Money, Finance and Global Macroeconomics: UNCTAD in the 1970s and 1980s

Roger Lawrence

Introduction

From the very beginning of UNCTAD, it has been understood that an organisation dealing with trade and development would also need to give prominent attention to questions of money and finance. In general, activities in UNCTAD sought to bring about a more adequate flow of financial resources to developing countries. Although in the case of the poorest countries these flows might be justified on distributional grounds, the principal rationale for them put forward in UNCTAD related to the role that they could play in creating income and wealth in the recipient developing countries. This role was highlighted in a series of complex modelling exercises undertaken over the years by the secretariat, which linked foreign exchange availabilities and financial flows to rates of investment and growth in the developing countries.

UNCTAD was also found by governments to be a useful forum for the discussion of proposals for modification or adaptation of the monetary and financial system. It was convenient for governments to consider such proposals, at least at their early stage, in a forum such as UNCTAD since this did not, in itself, have operational significance. Once such ideas had matured sufficiently, they were taken up by governments in the appropriate fora for decisions of an operational character. This was indeed the path followed by the proposal to link SDR creation to additional development finance, an idea that was elaborated and discussed in some detail in UNCTAD between 1968 and 1973 and then taken up by IMF's Committee of Twenty.

All of these activities were part of the overall role of UNCTAD in helping to bring about circumstances in which developing countries could better deploy their resources and energies so as to accelerate their own development. Implicit in these activities was the underlying assumption, which was held throughout the 1960s and the first half of the 1970s, that the world economy would continue to expand vigorously and that trading opportunities and international financial flows would grow apace. It was mostly taken for granted that this growth would be supported and reinforced by trade and financial regimes which by and large met the needs of the developed world. A major concern in UNCTAD was to ensure that these systems provided sufficient safeguards to the weakest members of the trading and financial community and that they created ample possibilities for developing countries to participate fully in the overall growth of world trade and output.

The World Economy and Developing Countries: the record of the 1970s

Developments in the world economy beginning in the mid-1970s called into question many of the underlying assumptions regarding the overall economic environment in which developing countries would have to prosper. These changes were complex, manifold and are well known, with the sharp recession in industrial countries in 1974-75, the apparent move of industrial countries to lower medium-term trend rates of growth, and sharp changes in prices of traded goods, particularly petroleum, being the main outward manifestations. These changes put intense pressure on the external accounts of non-oil developing countries and threatened seriously to disrupt the process of growth and development.

Throughout the 1970s, the international monetary and financial system provided to developing countries some scope — however limited and unevenly distributed — for dealing with the adverse consequences of these changes in the trading sphere. At the international level, governments reacted to the need to adapt financial mechanisms to the evolving situation by establishing the oil facility in the IMF and the structural adjustment lending programme in the World Bank. The first of these actions was taken in recognition of the need to assist countries in dealing with immediate problems posed by their increased oil

IDS Bulletin, 1984, vol 15 no 3, Institute of Development Studies, Sussex

import bills without endangering longer-run growth and growth prospects. It also reflected recognition that their enlarged deficit was simply the counterpart to the unadjustable surplus of oil exporters, thereby requiring financing on relatively easy conditions. The second reflected the growing perception that the payments problems facing many developing countries were quite different in character from those which developing countries had previously experienced. A significant component of the payments deficit of non-oil developing countries was 'structural' in character. That is, it reflected not a situation of excess aggregate demand, which could be adequately dealt with through a cutback in expenditure, but far-reaching and non-reversible changes in the world economy that required concomitant changes in the pattern and composition of production and consumption. Such changes could only be brought about on the basis of an adjustment programme characterised by an intensification and reorientation of investment. Of necessity, adjustment of a structural deficit would require financial support different in character and over a longer time span than had previously been available. It would also often require a reorientation of domestic policy effort and emphasis.

Private financial flows also adapted quite rapidly to the changed situation and a large part of the financial surpluses of oil exporting countries was recycled through the activities of the private commercial banks. The balance between official and private flows, however, was badly skewed in favour of the latter, with considerable consequences as regards the distribution of financial flows among developing countries and the future stability and viability of the system of international financial intermediation.

