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FINANCING NEEDS  
OF DEVELOPING COUNTRIES:  
PROPOSALS FOR INTERNATIONAL ACTION

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INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS

PRINCETON UNIVERSITY

Princeton, New Jersey

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# Financing Needs of Developing Countries: Proposals for International Action\*

The dramatic changes in commodity prices, particularly of oil and food, during the past two years pose unprecedented problems of international adjustment. Many have argued that the magnitude of the payments problems is such that the international trade and financial system will collapse, with untold repercussions for all. The main thesis of this paper is that, while there are many grave dangers ahead, there is a good chance that the world will be able to muddle through the crisis but that, in doing so, the weaker constituents of the international community, the developing countries, are likely to be hurt disproportionately unless specific measures are taken on their behalf.

The recent changes in relative commodity prices can affect real income and employment through two mechanisms: (1) They involve drastic shifts in the terms of trade, with attendant gains or losses in real income. (2) They necessitate huge changes in the patterns of international payments between oil exporters and the rest of the world. These changes should not be significantly moderated through exchange-rate adjustments, if only because such adjustments are all too likely to be of the beggar-thy-neighbor type, leaving oil importers as a group in an unchanged or worse payments position vis-à-vis oil exporters. Thus, unless countries in deficit can obtain financing to accommodate the payments they must make in the short and medium term, they may be forced to adjust by means of domestic policies that are likely to result in a reduction of real income and employment.

The purpose of this paper is to address the second problem: whether and how capital flows can be redirected to enable countries, especially developing ones, to finance the projected imbalances on current account attendant upon recent price changes. The focus is the medium term, three to five years. I assume that the problem will not disappear during this period through a restoration of pre-1973 price relationships. Oil prices will not revert to pre-1973 levels, and inflationary tendencies in the developed world will erode but not fully offset the higher oil price for developed countries, while exacerbating the problems of some developing

\* I wish to thank Robert Muscat of the Agency for International Development for his helpful comments on an earlier draft of this paper and Harriet Hentges for assisting in the preparation of statistical material.

ones. Longer-term analysis would be highly speculative, because potential increases in supplies of oil or energy from alternative sources and increases in food production will have important but hard-to-evaluate effects on energy and food prices.

My analysis will stress the different problems faced by various groups of developing countries, since the ability to accommodate huge payments imbalances without resorting to policies that would result in reductions in real income and employment varies significantly between country groups. I also hope to reach some conclusions about the kinds of additional instruments that are required to assist the international adjustment process in general and the developing countries in particular.

### **Relative Price Changes and Shifts in Current-Account Balances**

Strong inflationary pressures have afflicted the world economy since 1972. The inflationary spiral is not something that developed overnight. It evolved over time. But it has been marked by some spectacular increases in the prices of individual commodities, of which oil is the most important only in terms of the aggregate payments shifts it has caused. Prices of food and manufactures have also increased and, for some countries, may have been more important than the price of oil. Relative to a base of 100 in 1967-1969, the price of oil in current U.S. dollars stood at 751 in 1974, compared with an index of 315 for food, 193 for nonfood agricultural commodities, metals, and minerals, and 182 for manufactured goods. Price projections for 1975 show declines in the prices of metals, minerals, and nonfood agricultural products; relatively constant or slightly decreasing food prices (e.g., cereals); and continued increases in the prices of manufactures. Deep recession in many developed countries is exerting a significant downward pressure on many developing countries' primary exports. The situation in oil continues to be fraught with uncertainty, but relatively constant nominal prices may well be the best bet at this time.

The implications of recent price increases for the current-account balances of various countries will be reviewed by reference to three major groups: developed, developing, and oil exporters. Further subgroups will be identified later on, in the discussion of the need for capital flows to developing countries.

#### *Developed Countries*

The International Monetary Fund estimates that the current accounts of developed countries moved from a surplus of \$4.8 billion in 1973 to a deficit of \$41.6 billion in 1974, for a net deterioration of \$46.4 billion. For

1975, IMF projections show that developed countries will improve their current-account balances by approximately \$7 billion, running a deficit of approximately \$34.8 billion. Over the two-year period 1973-75, the net deterioration in the current-account balance is estimated at \$39.4 billion. This is equivalent to 29 per cent of the total reserves of these countries in the third quarter of 1974.

It is of considerable importance that, over the same two-year period, the deterioration on current account attributable to oil is \$53.5 billion for the developed countries as a group. Thus, in just two years, the developed countries are expected to improve their current-account position on items other than oil by \$14 billion. This improvement has to occur primarily at the expense of the developing countries.

### *Developing Countries*

The current-account deficit of developing countries is expected to deteriorate from \$9.6 billion in 1973 to \$23.7 billion in 1974 and \$30.4 billion in 1975, or a total deterioration of approximately \$20.8 billion between 1973 and 1975. While this is smaller in absolute terms than for developed countries, it represents 96 per cent of the third-quarter 1974 reserves for these countries. The deterioration is only in part (\$6.3 billion) attributable to the increase in oil prices. The rest (\$14 billion) is due to changes in other commodity trade. Despite increases in the prices of some developing countries' exports, especially in Latin America, the current-account balances of these countries have been adversely affected by overall price changes in commodities other than oil, especially food, fertilizer, and manufactures, combined with price declines in 1975 of major raw-material exports. In some instances, increases in the prices of manufactures, though not large in comparison to the increase in the price of oil, may have a serious effect, because a large portion of the developing countries' imports is accounted for by such goods, generally from developed countries.

### *Oil Exporters*

The broad facts about the oil exporters are well known. In 1974, the major oil exporters (Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Saudi Arabia, Venezuela) are estimated to have run surpluses on current account in the neighborhood of \$72 billion, or 185 per cent of their reserves at the third quarter of 1974. In 1975, the oil exporters' surpluses on current account are predicted to be of the order of \$66 billion, the decline reflecting primarily increased imports of goods and services.

There is no indication at present that this pattern of payments will

drastically change in the immediate future. Thus, current-account surpluses for oil exporters and corresponding deficits for the rest of the world can be projected beyond 1975, until alternative sources of energy flow to the market. While the rate of inflation in the rest of the world, combined with the development of alternative energy or oil sources, may well diminish the surpluses toward the end of the decade, it is reasonable to expect them to persist on a large scale in the next two to three years.

### *Implications for Different Country Groupings*

This situation poses different types of problems for each of the three country groups identified above:

1. Developed countries, normally capital exporters as a group, find themselves in need of capital inflows on a large scale.

