Summary of Workshop Discussion

Percy Mistry

A rule-based system

The sense of the discussion, if not a summary of it, was that John Williamson's diagnosis on the four core problems was quite sound, even if many participants felt it was somewhat partial in its coverage; a point which Williamson himself acknowledged. Williamson pointed out that it wasn't his intent to consider the International Monetary System (IMS) *and* the development financing system. That position causes me some concern especially if capital transactions involving LDCs and aid flows (which, in fact, in so many countries are substitute for the capital transactions) should not be a part of our consideration. If one talks about an IMS as looked upon by the people who really benefit from it and then leaves out the developing world, one disposesses a very large part of the world.

John Williamson's four points, which a lot of people have picked up essentially as three points are: first, policy coordination; second, what I would call APSID (Agency for Prevention of Self Inflicted Damage); third, DRA (Debt Restructuring Agency); and fourth, SDR allocations. If one really believes in a rule-based system which applies to everybody, one would merge policy coordination and APSID into one. But if one accepts, as John actually does, that the system is going to be (in real political terms) a different system for the issuers of reserve currencies and the users of reserve currencies, we should keep them as separate points. For a practical, real system to work it may very well be that we just have to accept that to a certain degree the G-7 (or G-3) deserves a right to impose or disobey rules applying to itself, whereas it may wish to be much more uniform in the way in which it applies those rules to others. Indeed, there may even be a distinction in the way those rules are applied to the other OECD countries, the NICs and the rest of the developing world. It's a problem of what I would call "dentures vs. teeth": basically the teeth are there to bite those who can be bitten, but they have to be removed when it comes to those who can't. Nevertheless, it would be nice to come up with a monetary system which really was rule-based, in which the individual proclivity to depart from the rules would be self-regulated.

John Williamson's prescriptions were generally found to be very useful from the point of view of generating a discussion. But opinions do remain divided both about their utility, the extent to which they really meet the problems that he has identified, and to the extent to which they are

From: Fragile Finance: Rethinking the International Monetary System
FONDAD, The Hague, January 1992, www.fondad.org

practicable. It was the general sense of the meeting, that one cannot seriously talk about an IMS (at least in a gathering which includes developing countries) without building in the requirements of development finance - especially if the developing countries are to be integrated into a well articulated IMS. Some of the implications of what was said, seemed to be that it didn't really matter whether developing countries were or were not integrated into the IMS, because in terms of global capital and money flows they didn't really matter all that much anyway. One can sympathise a great deal with the obvious reactions to that kind of implication.

Four key points

The four key points made during the discussions were, first, the need for adequate reserves, liquidity, and the restoration of creditworthiness without resort to continued massive net negative transfers; this was one set of issues in the development financing question. Second, the need for long-term development financing. Here both Henrik Fugmann and Gerry Helleiner seemed to be saying the same thing, but from an opposite side: why didn't we spend more time discussing the roles of the World Bank and the regional development banks? The third point concerned the need for much larger amounts of compensatory financing to meet exogenous shocks. Here I have a personal observation. There are two kinds of exigencies, one is a genuine "act of God", and the other are the kinds of "acts of men" which are inflicted on the defenseless. I do not believe that volatile movements in interest rates and exchange rates are "acts of God". Even if they are exigencies that other countries have to cope with, the whole purpose of an IMS is to equilibriate them out. If one group of countries decides in its own interest to inflict damage on another group of countries, either deliberately or accidentally, then the system ought to have some equilibrating mechanisms to help the others adjust. So we need to realise that exigencies really do fall into these two categories. The nature of an IMS has to recognise that very important distinction. The fourth point is that in building the requirements of development finance into discussions of an IMS, one really has to talk more about the roles of the multilaterals and regionals.

Let me elaborate a bit on the last point. Implicitly, when we have talked about the IMS, we have tended to talk about it as if we have taken for granted that the IMS must be built around the structural vestiges of a system that, in my view, is already dead. Bretton Woods is dead and gone - John Williamson has made a very powerful case for that - but its two orphans, the IMF and the World Bank, live on. They actually are grateful that exigencies arise to give them a role. Frankly, they have not done all that well in managing these exigencies. There were of course the oil shocks and the energy crisis in the

From: Fragile Finance: Rethinking the International Monetary System
FONDAD, The Hague, January 1992, www.fondad.org

1970s, and the debt shock and the adjustment crisis in the 1980s to give these agencies something to do. In the 1990s the collapse of communism has extended their lease on life and given them a new purpose. But a balanced opinion, taking both creditor and debtor sides into account, would probably come out with the conclusion that there has been a net welfare loss to the global system, partly as a result of the way in which these two agencies have operated. Reality may very well be that, if they hadn't existed, they would have been invented. But whether they would be invented with all the baggage that they carry, for me is really an open question.

If we're living in a market-driven world, whether in fact we need this kind of interventionism by the international financial institutions (IFIs) raises some rather fundamental questions. For instance, can't some of the things they do be done more efficiently by using markets and by finding other, much less costly mechanisms to cover risks which the market is unwilling to cover. We cannot just automatically assume that because they're there, a system must be built around them. The "real" roles of the IMF and World Bank is an important agenda for research in the future. We should not help inventing exigent roles for them - which take them far away from the intent of their founders - simply because they happen to be there.