The period of mid- to late-1970s was thus one of considerable difficulty for developing countries and one in which financial mechanisms provided inadequate support. Nevertheless, there were a number of elements which helped. Firstly, there was a commitment on the part of industrial countries to sustain growth. The deflationary impact on their economies of the 1974-75 oil price increase was clearly recognised and there was a consensus that it should be offset, at least in part. Secondly, the financial system, whatever its weaknesses, did allow many countries to counteract, at least in part, the adverse consequences of disruptions in the trading sphere. The sharp rise in financial flows from OPEC member countries was particularly helpful in this regard. Thirdly, larger financial inflows and adaptations of domestic policies did allow many developing countries to adjust their underlying economic position. This was reflected in a very substantial improvement in their trade balances (measured at constant import and export prices) between 1975 and 1980, and an improvement in the domestic savings performance of many countries, and higher levels of investment in an even larger number of countries.

In UNCTAD, responses to changes in the world economy during the 1970s were manifold. In the area of external financing, particular attention was focused on the question of debt and on proposals that would alleviate or avoid serious problems in this area. One proposal, which was agreed in UNCTAD in 1978, was to bring the terms on past official development assistance into line with donors' present policies. This idea, called 'retroactive terms adjustment', resulted in the granting of considerable debt relief by DAC member countries to poorer developing countries. It was particularly effective in instances in which donors had previously provided loans to a recipient country, but were currently providing only grants. In such a situation 'retroactive terms adjustment' often resulted in the conversion of loans to grants — that is, the writing off of the loans or the debt service due. In the area of commercial bank debt, proposals were put forward that would have allowed borrowers to refinance, at long term and at market rates of interest, short and medium-term loans from banks. This proposal, which would have helped avoid some of the major problems that emerged in the 1980s, was not given serious consideration by governments. Finally, attempts in UNCTAD to establish an agreed international framework to govern renegotiation of debt owed to official creditors were successful. These 'guidelines' are particularly useful in that they call attention to the need to ensure that the terms of debt renegotiation take adequate account of the underlying, longer-term character of debt-servicing difficulties.

These initiatives took place within the context of broader efforts to deal with the upheavals of the 1970s by enhancing perceptions of the need to bring greater coherence to the international financial system and to accelerate structural changes in the world economy as a whole. An important link between these two efforts was the attempt to heighten awareness of the importance of the interdependence of policies adopted in the areas of money, finance and trade. Structural change and interdependence were the themes of the Secretary-General's report to UNCTAD V, which was held in Manila in 1979.

The need for structural change in the world economy was hardly new to UNCTAD, and had, indeed, been the underlying rationale for its activities from the beginning. But the Secretary-General's report widened the discussion considerably: it explicitly recognised that certain basic changes of a structural character were needed not only to promote growth and development in developing countries, but also as a contribution to the solution of the problems of

unemployment, inflation and slow growth in the developed countries. The need for structural adjustment was thus seen as being thoroughgoing and wide-ranging, and as the avenue for securing better economic performance in the world economy as a whole. Nor was the importance of the interdependence of policies in the areas of money, finance and trade new. This issue had been on the UNCTAD agenda since UNCTAD III, and a number of major propositions in this area which have recently attracted attention — such as the importance of trade policies in developed countries for the smooth servicing of developing countries' debt — were first aired in UNCTAD in the 1970s. But UNCTAD V was the first major international conference at which negotiations on this question of interdependence, and on the establishment of international machinery to address this issue, played a significant role.

UNCTAD V thus marked an important step toward the formulation and discussion of development issues in a way which brought out their significance not only for developing countries, but also for the performance of economies in the North and of the international systems of money, finance and trade. Such considerations, however, were yet to reach centre stage.

The World Economy and Developing Countries in the Early 1980s

The disruption of the development process that occurred in the early 1980s bore a superficial resemblance to that which occurred in the mid-1970s. Both were characterised by recession in developed countries and a sharp rise in oil prices. However, there were significant differences. The most important of these was the decided shift in the emphasis of macroeconomic policies in the developed countries which focused on the task of combating inflation to the virtual exclusion of other policy objectives. Indeed, it was widely assumed that the decisive defeat of inflation was a necessary prerequisite to restoration of a viable growth process. At the same time, a number of major countries adopted monetary policies that placed exclusive reliance on the control of the growth of monetary variables, rather than giving weight to both interest rate and money growth objectives, as had previously been the practice. These two shifts, taken together, produced a contraction in aggregate demand that was accompanied by extremely high rates of interest. The impact on the external payments of developing countries was immediate and severe.