2. Most developing countries, which were already facing considerable difficulties in obtaining the capital transfers needed for their development, now are faced with large additional needs for capital inflows.

3. Oil exporters, whose economies share most of the characteristics of underdevelopment, are faced with a dual problem, (a) how to assure reasonable rates of return on their earnings from oil and (b) how to utilize these earnings to develop their economies.

The problems of the developed countries and the oil exporters appear manageable in the aggregate. Oil exporters are tied inextricably to the international financial centers and, by and large, have few options other than to invest their earnings in financial or real assets, primarily in the developed world. This is likely to result in an aggregate capital inflow from the oil exporters to the developed countries roughly comparable to the increment in the latter's payments for oil.

The problems of the developed countries are of rather a different nature: (a) While capital inflows to these countries may be assured in the aggregate, the question is whether financial markets can channel the flows to the various countries in proportion to their varying needs. (b) At present, there appears to be substantial divergence in the maturity preferences of lenders and borrowers, with the former seeking short-term instruments and the latter long-term.

Oil exporters are also a differentiated group: Some, like Iran and Venezuela, are well along in the development process and can use larger oil revenues for internal development; they will accumulate large surpluses only in the short term. Others are heavily populated countries with low per capita income and established development programs, for example, Indonesia and Nigeria. Their longer-run absorptive capacity is quite large, but they will probably accumulate large external financial assets

even over the medium term. Finally, there are underdeveloped areas with small populations, like Libya, Saudi Arabia, and some of the smaller Arab states, where large additional developmental imports will still leave them with substantial assets to invest abroad in the near- and longer-term future.

The developing countries have less manageable problems. These countries can be divided into two broad categories. In the first are those in the higher-per-capita-income range, for example, Argentina, Brazil, Korea, and the Philippines, which have been able to meet relatively large portions of their capital-inflow requirements by access to foreign private investment and borrowing in the international capital market on nonconcessional terms. In the second are those with per capita incomes below about \$300, whose capital inflows have been predominantly official and on concessional terms.

The problem faced by the first group is how to assure continued and, in absolute terms, higher borrowings from their main source of nonconcessional funds in recent years, the Eurocurrency bank-loan market. In a way, their problems are similar to those of the developed countries, but their creditworthiness is viewed by the private markets as inferior. And, in a period when banking liabilities are increasing rapidly relative to capital base, bankers may be less willing to lend increased amounts to relatively inferior customers.

Few options are open to the second group of developing countries, which include the so-called "Most Seriously Affected" by the energy crisis (MSAs). On the terms prevailing in private markets, their capacity to borrow additional funds is limited. Even if they were able to borrow, it is questionable whether they should, given their limited capacity to repay and their existing debt burden. At the same time, they cannot expect substantial increases in official flows from the developed countries. Public attitudes in many developed countries, including the United States, seem generally hostile to increased appropriations for concessional transfers to developing countries to enable them to meet increased oil bills. And with good reason: Why ask the developed-country taxpayer, who has already been hurt by OPEC policies, to pay also for the impact of those policies on the developing countries? In some countries, however, as noted above, the problem resulting from increased food and fertilizer prices is at least as important as the one generated by higher oil prices.

In summary, the financial problems faced by the MSAs result both from increased prices of oil, food, and other commodities and from a limited capacity to address this problem through use of their own reserves or increased private borrowing. Their need is for increased concessional

assistance, at a time when the major countries, the sources of concessional assistance, are themselves in financial difficulties and when the climate for foreign assistance has been deteriorating.

## **Muddling Through**

### *The Problem Will Go Away or Disaster Will Strike*

Soon after the posted oil prices were raised by OPEC in January 1974, the broad dimensions of the financial problem faced by the world became apparent. The reactions were predictable: Some argued that the problem would go away because such oil prices would be "untenable." Presumably, the prices would be untenable because either (1) OPEC members were "reasonable" governments and would realize that it was not in their interest to cause trouble to the whole world or (2) the prices would be forced down through a combination of efforts involving various degrees of coercion and conservation. The United States for a time argued that no action should be taken to assist countries, especially developing ones, likely to be in serious trouble because such action would tend to validate the oil-price increases.

Others, and their voices are still heard among us, predicted that the international monetary system would collapse and we would go through a period of unprecedented worldwide economic depression. Among the disasters that can still befall us, the following have been stressed:

1. The volume of capital flows needed to accommodate payments is so great that the international capital market and especially the Eurocurrency market will not be able to recycle oil exporters' funds to countries needing capital inflows.

2. The divergence between the maturity preferences of lenders and borrowers will make it impossible for the Eurocurrency market to play the important role it has to play as a conduit of capital flows.

3. As a result, developed countries facing payments difficulties will resort to a series of trade restrictions, deflation, or competitive devaluations, resulting in diminished trade, income, and employment.

4. Developing countries will be squeezed out of the private capital markets and faced with further problems as a result of reduced exports caused by trade restrictions and/or slower growth in developed countries.

The problem has not gone away, and we have not had worldwide disaster. Half-hearted confrontation with OPEC on price soon gave way to cooperative arrangements—even by the United States, which had taken the most rigid stance originally. Although demand growth slackened off and there has been downward pressure on the oil price, the price has

not come down; predictably, OPEC has cut back production to maintain it. On the other hand, disaster was averted not because we have been able to design and implement a comprehensive mechanism to deal with the problem, but rather because, "as usual," we have muddled through. While there are grave dangers ahead and possibilities of disaster lurk behind many bends the system will have to take in the next year or two, past experience with monetary reform suggests that we will continue to be able to manage through incremental changes and marginal shifts rather than through broad-scale reform or global responses to global problems. Yet there are two problems with this muddle-through approach to international finance:

1. It is not intellectually satisfying. It would be far more satisfying, for example, to have a worldwide organization to channel OPEC funds to other countries with appropriate guaranties, or to establish under UN auspices a general fund to help all developing countries in trouble.

2. More bothersome is the fact that, when muddling through, the weakest constituents of the international community, the developing countries, are less likely to manage well and more likely to suffer in the wake of international malaise. This is due to the limited adaptability and flexibility of their economies as well as to their poorer management of resources.

The remainder of this essay is devoted to a discussion of how we have muddled through so far and what we can do to continue to muddle through somewhat more effectively and equitably.

### *How Has It Worked So Far?*

*The Eurocurrency market.* The Eurocurrency market has shown vast potential for acting as an intermediary for capital flows. In 1974, publicly announced borrowing in this market amounted to \$27.3 billion compared with \$22 billion for 1973. This total does not reflect placements not publicly announced, which may account for 30 to 40 per cent more.

