect of recycling OPEC surpluses off-market and through official (IMF) channels to developing countries, would also facilitate the negotiation of these 'jointly shared guarantees' between governments, which alone would place this lending on an adequately longer-term footing. These guarantees are considered more fully in Appendix 1.

3.35 Whatever arrangements are worked out should make it possible to meet on a systematic rather than an *ad hoc* basis, and with adequate resources, the kinds of need for financing programmes of structural change which are currently being addressed only partially by a clutch of facilities within the Bretton Woods institutions – the Extended Fund Facility within the IMF, limited programme lending within the World Bank, and most recently the World Bank's structural adjustment loans. The area of finance for which there is inadequate provision relates to longer-term programme lending, extending from periods between the five years to which IMF loans are normally limited (or the maximum number of years which the IMF allows under its highly conditional Extended Fund Facility) to the 25 years that applies to Third Window lending by the World Bank. The private banking system has typically operated within the maximum range of IMF maturities and not beyond, and continued recourse to it has the effect of compounding a country's debt problem.

3.36 It would be possible to give effect to the financing arrangements that we have in mind through existing institutions: the World Bank on the one

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1. Independent Commission on International Development Issues, op. cit., page 279; emphasis added.

hand and the OPEC Special Fund on the other. This would require a relaxation of the rules under which the World Bank engages in programme lending and would also require a substantial addition to the resources made available to the IDA. Alternatively, the financing arrangements might provide the starting-point for a new institution such as the World Development Fund proposed by the Brandt Commission.

3.37 If the Brandt Commission's recommendations were adopted, the 'jointly shared guarantees' that are envisaged as a transitional measure could in due course be given permanent institutional form by their conversion into the callable, as distinct from the paid-in, capital of a lending institution. Callable capital in this sense need represent nothing more than a system of 'limited joint and several guarantees'[1] furnished by the member governments participating in the institution against which the institution is enabled to borrow in the capital markets. An appropriate sequence to implement this third step might then be (a) for the guarantee arrangements alone to be set up among interested countries in the first instance to enable the raising of monies for longer-term programme lending, including in this the proceeds of off-market reserve diversification arrangements which will have been channelled initially through the IMF; and (b) for the determination at a later stage of the paid-in capital obligations that would be required to establish a new institution.

3.38 We are conscious of the difficulties that are likely to arise in world-wide negotiations to implement these two stages. At the same time, some willingness appears to have been shown in current proposals for transforming the OPEC Special Fund into a Development Agency to proceed rapidly enough for the transformation to be completed by the beginning of 1981. In the interests of expediting this process still further during 1980 we suggest that the two stages involved should be sequentially implemented by interested parties.

Towards a World Development Fund

3.39 The proposals for transforming the OPEC Special Fund, with certain modifications which are described in Appendix 1, could serve two purposes. They could provide the basis for arrangements to meet more adequately the immediate financing needs of net oil-importing developing countries in 1980 and they could also lead to the establishment of the Brandt Commission's World Development Fund. This would involve, in the first place, enabling the OPEC Special Fund to raise, on the basis of supporting guarantees from

1. See Appendix 1.

OPEC governments, up to $8 billion to be disbursed during 1980 to developing countries, on average on Third Window terms. The terms could vary with the circumstances of the borrowing country, so that there was a spectrum of interest rates and maturities ranging from IDA to World Bank terms. The $2 billion available as the undisbursed portion of the $2.4 billion replenishment of the Fund this year would suffice to provide the subsidy element. If OPEC were willing to provide guarantees for up to $8 billion, similar action might also be urged on the developed countries to raise a matching total, with a matching subsidy element, also on the basis of guarantees, in the spirit of the formula for 'jointly shared guarantees' which was proposed by the Brandt Commission. One way in which the developed countries could provide the subsidy element relatively easily, if they were willing to swallow their objections to the principle involved, would be to apply their share of the current round of SDR allocations for this purpose.

3.40 The amount which could eventually be raised in this fashion would be very large – figures of up to $20 billion have been proposed for the OPEC Development Agency alone – and it would be reasonable to expect that a fund or funds of this magnitude, involving developed countries as well, would be in a position to widen its range of activities as compared, for example, with the transformed OPEC Special Fund. While the main area of activity of the fund or funds would always be the provision of long-term programme finance, particularly in the initial years of operation, more resources could over time be devoted progressively to project lending in priority areas such as food and energy and to promoting regional cooperation and integration among developing countries. It would be for consideration whether these activities should be administered by a common agency and the sums raised under two sets of guarantees should be pooled or whether it would be preferable to retain two separate agencies working in close collaboration. The developed countries might prefer to make use of the World Bank rather than set up a new institution and OPEC might be reluctant to entrust large sums to an agency over which its control had to be shared with other countries. In either case, the guarantees could be converted into the callable capital of an agency and the formal institutional arrangements completed by adding in a paid-in capital provision.

3.41 Looked at from the point of view of OPEC, a scheme of this kind might seem a somewhat involved way of making concessionary loans to developing countries, especially as most of the funds borrowed against guarantees would originate with OPEC depositors. They might prefer to use the OPEC Special Fund to make grants or loans on concessionary terms to the countries most in need of immediate help or to give partial relief to those countries. In extreme cases they might even be willing to do both. Given the relatively small quantities of oil involved, the effect of such rebates on oil markets would, with appropriate safeguards, be relatively insignificant. But if either of the possibilities just outlined – grants and soft loans or oil rebates – were adopted to the exclusion of guarantee arrangements, this would be likely to mean sacrificing the more ambitious scheme for a Development Fund in support of loans to accelerate structural change. It would also diminish the likelihood of arrangements, in which the OPEC countries might see virtue, that allowed for participation on equal terms by the developed countries. These are important advantages that it would be a pity to lose. Whatever is done by OPEC, there is an opportunity and a very real need for an initiative by the developed countries in the mutual interest of both developed and developing countries.