Of equal importance, however, was the very different role played by the financial system in the early 1980s. To be sure, in 1980 and 1981 the pattern of behaviour was similar to that of the mid-1970s. Countries sought to increase borrowing from whatever sources were available in order to offset the disturbances in their balance of payments resulting from the deterioration in their terms of trade and the need to make higher interest payments. But as 1981 and 1982 progressed, the circumstances which had up to then allowed this pattern to emerge gradually disappeared. For the first time, the export earnings of a large number of developing countries stagnated, or actually deteriorated and pressures on external accounts became particularly intense. In these circumstances, it was not possible for many developing countries to meet out of export earnings both the import requirements associated with growth and debt-service obligations. There were several responses to this situation. All countries sought to reduce imports to the bare minimum. Even so, an increasing number of developing countries were obliged to reschedule their official and officially-guaranteed external debt. Others continued to borrow, in some cases using the proceeds to pay interest on past borrowing. Many countries also ran down reserves. As this situation continued and was increasingly viewed by private lenders as untenable, the private banking system attempted to reduce its exposure to developing countries and to shorten the maturity of its claims on them. The stage was then set for the intense crisis in the system which became manifest in the latter part of 1982, a crisis which required *ad hoc* emergency action by the governments of the major creditor countries and the BIS in order to forestall the danger of a full-scale collapse. Thus, rather than providing some insulation to growth in developing countries from external disturbances, the operation of the private component of the monetary and financial system had itself become a source of external disturbance and intensified the downward pressure on growth in many developing countries.

Five broad conclusions regarding the character of North-South discussion could be drawn from the experience of the early 1980s. The first and most important was that domestic policies of developed countries, pursued for purely domestic reasons, were having a greater impact on developing countries than the 'development policies' of these countries. For example, the impact of interest rate policy in developed countries was having a significantly greater immediate influence on industrial output and investment in most newly-industrialised countries than was the Generalised System of Preferences. Similarly, the collapse of commodity prices brought about primarily by recession in industrial countries was making a larger impact on the external purchasing power of many developing countries than were the aid policies of industrial countries.

Secondly, the difficulties being experienced by developing countries had important, direct ramifications for activity in developed economies. The collapse of developing countries as growing markets for the exports of developed countries was itself an important contribution to the continued recession in industrial countries.

Thirdly, the experience of the early 1980s exposed the vulnerability of the monetary, financial and trading systems that had accumulated over the preceding years. The possibility that some of the major developing country borrowers might not be able to deal with their debt problems posed a significant threat to the international financial system. The process of demand deflation was also accentuating strains on the trading system, which were leading to a progressive deterioration in the scope and applicability of accepted rules and procedures and to a growing role for the *ad hoc* management of trade. Moreover, it was becoming increasingly evident that the short-run policy responses to emergency situations were themselves affecting the evolution of the financial and monetary system in ways that could not be foreseen. For example, closer collaboration emerged among individual commercial banks — a development which may reduce competition and produce a more uniform set of policies and operations *vis-à-vis* individual developing countries. Moreover, whereas in the past, borrowing from commercial banks was for some countries an alternative to borrowing from the IMF and therefore provided a source of balance-of-payments financing that was free of conditionality, the arrangements that emerged from end-1982 onward have linked tightly the activities of commercial banks and those of the IMF. Such arrangements were arrived at in order to deal with very pressing short-term problems. Should they persist, however, they would represent rather profound structural changes in the relationships among major sources of international finance, and hence in the international monetary and financial systems.

Fourthly, it was evident that the emergency operations had been oriented towards those countries whose actions were of greatest significance for the private banking systems of the developed countries. Difficulties of other countries, which were often no less acute, did not always receive the same attention.

Fifthly, the experience of the early 1980s had clearly demonstrated the need for significant adaptation of policies in the developing countries themselves. The issue here was not so much whether policies in the 1970s had been 'good' or 'bad'; rather, it was to understand what was required by the changed international economic environment and how policy adaptations could contribute to minimising the negative impact of those changes and to creating conditions in which growth could resume.