In the absence of this expansion, the financing situation for many developed and developing countries would have been vastly more serious. Developed countries have accounted for \$16.6 billion or 61 per cent of this borrowing, developing countries for \$8.4 billion or 31 per cent, and oil exporters, international organizations, or non-IBRD members for the remainder. The United Kingdom, France, and Italy together accounted for \$11.1 billion of the credits, mostly in the first half.

The expansion of the market slowed down considerably over the second half of 1974 compared with the pace of the first half. The total for the second half was only \$8.2 billion as against \$19.1 billion for the first half.

Furthermore, developing countries' borrowing dropped 48 per cent from the first half. The reasons for the decrease were concern over the short-term nature of OPEC deposits and the future availability of these deposits, the apparent desire of some depositors to deal only with large banks, and decreased confidence in the system, as a result of a small number of widely publicized bank failures.

Another disquieting sign was the decline in long-term Eurocurrency borrowing. Eurobond issues in the first three quarters of 1974 were about \$2 billion, compared with \$4.6 billion for 1973. There were no compensating increases in foreign borrowing from any of the other long-term capital markets, despite the fact that the United States eliminated the interest-equalization tax. There was a slight resurgence in overall borrowing during the third quarter, primarily resulting from larger IBRD and Canadian borrowing. Only two developing countries, the Philippines (\$17 million) and Brazil (\$25 million) borrowed in the international market during 1974. Paraguay and Nicaragua made small placements in the United States, Korea \$19 million with the United Arab Emirates, while Israel borrowed heavily by both public and private placements.

*Developed-country cooperation.* Developed countries have made substantial progress in cooperation. Early in 1974, a \$2 billion German loan and similarly large European Community credits to Italy were important elements of initial cooperation in the financial area. They were followed by an agreement in January 1975 to establish a solidarity fund within the OECD of \$25 billion for two years to provide developed countries with financial assistance as a last resort. Under this arrangement, the developed countries in the OECD are apportioned quotas that determine their borrowing rights, obligations, and voting power. Participants facing serious balance-of-payments difficulties can seek loans, which will be raised through borrowing in the private markets, credit arrangements through central banks, or direct contributions. Loans up to the quota limit require the approval of members holding two-thirds of the voting power and must be guaranteed by all in proportion to their quotas. For loans larger than quota, stiffer voting requirements are necessary.

This agreement, at the very least, formalizes what may have occurred *de facto* through mutual support of Western central banks when a major developed country found itself in difficulty. Such cooperation existed before but became critical in current circumstances in light of the large payments deficits incurred. It represents the culmination of the American effort to organize a "safety net" for the OECD countries that is independent of cooperation by OPEC members.

On the trade side, little progress was made in the Multilateral Trade

Negotiations. The effort was delayed in large part by U.S. congressional inaction on the trade bill. Now that the bill has passed, the stage is set for future liberalization. Another reassuring sign in this area is that, despite heavy pressure, only limited instances of resurgent protectionism have occurred.

*Oil exporters.* The understandably cautious attitude of oil exporters, both with respect to the nature of the instruments in which they invest and the maturities at which they lend, has been the basis of considerable uncertainty so far. A large proportion of Arab official reserves is kept in very-short-term deposits. OPEC lenders have been concerned both about the political vulnerability and possible losses of captive funds in European and U.S. banks and about assuring themselves of a significant return. As time passes, however, significant shifts of attitude have been occurring in at least some countries, which are venturing into longer-term direct investment or lending. Typical among these investments are the Iranian purchase of a 25 per cent interest in Krupp and the complex arrangements in support of Pan Am, as well as the Kuwaiti bid of \$250 million to buy control of one of the United Kingdom's major real estate firms, St. Martin's Property Corporation. Kuwait is reported to seek a diversified portfolio with 20 per cent of its investment in real estate. Iran, Iraq, Venezuela, and others have extended longer-term official credits to developed and developing countries alike. Yet the actual disbursement of funds has so far fallen far short of commitments (see below, page 10).

*Developing countries.* The international mechanism has probably worked least well in the case of developing countries. The expansion of developing-country borrowing in the Eurocurrency market in 1974 barely sufficed to meet the additional needs of the higher-income developing countries. These are the countries which are also best able to take advantage of the major new international instrument established to assist countries in difficulty as a result of the oil-price increase—the IMF Oil Facility. Through the end of 1974, the Facility had lent \$2.0 of the approximately \$3.5 billion in first-year pledges by oil producers. Of this total, 56 per cent was borrowed by developed countries, with the lion's share going to Italy. Of the 44 per cent going to developing countries, 32 per cent went to the MSAs, with both India and Pakistan borrowing heavily. The extension of the Facility for another year and its increase to about \$6.5 billion implies that additional financing will be available to both developed and developing countries from this source. Even at present rates of inflation, however, the terms of the Facility—averaging 7 per cent for seven years—are more suitable to the higher-income developing countries than to the MSAs. The Interim Committee of the IMF

has decided to establish a separate account for the MSAs, using about 25 per cent of the \$6.5 billion available to the IMF Facility and at the same time to seek alternatives whereby the interest cost could be partly subsidized. Yet at present there are few indications that a subsidy arrangement can be implemented.

Despite the extension of the Oil Facility, the outlook for the MSAs is bleak. According to the most recent AID estimates, this group of thirty-two countries ran a current-account deficit of \$5.4 billion during 1974, financed in part by additional borrowing from traditional and new international sources and the IMF, in part by borrowing from OPEC members. A good deal of the requisite adjustment had to be made through reductions in imports and real income. In 1974, the growth of GNP in these countries fell to an average of 2.6 per cent per annum compared to 3.7 per cent in 1973. In per capita terms, the growth rate was probably zero in 1974.

For 1975, AID estimates the current-account deficit of this group of thirty-two countries at \$6.0 billion. The expected capital inflow is approximately \$4.5 billion, leaving a gap of about \$1.5 billion.

When oil prices were first raised, the immediate reaction among most donors was to suggest that the additional burden placed on the developing countries should be borne by the oil exporters. The reaction of the oil exporters has been mixed: To date there have been at least forty-five new special funds, multilateral arrangements, and bilateral deals involving oil exporters and developing countries. Few of these, however, have resulted in significant disbursements of funds to the developing countries that need them most. The OECD has estimated that OPEC members have made \$7.2 billion in bilateral commitments alone. Of this sum, only \$2.0 billion has been disbursed, and fully \$1.2 billion went to Egypt, Syria, and Jordan, with an additional \$355 million to Pakistan.

