6 Global economic policies

IMF AND WORLD BANK

Towards the end of World War II, when victory for the Allies seemed assured, discussions began to determine the shape of the post-war world, which the victorious powers were able to influence to a very large extent. Within the political-diplomatic sphere, which falls outside the boundaries of this volume, the United Nations was founded to replace the practically defunct League of Nations. As far as the world economy was concerned, a number of key decisions were taken at a conference of delegates of forty-four nations held at Bretton Woods in New Hampshire in July 1944.

It was a time when the United States held virtually all the levers of economic power in her hands, and the structures which evolved were essentially those proposed by the American representatives. Two major institutions were created as a result of Bretton Woods: the International Monetary Fund (IMF) and the Bank for International Reconstruction and Development, commonly known as the World Bank. In due course most countries took up membership: thus the IMF had 179 members by 1994 and the Bank had 177. Their founders were strongly influenced by the lessons drawn from the inter-war years and were determined not to repeat the mistakes which had led then to world depression and war.

It had been the experience of the 1930s that countries suffering from unemployment were likely to try to improve their position by devaluing their currencies. By this means their exports would appear cheaper to foreign buyers, who would therefore buy more of them, while at the same time foreign imports would be cut because they would now appear dearer. In that way they hoped to create more jobs at home. Some countries imposed even cruder methods, for example controlling and rationing foreign currencies or obstructing imports in order to stop their people buying things from abroad. The trouble was that other countries could retaliate by doing the same, and there ensued an ever-widening campaign of devaluations and obstructions to trade and payments which disrupted commerce and harmed everyone. The IMF was designed to prevent a recurrence of that sequence of events.

One of its basic ideas was that in order to prevent that kind of competitive devaluation which had been so harmful in the 1930s, exchange rates of all currencies would be fixed right at the start and not changed thereafter, except in defined special circumstances. Since the most likely threat to a fixed exchange rate system was presumed to be a payments imbalance, that is, a country being unable to pay for its imports with sufficient exports, the IMF was designed to be a holder of a buffer stock of currencies, ready to tide members over such difficult years.

The system was to work in the following way. Each member country would, usually through its Central Bank, pay a deposit into the Fund, mainly in its own currency but to the extent of one-quarter in gold or dollars. The size of the in-payment was determined on a quota basis calculated to be roughly in proportion to a country's economic strength. If it got into difficulties, in the sense of owing to other member countries more than it could pay by exports, the Fund would lend it the required sum out of its stock of currencies held. That loan had to be repaid within five years. However, the larger the required loan, the more stringent the conditions and there was a maximum, thus discouraging heavy borrowing. The penalties on excessive borrowers were, however, not matched by comparable penalties on excessive lenders: it was obvious at the time that the lender whose currency would be in greater demand than any other would be the United States. The only defence against the excessive lender was that its currency could be declared a 'scarce currency', and then other countries could impose certain restrictions on imports from that country.

Clearly, this was a structure designed to deal with short-term problems, and if the payments deficit of a country was indeed due to some temporary blip, the IMF could help. But if, as was commonly the case, it was due to a more persistent structural weakness, the country concerned was expected to use the loan in order to undertake remedial action. Three types of possible action had been known in the inter-war years: a country might devalue its currency – but that was precisely what was prohibited under the IMF rules; it could raise tariffs or in other ways hamper imports – but that, as

we shall see, would break other international agreements, and in any case the IMF was specifically intended to secure freedom of trade; or, third, it could go in for policies of internal deflation, that is, it could take steps to reduce the incomes of its people, so that less was available to be spent on imports. However, such policies, which involved unemployment, would be unpopular, would damage the economy and, in contrast to the inter-war years, had become politically unacceptable.

In practice, therefore, even in the period up to 1971 during which the gold-dollar base held up and the system worked reasonably well, countries with serious and persistent balance of payments difficulties opted for devaluation, with or without consent of the IMF. Thus in 1949 sterling was devalued by 31 per cent and a large number of countries followed suit; other countries, including Germany, the Netherlands and Switzerland, revalued (that is, up-valued) their currencies at different times in those years.

In 1971 there was a drastic change. The dollar, hitherto thought to be as good as gold itself, came off the gold standard, and at the same time the regime of fixed exchange rates came to an end. Currencies were allowed to 'float' and they did so in different ways, though there were various regional schemes to peg some currencies to each other, as we shall see in the next chapter. This represented a critical break in world economic policy: it meant, in effect, the end of an era based on the post-war settlement. The original task of the IMF to ensure that exchange rates remained fixed had ended in failure.

By contrast, the IMF's role as a provider of an international currency reserve had expanded far beyond the initial concept. Even before 1971, it had ceased to be simply a supplier of dollars and had begun to meet much more varied needs. For one thing, other currencies were now in demand. Thus, in the four years 1967–70, dollar drawings totalled $2,850 million, while those in other currencies came to no less than $6,247 million. Beyond this, the initial deposits soon proved inadequate to the task of providing a significant share of the world's liquidity as trade grew and the value of the dollar fell. There followed a series of substantial, almost spectacular increases in the loanable funds handled by the IMF. The quotas were raised in 1959, again in 1965 (for some) and once more in 1970, increasing the available funds from US $9.3 billion to almost $29 billion in the process. Meanwhile, in 1962, the ten largest countries concluded the General Agreement to Borrow (GAB) to lend the Fund up to $10 billion, and in 1966–7 the Group of Ten devised an entirely new access plan of resources for borrowers in the form of Special Drawing Rights (SDRs), to be provided by members but drawn through the IMF. In 1970–2 $9.5 billion were set aside, and another $12 billion in 1979–81, though meanwhile other forms of liquidity had been developed. Although the gold base had hardly changed in the interim, the sums that could be counted as international reserves had rather spectacularly increased tenfold from $47.4 billion in 1945 to $477.7 billion in 1985.[1]

By then the main function of the IMF had changed once more. It had now become a reserve holder for the developing world: by 1980–1, 93 per cent of its credits went to it. These countries had special needs, and were likely to suffer more severely from the decline of certain commodity prices as well as from external shocks. As early as 1963, the Compensatory Financial Facility (CFF) was authorized to provide credit to offset falls in their export earnings. This was extended in 1976 to help in case of excessive wheat import costs and in 1990 for the same purpose for oil imports. An Oil Facility had been set up in 1974 to meet the first price increase, and a Supplementary Financing Facility (SFF) in 1979.