Activities at UNCTAD VI

It was against this background that the theme of recovery and development came to the fore at UNCTAD VI. The analysis presented to the Conference by the Secretariat emphasised the need for a two-pronged attack on world economic problems. In the first place, the Secretariat proposed that immediate measures be taken within the present institutional framework to bring about a balanced revival of the world economy and restore the momentum of growth in both developed and developing countries. Secondly, the Secretariat saw the necessity for governments to initiate an examination of how international economic relations should be reshaped, with respect to structures, institutional and other fundamental aspects, in order to sustain rapid growth and development once it was restored. At UNCTAD VI development issues were thus seen as an integral part of a broader discussion of ways in which the world economy could be revitalised and the systems of money, trade and finance made to better support growth in developed and developing countries. The easy assumptions of an earlier period — that growth in developed countries could be counted on to provide a favourable backdrop to development and development policies; and that the systems of money, finance and trade could be counted on to meet the needs of expansion in the North — were thus set aside.

Given the urgency of improving the difficult economic situation in which many developing countries found themselves in mid-1982, the focus of attention naturally was on the immediate measures needed to restore growth in the world economy. Here, the Secretariat envisaged a set of measures falling under three headings. The first of these concerned the macroeconomic policies of the industrial countries. By mid-1982, these economies were characterised by considerable though somewhat uneven success in mastering inflation, and a substantial pool of idle resources. On both counts, therefore, it appeared that somewhat more expansionary fiscal and monetary policies were in order, although these would necessarily have to be used prudently to ensure that gains in the fight against inflation were not jeopardised.

The second broad area consisted of international measures to provide immediate financial relief for developing countries and stem the growing disorder in the international financial system. These measures were designed to harness existing institutions and facilities in the international financial sphere so as to

enhance significantly the flow of resources to developing countries. It was also envisaged that this monetary and financial package would be accompanied by immediate measures to strengthen earnings from the principal commodity exports of developing countries.

Thirdly, it was envisaged that there would be vigorous action on the part of developing countries with regard to their own domestic policies, designed to allow them to take full advantage of the improved external environment that would result from measures in the first two areas.

The approach to world recovery envisaged by the Secretariat at UNCTAD VI was thus designed to ensure that expansion should be reasonably balanced as regards its distribution among countries. In particular, the financial package was seen as a critical ingredient, which would allow developing countries to cope with debt servicing difficulties while sharing fully and promptly any improvement in the economic circumstances of their industrial trading partners. By the same token, the package would allow, to the greatest extent possible, economic policies and performance in developing countries to assist, rather than retard, recovery in the North. In brief, financial policies at UNCTAD VI were conceived in the context of global macroeconomics.

The discussions at UNCTAD VI itself fell considerably short of what was required to make significant progress in this area. There was, for the first time at an UNCTAD Conference, a detailed review of the world economic situation, which was contained in the 'statement' annexed to the report of the working group on agenda item 8. However, the language of this statement did not capture an emerging consensus on how economic problems were to be tackled; rather, it masked continued wide divergencies of view among countries as to how the international economy was operating and what needed to be done in order to improve matters.

Beyond UNCTAD VI

The failure of governments to respond positively to the challenge of UNCTAD VI has left developing countries in a desperate situation. With financing available only on a greatly reduced scale, the current account deficits of developing countries fell by half in 1982-83. For most countries, the predominant part of this contraction took the form of a compression of imports, and relatively little occurred through export expansion. Consequently, this process has necessitated, in most cases, a severe cutback in growth, and in some instances declines in output.

The diminution in current account deficits that takes place through such a process does not constitute balance of payments adjustment in any meaningful sense of the word. The object of adjustment is not to get rid of deficits by foregoing growth but rather to transform the structure and magnitude of imports and exports so that growth and a viable external payments position will become compatible. It is only in this sense that the term 'adjustment' has any real meaning.

This process of adjustment, designed to tackle the underlying structural character of the current payments problems of developing countries, requires substantial amounts of new investment — investment to expand production of exportables and investment to expand production of import substitutes, particularly in such areas as food and energy. Although complete and systematic information is not available at the time of writing, investment appears to have been one of the major casualties of the process of contraction that characterised developing countries in 1982-83.