The means of recycling the greatest amount to those in greatest need may be contained in the suggestions already set forth. These include instruments for concessional lending, short-term financing, long-term development projects, and opportunities for reasonable returns on investment. It will be necessary, however, to coordinate the use of these many instruments and relate them to the needs of each of the nations affected by the shift in commodity prices.

The overall UN effort to mobilize assistance through the Emergency Fund for the MSAs yielded minuscule results. The European Community, the largest contributor, committed \$500 million. Of these funds, \$250 million have already been disbursed, and disbursement of the rest is ex-

pected by the end of fiscal 1975, but its additionality to previous commitments is questionable. The U.S. response has been mainly through increases in food aid. The level of commitments under the Food for Peace program in 1975 is estimated to be \$1.6 billion—reflecting an increase of approximately 65 per cent in both volume and value over fiscal 1974. The problem with the U.S. response is that it has been slow and hesitant because of budgetary concerns, as well as concern about the effect on the U.S. domestic price level of increased food shipments. The final commitment level was not agreed upon until nine months into the fiscal year, making it unlikely that the full level will be used. Shipments are likely to fall considerably short of what has been budgeted for this year, and, because of the rules governing the Food for Peace program, anything left over will be applied to next year's budget.

### **General Measures to Reshape the Monetary System**

Helping the developing countries through the current problems can be accomplished in two basic ways, by improving the overall system so that every country or group of countries benefits, and by designing specific programs oriented directly toward the developing countries.

About two and a half years ago, the world embarked on a major effort to restructure the monetary system under the auspices of the Committee of Twenty (C-20). The developing countries supported the effort mainly because they hoped that through the reform they could increase, either directly or indirectly, the amount of Special Drawing Rights (SDRs) allocated to them.

In time the effort fizzled, as the pressures and uncertainties of the price increases of oil and other commodities either overshadowed or made temporarily irrelevant some of the issues of reform. The agreements reached on the valuation of the SDR, its interest rate, and the guidelines for floating have been useful but beg the major questions over which the C-20 labored, such as the operation of the adjustment process, convertibility of the dollar balances, the valuation of reserve assets, and the SDR link. The U.S. dissatisfaction over the asymmetry in the adjustment process became somewhat academic when it became apparent that the United States may fare relatively better than many other developed countries as a result of the commodity price changes. Similarly, the dollar overhang has become an important source of funds to be tapped by many countries having to finance oil imports. Limited progress was made mostly in response to the necessities of the situation rather than as a part of a grand design to restructure the system or to address the financial

implications of the commodity price increases. It was clear, for example, that countries could not manage with a strict fixed-rate system, nor were they willing, as Jeremy Morse said in the September 1974 issue of *Finance and Development*, "except for relatively brief periods when the hurricane rages or the dikes break to let their exchange rates go where they will." Similarly, the Europeans' concern about the usability of their gold to finance prospective deficits was partly allayed by the agreement reached by the Group of Ten to allow use of gold reserves as collateral for borrowing and to value them for this purpose at market-related prices.

The developing countries did not get the link in any form. The raising of the interest rate on SDRs probably hurts them more than others, while increased flexibility in exchange rates is a mixed blessing. On the one hand, it promotes a more positive attitude within developing countries toward timely exchange-rate adjustment, thus increasing the likelihood that their management of exchange rates will improve. On the other hand, flexibility in the exchange rates of developed countries probably makes it more difficult for developing countries to manage their exchange rate and international reserves.

The recent agreements in the Interim Committee were useful overall, but do not hold great promise for the developing countries specifically. For all practical purposes, the Committee shelved the SDR link. Its main contribution to the poorest countries was to recommend that a portion of the Oil Facility be set aside and used for the MSAs at subsidized rates, but the mechanism for the subsidy is still uncertain. The Interim Committee also agreed to an increase in IMF quotas, which would obviously benefit the developing countries, and in this respect the developing countries won another small victory: The Committee agreed that their total share in IMF quotas *would not decline*, as would have happened if the standard rules on which quotas are determined had been applied.

The developing countries will of course benefit by developed-country cooperation, which allows the latter to operate in an economic environment free of trade controls and beggar-thy-neighbor policies. The establishment of the safety net and the Oil Facility may well make it possible for the developed countries to do this until the relative price of oil declines after a few years. Continued cooperation among the developed countries is, of course, necessary to assure that, in their efforts to curb inflation, they do not deepen the already deep worldwide recession to the detriment of all, especially the developing countries. A decline in the oil price in response to joint developed countries' pressures would be welcome in this and every respect, but, despite current U.S. efforts, I doubt

that it will occur to an extent that will mitigate significantly the problems discussed here.

The international picture should improve further as OPEC members become more familiar with long-term investment opportunities and feel less insecure about acquiring instruments with longer-term payoffs. A long-term agreement with oil producers that involves investment on their part in developed countries could build up confidence and integrate the oil exporters into the international financial community. More voice for the oil exporters in both the IMF and other international bodies may also play a role in this area.

Technical improvements in the management of developed countries' financial markets can also be of considerable importance to the working of the system and may benefit the developing countries as well. One of the dangers noted earlier is that the commercial banking system is faced with a very large increase in short-term liabilities relative to its capital base. Rapid shifts of funds between banks could cause the collapse of important banking institutions. Commercial banks can, of course, refuse deposits or accept them only at reduced interest rates, if the terms on which deposits are offered are viewed as inappropriate. This could push funds elsewhere, essentially into longer-term instruments. Central banks can assist this process by designing whatever additional financial instruments are desirable to help OPEC members with surplus funds to move from the commercial banking system into longer-term but liquid financial assets with guaranteed returns. Instruments such as U.S. Treasury securities with twelve- to eighteen-month maturities and guaranteed interest rates could prove attractive to OPEC members wanting assets that combine liquidity with secure and competitive returns.

Mention should also be made of the proposal to increase the official price of gold so as to add to the ability of both developed and developing countries to finance payments deficits. However, I am skeptical about the usefulness of the measure. An increase in the official price of gold will implicitly weaken the future role of the SDR—something I view as inherently undesirable. The Interim Committee has in fact recommended that the official price of gold be abolished, something that may well happen later in the year. At the moment, the *de facto* valuation of gold reserves can fluctuate, but it is many times higher than the official price. But an increase in the official price would give the richer developed countries an increase in liquidity to meet oil deficits while helping poorer developing countries relatively little. Their gold/reserve ratio is lower. Yet the poorer countries face similar deficits and have less borrowing pow-

er. To redress this obvious inequity, one could visualize a new issue of SDRs on a formula that helps the developing countries. But such an increase in world liquidity would not be an optimal solution during a period of strong worldwide inflationary pressures. It might be better, then, to work on ways to distribute existing liquidity more effectively rather than try to augment it.