However, the developing countries were not only from time to time desperately in need of credit; they were also less able to repay their loans than the industrialized nations for whom the IMF had initially been planned, and many dragged out their loans far beyond the regulation five years, turning the IMF against its will into a provider of long-term credit. More drastic measures had to be taken to protect the IMF's funds. It developed the principle of 'conditionality', which meant inspecting the borrowing country from time to time to make sure the funds were 'properly' applied. Countries were expected to use the IMF's funds in line with its own notions of what constituted good housekeeping to ensure repayment and this, in turn, caused resentment among the recipients. As mainly an issuer of loans to the poorer nations, the IMF had by the 1980s inevitably become involved in the global debt problem of that decade, to be discussed further below.

The World Bank, the other institution devised at Bretton Woods, was from the start intended to provide long-term loans. Its structure differed basically from the IMF in possessing only limited resources of its own – the initial capital being US $10 billion, of which only 20 per cent were paid up – acting instead as an intermediary between borrowing countries and providers of credit. Such credit would be raised in the market by issuing bonds, repayable in the same currency. The Bank was limited to development projects which

promised reasonable returns, but which for one reason or another were unable to attract private funds directly.

In its early years, its loans went mostly to war-devastated European countries; in the 1950s they tended to be switched to middle-income countries and others inhabited by Europeans overseas; and thereafter they went almost exclusively to developing economies. These had received 47 per cent of the loans in 1948–52, but accounted for well above 90 per cent from 1970 onwards. The key was to help them on to a development path, while also, about that time, under the influence of its chief executive, Robert S. McNamara, the Bank set itself the task of lessening poverty in the world.

There was much optimism in the first two decades of its working: given reasonable projects and technical advice, it was believed, the loans for capital investment made available through the World Bank would soon lead to structural transformation which would allow sustained growth into economic development to take place. At the same time the creditors, such as American and western European banks, insisted on generally 'sound' overall economic policies on the part of the receiving governments, in particular policies which favoured market orientation and *laissez-faire*.

These obligations were enforced much more strictly in the deteriorating world economic conditions from the 1970s onward, in which commodity prices collapsed with devastating effects on some Third World countries. Denationalization, deregulation and liberalization of markets, and measures to benefit enterprise and weaken trade unions, became almost routine. Budget deficits were to be met by tough deflationary measures, which caused widespread unemployment and much hardship among many of the weaker economies.

Yet at the same time, banks often tended almost to force their loans on to the poorer countries, sometimes known as the 'South': the reason was the declining investment opportunities in the richer 'North'. New types of 'softer' loans, carrying easier conditions, were introduced under the aegis of the International Development Association (IDA) and the International Fund for Agricultural Development. An International Finance Corporation (IFC) was set up to promote the private sectors in the poorer nations and the Multilateral Investment Guarantee Agency (MIGA), founded in 1988, was to protect foreign direct investors there. World Bank lending was targeted either on 'structural adjustment' (SAL) or the more specific 'sectoral adjustment' (SECAL).

Commitments of the World Bank rose from (current) US $610 million in 1961 to $1,680 million in 1970 and $14,244 million in 1994.

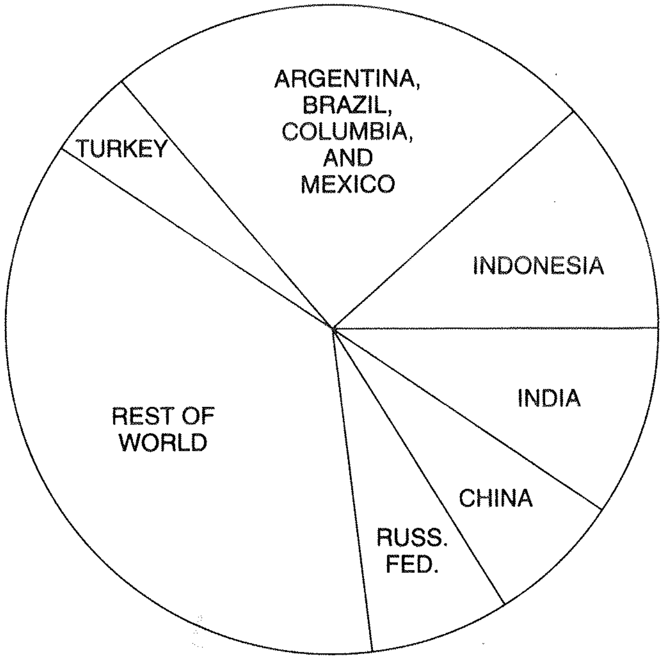

Figure 6.1 Shares of the $109.3 billion of World Bank loans outstanding in 1994

The major recipients of the total of $109.3 billion of loans outstanding in 1994, are shown in Figure 6.1. Other countries which received $2 billion each or more were South Korea, Morocco, Nigeria, Pakistan, the Philippines and Hungary.

Taken from: Sidney Pollard, *The International Economy Since 1945*, London and New York: Routledge (1997).