In other words: What do we do in terms of the possible roles of these institutions? Gerry Helleiner's point about the importance of the regional development banks is a very good one. What aspects of the roles which the staffs of the IMF and World Bank are unwilling to change must be changed? What do we add to roles which ought to be performed, but which are not being performed? And how do we build agencies like BIS more closely into the network of IMF, World Bank, etc.? For there is a role that BIS very quietly plays on its own, which actually overlaps quite substantially with the roles of the IMF and the World Bank.

Missing links

The fifth broad set of points is what Helleiner has called 'missing links', which have come up more en passant than deliberately. They basically fall into four parts, one part partly going to be a repetition of what I have already said.

The first is this whole question of an excess burden of adjustment (and we almost take it for granted now) falling on deficit countries, except the largest reserve issuing country. Also, in a market-driven regime (in which taxation and fiscal policy seem to be off the agenda for discussion) the burden of adjustment inevitably falls entirely on the interest rate and the exchange rate. We may have reached the point where those two tools simply cannot bear the weight; the IMS may need some element of fiscal policy coordination as well in order to function properly.

From: Fragile Finance: Rethinking the International Monetary System
FONDAD, The Hague, January 1992, www.fondad.org

The second question opens up a broad agenda of issues which fall into a category of what I would call 'regulatory concerns', to ensure that virtuous cycles of net inflows do not rapidly turn into vicious cycles as in the past. This is something Stephany Griffith-Jones' paper was useful in portraying; it asked the question, but it seems much too premature to provide an answer. It's very clear from what both John Williamson and Stephany Griffith-Jones have said that the answer to the distinction between virtuous and vicious cycles of capital flows lies very clearly in both the institutional mechanism and the efficiency of regulation. Although the BIS has moved further than most others in setting up capital requirements for banks, the exchange markets, commodity markets, OBS liabilities markets and securities markets still leave a lot to be desired in terms of regulatory lacunae; the flows in these markets are extraordinary large.

The third question is the issue raised by John Williamson of the role of reserves in an environment where creditworthiness and credit standing rather than the quantum of reserves determine access to global liquidity. How do we trade those two off? To what extent are reserves themselves an indicator of creditworthiness? And to what extent do borrowed reserves really amount to real reserves?

Let me give you an appropriate case: In 1991 India's reserves dropped in nine months time from a healthy $9 billion to a very unhealthy less than $1 billion, as $5 billion worth of non-resident deposits departed the country, both because of political instability and bad policies. Since then, reserves have been built up to $4 billion, entirely as a result of World Bank and IMF intervention. Frankly, much to the credit of the Indian community, no Indian seriously regards these as reserves, because they know that if they draw them down it's curtains for the country. And I am amazed that in the international community the general feeling is that India's creditworthiness is now restored, because of its reserves. This issue of reserves and creditworthiness is an area which therefore needs some very careful looking at.

The fourth point is the question of the underlying problem of constructing an IMS which has an inherent balance of power between those who issue reserve currencies (not all of whom are necessarily surplus countries) and those who use reserve currencies. But there is a secondary aspect to that concern: in the last ten years the users of reserve currencies in the system, primarily the deficit countries minus the USA, have legitimately been concerned about the extent to which the IFIs themselves have been used to amplify the burdens of adjustment and to exacerbate them rather than ameliorate them. In fact the large net transfers from the developing world to these institutions have now become a large part of the problem and no longer a solution, and thus raise some fundamental questions both about their functioning and about their structure.

From: Fragile Finance: Rethinking the International Monetary System
FONDAD, The Hague, January 1992, www.fondad.org

The aid enterprise

A final personal point about development aid. The discussion with Arjun Sengupta did raise the issue of development financing, the constituency for aid, and the question of how to rebuild that constituency. I've been grappling with this since I was personally involved with and responsible for IDA funding negotiations (when I worked at the World Bank). The first time I came across the phrase 'aid fatigue' was when I read some documents dating back to discussions in 1956. I seriously believe that in a market-based regime the ability of the world to tug at the world's heartstrings on the grounds of progressive taxation, and social justice, etc., has reached an absolute limit, mainly because of widespread misperceptions of large scale abuse of aid. It is true that there has been abuse of aid, but if you look at the whole field of public endeavour as Bob Ayres has put it, it is fair to say that the aid enterprise has probably performed with greater efficiency and less corruption than defence, public works, education or health care. One needs to look at aid in a relative context. The fact that $4 billion out of $50 billion may be misappropriated is certainly a cause for extreme concern. But my own feeling is that the real theoretical and conceptual justification for what I no longer wish to call aid, but must be called 'necessary resource transfers', is rooted in market theory itself. To the extent that developed countries choose to protect lifestyles and choose to deliberately distort international markets in a way which causes damage to developing countries, the theoretical, conceptual and legal case for compensatory offsets becomes a very powerful one. My own feeling is that the only theoretically and conceptually respectable rationale for aid is a rationale which is based on compensation for market distorsions, rather than humanitarian or moral (which I hope will continue to flow). But I think that humanitarian aid may flow better through churches and NGOs rather than through governments per se. If, in fact, this market-based regime is to prevail, the sooner we legitimise the idea of resource transfers on the basis of market distorsions (in some instances these are quite easy to calculate) the better. Such a calculation would be much easier to defend than the 0.7 per cent of GDP or an international income-tax mechanism.

From: Fragile Finance: Rethinking the International Monetary System
FONDAD, The Hague, January 1992, www.fondad.org