### **New Proposals for Developing Countries**

At least three new proposals to help the developing countries are currently being discussed internationally: (a) the establishment of a \$1.5 billion Trust Fund for the MSAs, (b) the establishment of a "Third Window" at the IBRD, (c) the subsidization of a portion of the Oil Facility for the MSAs. All three have similar features, suffer from similar drawbacks, and are likely to encounter similar difficulties.

The main objective of the proposals is to reduce the interest cost of borrowing for the MSAs and other developing countries. The Oil Facility and the Trust Fund would operate within the IMF by borrowing from OPEC members at near commercial rates and adding some grant funds to reduce interest costs to somewhere between IDA terms and normal IMF or IBRD rates. The World Bank Third Window would borrow from various sources including OPEC and also reduce costs to MSAs by adding grant funds.

The key problem in all cases is where to obtain the grant funds needed for the subsidy. Assuming the OPEC members will contribute some grant funds but *not* the entire amounts needed, the alternatives are either through budgetary appropriations or through some new type of monetary instrument. It is becoming more and more difficult to increase budgetary appropriations for foreign assistance, especially in the United States. It is partly for this reason that the U.S. proposal for a Trust Fund calls for the necessary grant contributions to be financed through gold sales. The Interim Committee has agreed that in the future IMF quotas need not be paid partly in gold. Sales in the open market of the gold thus released could provide financing for the Trust Fund.

The notion of gold sales, either directly by the IMF or—slightly more acceptable politically—by the individual countries, is an attractive idea, because it has all the attributes of a "manna from heaven" instrument. The notion can be sold to legislators in the United States and around the world even though it gives fits to finance ministers, especially in Europe. It would also appear to be an equitable way of spreading the benefits of the increased valuation of gold reserves while in part deemphasizing gold

as a reserve instrument. The problem with the notion is that the international market for gold is quite thin. Sales from official stocks have to be undertaken with great caution so as not to drive the price of gold so far down that the value of reserves of all countries is reduced in the process. The problem is further complicated by the fact that there is great uncertainty about the price elasticity of the demand for gold in the international market. That market is all too often affected by a variety of speculative factors that are difficult to predict.

On balance, I would argue, the idea is not too bad and should perhaps be tried, if only because the alternatives of raising funds for subsidies may be too difficult. It is questionable, however, whether an agreement on gold sales can be reached. It is also interesting that the developing countries gave a cool reception to the U.S. proposal for gold sales. This was apparently because they viewed it as a way to sidetrack the SDR link and because some of their finance ministers were concerned about the consequences of gold sales for the value of their gold reserves.

Both the Trust Fund and the Oil Facility are viewed as one-year stop-gap measures, while the Third Window is proposed as a permanent instrument. The temporary nature of the first two plans is predicated on the assumption that the oil price may fall and they may not be needed. This is a doubtful assumption that adds to the uncertainties faced by the intended beneficiaries. Unable to know how much financing will be available and on what terms until well into any given year, developing countries by necessity tend to adopt a conservative approach to financing, ultimately leading to lower growth rates for both imports and GNP. Evidence of this can be found in their performance in 1974, which is likely to be repeated in 1975.

The Third Window idea has been discussed informally many times before. The main problem of implementation it faces—similar to that of the other two proposals if either were to become a permanent instrument—is that the amount of grant financing required to bring down the cost of borrowing is quite substantial. Given the tight budgetary situations prevailing in many important developed countries and especially the United States, there is no assurance that establishment of such a facility will not reduce the appropriations for the most concessionary multilateral financing of IDA or the soft windows of regional development banks. Finally, in the present context, the Third Window has the drawback that it is likely to be used in large part for project assistance, so that disbursements will occur more slowly than under the other two schemes currently being considered.

On balance, all three proposals face serious problems of implementa-

tion and some drawbacks. However, given the urgency of the needs of the developing countries, they should continue to be pursued; despite their drawbacks, even partial or temporary implementation of any one could provide benefits to the developing countries. In addition, I believe some other alternatives offering opportunities to assist developing countries should be explored. Two approaches are discussed below: for higher-income developing countries, mechanisms to increase access to private capital markets; for lower-income developing countries, alternatives to expand food aid.

### *Increased Access to Private Capital Markets*

In the period 1960-73, developing countries' foreign bond issues represented less than 5 per cent of total external sources of funds and were concentrated in a few countries, especially Mexico and Argentina. A slowly rising trend in 1972 and 1973 was followed by a precipitous decline in 1974.

At the same time, the Eurocurrency market, the most important single source of foreign private financing in the last few years, may not continue to expand at the rate that it has in the past, and there is evidence of significant slowdown in the last few months. While OPEC deposits may continue to flow into this market, the rate at which such deposits will be accepted will drop because the ratio of liabilities to capital in the commercial banking system has increased tremendously.

In a sluggishly growing market where developed countries are competing with developing countries for increased funds, the developing countries are likely to be partly squeezed out. Because of the refusal of the international commercial banking system to absorb petrodollars at the rate that it did in the earlier part of 1974, increasing amounts of OPEC funds may be shifted to the U.S. capital market. The latter is unlikely to channel funds to developing countries in amounts that the developing countries are accustomed to obtaining from the Eurodollar market; the orientation of the U.S. market is more toward U.S. domestic activities and borrowers than toward international operations.

Whatever happens to the U.S. or European commercial banking markets, it is probably preferable for developing countries to increase their borrowing through longer-term instruments such as those offered by the bond market in the United States and abroad. The costs in those markets may well be less than those obtained in the commercial banking market and could be reduced further.

To address the developing countries' need to obtain funds from the private capital market on softer terms than currently prevail in the Euro-

dollar market and to open up the opportunity for additional funding through entry into the long-term market, especially in the United States, the most appropriate instrument is the extension of guaranties to developing countries' bond issues in their respective capital markets. The guaranties could be extended by each OECD country with respect to issues in its own capital market. The only national markets of significance are in the United States and the United Kingdom, and to a smaller extent in Germany and France.