Stagnant or falling levels of investment reflect deficient aggregate demand, both at home and abroad, and the fact that the resources necessary to finance investment programmes are not forthcoming. In the past, investment has been financed from two sources: domestic savings and net capital inflows from abroad. At the present moment, however, both sources of financing are under intense downward pressure. Although domestic savings efforts improved in a number of developing countries during the 1970s, the savings effort must now go forward against the background of falling *per capita* output and lowered standards of living in a large part of the developing world. Under these circumstances, further improvements in savings performance cannot reasonably be expected and, indeed, some weakening in savings performance appears to be indicated. For a number of countries, however, an even more worrying aspect is the radically changed role of external capital flows. In the past, positive net transfers of resources to developing countries permitted investment to take place at a level higher than would have been allowed by the domestic savings effort alone. Now, however, external financial transactions are giving rise to a negative net transfer, ie an excess of interest and debt repayments over current loan receipts, for a number of developing countries. Indeed, the negative net transfer of resources for Latin America as a whole is believed to be of the order of $15-20 bn in 1983. Thus, instead of augmenting the investible resources available through domestic savings, the international financial system is itself absorbing a part of that savings effort, so that domestic investment must now be constrained to levels that are lower than those that would be

permitted by domestic savings alone. The retrenchment imposed on developing countries in the present situation and the behaviour of international financial flows thus combine to hold back investment, thereby impeding the process through which genuine balance of payments adjustment must occur. Yet, if it does not occur, or occurs only every slowly, the only means available to developing countries to control the magnitude of the external deficit will be to continue to suppress growth below levels warranted by their growth potential and below levels necessary for their future development and the well-being of their peoples.

The recovery that began in North America in 1983 and that is spreading to Europe and Japan in 1984 is expected to have a favourable impact on developing countries. Given the great damage which has been done to the external financial position of many developing countries, there are a number of reasons for believing that the process through which growth is transmitted from developed to developing countries will be less robust than historical experience would suggest.

First, the growth of protectionist measures in the major markets for developing country exports means that increased output and demand in industrial countries would have a smaller effect on imports from developing countries than previously. Second, private markets are currently providing financing to some developing countries that exceeds the amounts that they would provide on a purely voluntary basis. If net bank lending to developing countries continues to move downward, any increase in export earnings would need to be used — at least in part — to close current account deficits further, rather than to finance the imports required for growth. Third, official reserves have been reduced to extremely low levels. Increases in export earnings may therefore also have to be devoted to building up reserves, rather than to financing the imports required for growth. Fourth, payments arrears by developing countries on both commercial and capital transactions have expanded rapidly in the past two years. The elimination of payments arrears always takes high priority in discussions between creditors and debtors. It can therefore be assumed that any substantial advance in export earnings of the debtor countries concerned would need to be allocated to reducing arrears, thereby lowering the amounts available to finance the imports required for higher growth. Fifth, the renegotiation of debt in recent years has, in many cases, left a profile of debt-service payments that bulges significantly in the coming years, as grace periods on past reschedulings come to an end. If debt payments are not to absorb a high proportion of any increase in export earnings, creditors must be prepared to continue the process of providing debt relief even after the export prospects and earnings of the debtor countries have shown improvement. Sixth, to the extent that expansion in North America produces an upward movement of interest rates — and there is evidence of this in early 1984 — higher interest payments by developing countries will tend to offset higher export earnings.

This is not to suggest that recovery in the developed world will have no impact on developing countries. Indeed, in a number of Asian developing countries that have succeeded in avoiding debt servicing problems, the improved world economic climate is being translated into higher growth. But dependence solely on a resumption of growth in developed countries to deal with the problems of developing countries with overt and acute debt servicing problems means, at the very best, that these countries will be condemned in the months to come to a painful period of relative economic stagnation.

The agenda for the international discussion of development issues during the coming months must thus remain largely unchanged from that spelt out for UNCTAD VI. The most important immediate objective is to retore growth momentum in the developing world, particularly in Africa and Latin America. As before, this is a question which must be addressed in the context of global macroeconomics. The question of policies in the developed world remains central to development perspectives. It is essential that the current upturn be sustained and that it become characterised by a lowering of interest rates. Means need to be found for repairing the very substantial damage that has been done to the external financial situation of the developing countries by the experience of the past several years, and for fostering an expansion of financial flows to them. The question of domestic policies in developing countries also needs systematic attention in the period ahead: under the present circumstances, the cost of policy shortfalls can be unusually high.

Attention also needs to be given, however, to that part of the agenda for UNCTAD VI that did not receive detailed scrutiny at the Conference. The question of reform of the systems of international trade, money and finance needs to figure prominently in international discussions in the months ahead. Such a discussion will be particularly difficult: there is little agreement, particularly among the major economic powers, as to how the international systems are presently functioning, how domestic policies are influenced by and react upon the international systems, and the desirable direction of change. Nonetheless, there is a growing perception that improvements in the functioning of these systems hold the key to better performance of national economies, both developed and developing.