With respect to the international (Eurobond) market, a joint guaranty could be developed by the members of OECD, working through a financial institution such as the Bank for International Settlements. OPEC members could be invited to join the arrangement and themselves provide guaranties in the international market. This has already happened in the case of Kuwaiti guaranties of Sudanese borrowing in Eurodollars. OPEC guaranties could be an important feature insofar as they will address the potential criticism that OECD countries would in effect indirectly guaranty that OPEC members get paid back by developing countries. Short of an international joint guaranty, which may be difficult to negotiate, guaranties in the international market could be given by the individual developed country participating. For reasons discussed below, such a looser arrangement based on a less formal commitment by OECD or OPEC may well be more feasible.

In the U.S. market, the main impediments to borrowing by developing countries are of an institutional nature. They involve in part the requirements of the Securities and Exchange Commission (SEC) for registration and in larger part the reluctance of primary investors (largely life insurance companies and trusts) to purchase developing-country bonds.

Registration with the SEC is required for any bond issue that is to be held by more than 300 U.S. residents. Extensive information is required for the prospectus, including politically sensitive data. Another problem is that many developing countries lack technical knowledge pertaining to the details of placing an issue in the market. Even with fewer than 300 U.S. residents involved (so that SEC registration is not required), it is by no means easy to find enough investors to absorb such issues, owing to their lack of liquidity. The life insurance companies are reluctant to buy developing-country bonds because they do not regard any normal risk premium adequate to compensate them for holding an asset that can be traded only in a very thin market and for the risk that such assets will be given a relatively low evaluation by the Valuation Committee for the National Association of Insurance Commissioners in regard to their admitted asset value. In addition, they are unfamiliar with the

economies of most developing countries, and the standard bond-rating agencies (Moody's, Standard and Poor's) are not staffed to evaluate developing-country issues. Thus, in view of the time and effort required to make investment decisions and the contribution of assets purchased to admitted assets, there are strong incentives for the main primary investors to take the much easier and safer course of purchasing well-known U.S. securities instead of developing-country offerings.

The characteristics of the national markets in Europe vary considerably. The U.K. market has been used by developing countries in the past, especially by Commonwealth countries. However, U.K. balance-of-payments difficulties in recent periods have made it reluctant to allow significant developing-country borrowing, and the market has dried up. Placements in the German national market have also been insignificant, primarily because of the special nature of the German banking system and discouragement by the Bundesbank of such lending.

The requirements associated with SEC registration do not exist in the international market. Partly for this reason, developing-country borrowings in that market increased rapidly in the last three years. However, at present the Eurobond market has dried up, primarily because of the time preferences of depositors. In the absence of major changes in time preferences or structural shifts in payments that would move long-term funds away from the United States and toward the Eurobond market, it cannot be expected to return to its previous importance. In fact, as noted above, the opposite is likely to occur. In addition, the market is somewhat fragmented, a factor that may pose some difficulties if a large guaranty system is set up.

The provision of guaranties will make it possible for developing countries to obtain access to the U.S. capital market, by far the most important of all the national markets. A U.S.-guaranteed bond eliminates the requirements that the issue be subject to SEC disclosure requirements. In addition, it breaks down the main obstacles to entry that exist as a result of institutional indifference to developing-country bond issues. A U.S.-guaranteed developing-country bond could be an attractive instrument, comparable to other types of financial instruments in which institutional investors place their funds. The guaranty eliminates in large part the investor's concern about the creditworthiness of the borrower by interposing the U.S. government. Similar advantages are gained by developing countries with respect to entry in other national markets.

The problems in the international market are of a somewhat different nature. Here, access is less of a problem than lack of resources. Uncertainties about the international banking system have scared depositors

away from long-term instruments. Guaranties for developing countries' borrowing might induce some depositors to return to this market and enable banks to absorb developing countries' issues, since their investments would be secured by developed-country guaranties.

A guaranty system might operate in the following way. The developed country, upon receiving a request by a developing country, would investigate the latter's creditworthiness and extend to it such additional technical assistance as it needs to place the issue in any specific market. If a favorable decision is reached, a guaranty of the repayment of interest and principal would be extended. The amounts guaranteed to each developing country by each developed country would have to be considered in extending additional guaranties during each time period. Obviously, there would be some maximum consistent with the creditworthiness and prospects of different developing countries, but no arbitrary predetermined quotas are envisaged. On the other hand, some minimum size may be postulated for each bond issue guaranteed, especially in the U.S. market, for the purpose of supporting a secondary market in these issues.

Guaranties might require the creation by the guarantor's of contingency funds. Such contingency funds, which may not have to be larger than 5 per cent of the outstanding liabilities under the guaranty, are not strictly necessary for the operation of the guaranty system but could enhance its attractiveness in the eyes of the investing community.

There are various ways to finance a contingency fund, depending on the precise organizational structure built. One is to establish an international fund to which developed countries would contribute in proportion to the guaranties they will commit themselves to undertake. This device, though perhaps ideally preferable to others, poses some problems of implementation. The developed countries may find it difficult to make long-term commitments, since a great deal might depend on the balance-of-payments situation of each country, as well as on the future of various international markets that at present face many uncertainties. Thus an international joint guaranty mechanism might be quite difficult to negotiate. One could also argue that a joint mechanism may be only as good as the creditworthiness of the stronger guarantors. It is doubtful, for example, if Italian participation would at present add a great deal to a U.S. or German guaranty. Under present circumstances, a looser arrangement might be more feasible, under which OECD and OPEC members in relatively strong positions agree to furnish parallel guaranties in their own markets or international markets, at their option, with each deciding on the details of the guaranty mechanism and specific ways to finance a contingency fund. This would enable a country like the United Kingdom to

participate on a voluntary basis and as circumstances in the U.K. capital market or the international market develop.

From the standpoint of the developed countries, a guaranty proposal offers a number of attractive features:

1. Through the guaranty mechanism they would be able to mobilize substantial resources to the developing countries which they could not have mobilized through the ordinary mechanism of appropriated aid funds. Compared with the alternatives discussed earlier, a guaranty mechanism has a higher leverage ratio, with much less funding required for its operation, than interest-subsidy schemes like the World Bank Third Window proposal. In addition, the amount of money that would have to be appropriated to undertake a guaranty program would not have to be expended except in the unlikely circumstance of default and thus may be easier to obtain, at least in the U.S. context.

2. Often, in national and international aid programs, the alternative is either to extend assistance on highly concessional terms or not to extend assistance at all. If a guaranty system is established that supplies funds to higher-income developing countries, those concessional funds that are available can be channeled to lower-income developing countries.

3. The guaranty mechanism can be used to assist developing countries eventually to enter the long-term capital market on their own. The transition from borrowing with a guaranty to borrowing without a guaranty is a difficult one. It can be helped along by serializing developing-country issues so that investors are exposed to developing-country performance in servicing long-term debentures.

No precise limit can be established as to the magnitude of a guaranty program. However, a program that results in \$5 billion in total outstanding liabilities over a period of about five years (\$1 billion borrowing per annum) may not be unreasonable in terms of what the developing countries or capital markets can absorb. A program of this type would not compete with borrowing that developing countries undertake indirectly through the intermediation of the World Bank and other regional development banks. The amounts involved are small relative to the total size of funds seeking investment outlets. In light of developing-country needs over the next several years, it is likely that developing countries could use both an expanded IBRD and regional-development-bank loan program and increased loans guaranteed by developed countries. Some substitution would probably occur, not between guaranteed credits and credit obtained from international institutions, but between guaranteed credits and commercial-bank borrowing or export credits. But this would probably tend to improve the overall debt structure of developing coun-

tries, since guaranteed credits would have longer maturities and often lower interest rates.

It is important to stress one final point with respect to the operation of the guaranty. One of the basic attractions of Eurocurrency bank borrowing has been the fact that there are few strings attached to the credits, and credits have been easily arranged through normal commercial channels. For the guaranty proposal to work, it is important that guarantor governments minimize their interference. If they fall into the temptation to use the guaranty to exert leverage over developing-country policy, they are likely to make the guaranty proposal an unattractive alternative from the developing-country standpoint and defeat its usefulness as an instrument for recycling funds to the developing countries.

### *Means of Increasing Food Aid*

While improved access to capital markets might be an important new element in assisting higher-income developing countries, it will do very little for the poorest countries, for which the terms prevailing in capital markets, even with guaranties, are likely to be inappropriate. The poorest countries need large concessional assistance. One of the major components of such assistance should be an enlarged food assistance program. This was the subject of considerable debate and controversy at the recent World Food Conference.

The Conference assessment of the future food situation showed that, under current production trends, developing countries are expected to increase food production by approximately 2.6 per cent annually over the period 1971-85. At that rate, developing countries will be faced with increasing food deficits, since population growth and increased consumption of food per capita would offset the projected growth in food production. As a result, developing countries' food-import requirements are estimated to be some 40 million tons a year in the mid-1980s, or nearly twice the current level. These import requirements can be reduced only through intensive efforts to increase food production in the developing countries.

Developed countries can provide considerable assistance to developing countries striving to increase agricultural productivity. But even if substantial productivity increases occur, the need for increased concessional food assistance is likely to continue, especially in the short-to-medium term, because a good deal of the projected food deficit is likely to occur in countries unable to finance food imports through their own resources and because substantial productivity changes in agriculture take time. Of course, it is critically important that concessional food

aid be extended under conditions that would not reduce incentives to domestic agricultural production.

In recognition of the need for assistance, the Food Conference called for an annual commitment of concessional aid of 10 million metric tons of food grains, or more than double current levels. Little has been done since the Conference to develop international instruments to finance the additional food-aid flows. A November meeting of major donors (under the auspices of the Food Finance Subcommittee set up by the Food Conference) to discuss immediate needs concluded that there will be a food-import gap of 7.5 million metric tons for the period November 1974-June 1975. While the United States has expanded its food-aid program since last year, this alone will not be sufficient and alternative approaches should be urgently explored.

*U.S. food aid, OPEC, and SDRs.* The United States plays a crucial role in terms of both food production and food aid, especially in grains. At present, the U.S. government's objective appears to be to design an agricultural policy that will provide farmers with remunerative prices while avoiding overproduction and U.S. government acquisition of surplus stocks. The Secretary of State, in his Rome speech, rightly emphasized the need for both the developing countries and food exporters such as the United States to increase production of agricultural foodstuffs if the food problem is going to be addressed. Expansion of production in developed countries to the degree required to meet developing countries' import needs will result in oversupply unless the developing countries have the financing means to purchase such production and build up their depleted reserves. It is of course possible to expand production from the levels of the last two years and still maintain remunerative prices to developed-country farmers without accumulating excess stocks—but also without meeting developing-country import requirements. But under such circumstances the food problem will not be truly addressed. However, it is unlikely that the U.S. Food for Peace and other food-aid programs will be expanded in the near future to provide for a substantial increase in food shipments to the poorest developing countries.

Traditional support for the U.S. food-aid programs was based both on domestic agricultural interests and on foreign-policy considerations. As the United States was accumulating surpluses in grains and other commodities, the food-aid programs provided a safety valve that allowed for these surpluses to be channeled abroad, where they could serve foreign-policy objectives as well. In the present period of relative scarcity, that domestic support has been eroded. The reason is not so much that expanded food-aid shipments will raise the domestic price level, since com-

mercial exports, particularly of grains, have continued unabated through the period of relative scarcity and rising domestic prices. Rather, the concerns are twofold: (1) that food aid results in budgetary outlays which the administration wishes to keep down for anti-inflationary purposes and (2) that food-aid shipments cut into sales of agricultural foodstuffs on commercial terms and thus have adverse balance-of-payments implications. In periods of ample supplies, these concerns were overshadowed by the obvious attractiveness of food-aid shipments as a means of reducing domestic stocks and helping to implement the domestic-agriculture price-support programs. Now the United States has been forced to view food aid as it does other aid programs; food aid must compete on budgetary terms with other programs for the attainment of various objectives.

Another, and perhaps the optimal, answer to the developing-country food-financing problem is to seek contributions from oil producers. While such efforts should obviously continue unabated for this and other objectives of recycling, the problems with this approach are well known and have been discussed above. OPEC members have been reluctant to extend untied credits to developing countries on concessional terms in order to enable the latter to obtain food from the United States or other food exporters.

In light of these difficulties, other suboptimal instruments must be sought to transfer liquidity into the hands of the poorest developing countries. One such instrument that relies neither on appropriated funding by the developed countries nor on OPEC assistance programs is to have special issues of SDRs that would be used to assist poor developing countries to finance food imports.

This is clearly a second-best solution since, as argued above, the problem at present is not lack of world liquidity but redistribution of existing world liquidity. However, it could be argued that such special issues of SDRs need not be as inflationary as they might appear, for the following reason. If the developing countries cannot purchase additional food, food production in the developed countries will not expand to the degree required to provide an adequate level of nutrition in the developing countries. Thus, the creation of additional liquidity would be conditioned on, and related to, the creation of additional supplies of foodstuffs; this would absorb the additional liquidity injected into the world financial system.

Opponents of various types of SDR links proposed in the past will view this as a link of the worst kind, because it introduces concerns about development directly into financial considerations affecting liquidity creation in the world as a whole. The common argument against overburdening a delicate new international reserve asset with many diverse

functions could also be repeated here. The evolution of debate on the SDR link has now reached the point where even the developing countries have said that what they want is a larger share of whatever liquidity is created for the system as a whole but that the decision on the total amount of liquidity created should be made on the basis of liquidity considerations alone and not of development assistance.

The fact of the matter, however, is that even in the developing countries as a group there are tremendous differences between the additional reserve assets they need and what they would obtain if traditional formulae for allocating SDRs were applied. The purpose of special SDR allocations geared to needs to import food is precisely to extend the liquidity to those countries that need it the most and must use it for the very purpose of survival.

*Implementing a fund for food.* To finance the food-import needs of developing countries, a special allocation of SDRs should be made periodically to a fund administered by the UN World Food Program or some other separate international entity set up for this purpose under the Food and Agriculture Organization (FAO). Alternatively, the IMF itself could administer such a fund. IMF administration of the fund would perhaps provide better assurances that the financing needs and alternatives are properly evaluated. The allocations of SDRs to the fund could be made on a predetermined schedule over time, for example, 5 billion SDRs over five years. However, financing by the fund of specific requests by individual developing countries would have to remain on an ad hoc basis and after evaluation of the financing needs of individual developing countries.

Under existing provisions, the interest rate charged for the use of SDRs (5 per cent  $\pm$  60 per cent of the divergence of the interbank rate from 11 per cent) is probably too high for lower-income developing countries. A lower interest rate would perhaps be appropriate, in the neighborhood of 3 or 4 per cent per annum. Various alternatives could be explored to soften such terms. If IMF gold sales are effected, some of the proceeds could be used for that purpose.

On the other hand, even if no reduction in interest rates were effected, the fact remains that SDR terms are quite soft by present standards. Estimation of the grant element in SDR use is complicated. Under existing rules, countries are supposed to use on average no more than 30 per cent of the SDRs allocated over a five-year period. Assuming that a developing country uses a constant 30 per cent of SDRs allocated, there is no requirement that it reconstitute the full amount of SDRs allocated at

any point in time. To approximate the grant element in SDR use, let us assume that a developing country uses 30 per cent of its allocation and reconstitutes at the end of twenty-five years. This is equivalent to a twenty-five-year-loan at SDR interest rates. The grant element in such a loan is 43 per cent using a 10 per cent discount rate, and would be larger at present interest rates. This is not that different from the grant element in P.L. 480 (Food for Peace) loans, which is about 50 per cent.

According to existing rules, however, recipients cannot use all the SDRs allocated. (These rules may be changed and reconstitution requirements liberalized, if the IMF acts on an Interim Committee recommendation to this effect.) In the present case, this problem could be addressed in the following way: The food fund could be designated as an eligible holder of SDRs, but the reconstitution requirements could be waived or lengthened to, say, twenty-five years. That would allow the fund to extend loans of twenty-five years at about 5 per cent (or less if some other means for subsidies are developed). At the same time, this operation could leave the general rules pertaining to SDRs unchanged. Such changes would require changes in the IMF Articles of Agreement, but this should not be too difficult, especially since several changes are already contemplated as a result of the Interim Committee recommendations.

The proposal thus calls for an indirect link. Direct allocation is not desirable for two reasons: (1) It could have adverse effects on incentives for food production in developing countries. (2) A formula on the basis of which SDRs could be allocated directly to developing countries for the purpose of obtaining food imports would result in serious inequities in intercountry allocations. If the formula is based on food imports or food deficits, it would neglect the fact that some developing countries have the financial capacity to undertake such imports on their own. In addition, such a scheme could not take into account the substantial year-by-year variations in food output or need to import food. A formula based on per-capita-income criteria (say, all developing countries with less than \$300 per capita) might well be more equitable but should take into account differences in the ability of developing countries to produce food-stuffs and to finance imports.

Certain technical problems connected with the establishment of such a food fund must be addressed before it can become operative, and it will take some time to make the appropriate changes in the IMF Articles of Agreement. The problems are similar to those involving other types of indirect links—whether or how to designate the fund as an eligible recipient of SDRs (whether it is in the IMF or not), or how the creation

of additional SDRs affects the commitments of developed countries to hold SDRs in proportion to their original allocation. The fund might be set up as a simple conduit of SDRs to developing countries—particularly if an interest subsidy is provided—and not as a recipient itself. Alternatively, the fund could be made a recipient, with a change in the reconstitution requirements. In any case, the IMF, in an earlier study of the matter, concluded in its usually guarded language that “It appears unlikely that any of the [link] proposals would have to be considered technically impossible.”

This proposal is made here in recognition of the fact that there are major constraints on increasing food aid by traditional means or by efforts to recycle OPEC funds. The need to provide developing countries with the wherewithal to purchase more food is a fundamental problem which affects the whole world and which should be addressed urgently in some manner. If traditional approaches fail, no alternatives should be left unexamined. We must address critical needs affecting large portions of humanity.

### **Conclusion**

The shock of sharp increases in energy and other costs and the attendant need for major adjustments in international payments pose a challenge to developed and developing countries alike. The challenge is being met not through new and imaginative ways to accommodate payments imbalances and exciting wholesale reform but through marginal adjustments allowing the international monetary system to plod along. In the process, the weaker members of the system, the developing countries, are likely to be the hardest hit and the most in need of special measures to help them carry out the necessary adjustments. A number of such measures have been proposed, but most appear inadequate by themselves to deal with the multiple problems faced by the developing countries.

Two initiatives are proposed: a guaranty system designed to assist developing countries' borrowing in developed-country capital markets, and a fund to channel food aid to the lowest-income developing countries. Both initiatives are needed and both can be undertaken with minimum budgetary outlays by developed countries. The latter characteristic is, I think, critical to the implementation of any initiative to help the developing countries by the traditional industrialized nations and especially the United States. Competing claims for budgetary outlays and a growing disillusionment with the effectiveness of development-assistance efforts are going to inhibit the implementation of new proposals for assistance

that depend on normal appropriations. Thus the need arises to explore new alternatives and new modes for resource transfers. The most promising of these seem to be arrangements that use the guaranty power of developed countries or schemes that employ newly created or higher-valued monetary instruments such as gold or SDRs.

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