STATEMENT FROM ISTANBUL

A Report on the Istanbul Roundtable
on
World Monetary, Financial
and
Human
Resource Development Issues

Preface

The North South Roundtable and the UNDP Development Study Programme convened a group of thirty-six leading monetary, financial and development experts for a brainstorming session in Istanbul, Turkey, on August 29-September 1, 1983. The group was to address specifically:

- the inherent dangers in the current international monetary and financial situation and possible response to these problems;
- the enormous human costs for the poorest people and nations implicit in the present situation and specific proposals to avoid such costs;
- insufficient attention and support given to human resource development, which have strained economic and social progress; and
- the opportunities for continuing and accelerating the process of global cooperation started after the Second World War.

Meeting in their personal capacities, participants held candid debate on the issues and produced an exciting range of fresh ideas. Some disagreement arose in the course of discussion, but on many issues a broad consensus of opinion emerged. The Istanbul Statement summarizes the major ideas and concerns expressed by the participants, without presenting any collective position on detailed proposals.

A week before the Istanbul Roundtable, a Core Group of six members of the Roundtable met in Islamabad, Pakistan to prepare a position paper for the Istanbul Roundtable. That paper is annexed to the statement, as are the rapporteurs' reports on the five workshops held at Istanbul. A complete record of the Istanbul Roundtable along with the background papers will be printed and distributed by the Roundtable Secretariat.

The Istanbul Roundtable was merely the beginning of a process of creative dialogue on the international monetary and financial systems-a process that the North South Roundtable intends to continue by organizing a series of meetings. We hope that these discussions will make a valuable contribution to the ongoing search for those policies and institutional changes which can best promote maximum and equitable growth of the world economy, which would accelerate human resource development, and which will lead to the full development and utilization of human potential all over the globe.

It is in this spirit that we wish to bring this report to your attention.

Mahbub ul Haq　　　　Bradford Morse

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1. The world economy is in serious trouble. It cannot function smoothly again without careful management and some fundamental changes. The dilemmas we face are complex and many:

- Sustained growth of the world economy is the only viable, long-term solution for most of the current problems. Yet such sustained growth is simply impossible in the prevailing environment of trade restrictions, shrinking world liquidity, and deflation in many countries.
- The creation and distribution of world liquidity have become increasingly uncertain, because of both ad hoc policies governing national reserve creation and increased dependence on private financial markets.
- The distribution of world economic and financial resources has become increasingly multiplier, with the U.S. share of world GNP declining from two-fifths to only one quarter in just over two decades, while the control of world financial policies has remained largely monolithic, owing to the predominant role of the U.S. dollar.
- There has been a gradual retreat from multilateralism precisely at a time when the world has been growing ever more interdependent, requiring cooperative solutions, not isolated national actions.
- The human and social costs of short-term adjustment measures have become severe, with the poorer segments of societies shouldering disproportionate burdens.

2. Sustained growth in the world economy is vital to all countries-for the creation of jobs, for reduction of debt burdens, for a lessening of protectionist pressures, and for new investment that will permit smoother adjustment. For the developing countries in particular, benefits from sustained world growth should include higher commodity prices and increased exports which should improve their development prospects and reduce debt burdens. Recovery can be strengthened and broadened by appropriate expansionary policies in industrialized nations, by positive adjustments in their industrial structures, by reducing barriers to the developing countries' exports, and by providing them with increased financial flows in order to overcome debt-caused constraints on their growth. Reduced interest rates, especially in the U.S., are necessary both to support recovery and to diminish the burden of debt. And new productive investment will be needed to take advantage of new trade opportunities, while all countries resist protectionism and permit such opportunities to grow.

3. The debt crisis in most LDCs has created a necessity for adjustment in the deficit countries. But creditor countries also have an obligation to adjust through growth and resource flows to debtor countries. New mechanisms may be necessary to encourage such symmetry of response.

4. Deflation in government expenditure is the main feature of the adjustment package that is normally required of debtor countries in financial difficulties. The aim is to reduce imports and release resources for exports. With existing constraints on export markets, the main adjustment at the national level has inevitably come from reduced incomes and imports. This has involved very substantial cuts in real wages and social expenditures in some countries. The result has been very real hardship, often concentrated in low income groups whose margin for survival is very small. While the cuts in income have created great hardship and involved major human and social costs, in many cases they have not brought about sufficient adjustment, and further cuts may be needed. From a world perspective, successive cuts in imports by a large number of countries reduce world markets and limit the very possibility of adjustment through an expansion in exports.

5. One reason for the harsh adjustments is the shortage of finance, as private capital flows have slowed down and overall aid has been nearly stagnant: There is an urgent need for more medium-term financial support. New financial mechanisms should be developed to attract institutional investors such as insurance companies. The development of a secondary market in bank loans could help to maintain levels of bank lending.

6. There has been a decline in foreign exchange reserves precisely when they are most needed; and private banks are in no position to contribute to world liquidity as they did in the past. A new and substantial allocation of SDRs is now required to strengthen the recovery of the world economy. Furthermore, SDRs should become the principal vehicle for liquidity creation in the future, and their distribution should not necessarily be related only to IMF quotas.

7. Expansion of the IBRD and of the regional multilateral banks would offer am opportunity for increasing financial flows to developing countries. These institutions have made

extremely valuable contributions to development in the past but are mow constrained by limited resources. Their capital should be increased substantially, restrictive policies and conservative gearing ratios should be prudently eased, and their policies should emphasize rapid disbursements of already approved loans. There should be am immediate expansion in the IBRD's capital through a selective increase that would parallel the eighth review of IMF quotas. In the field of human resource development, the United Nations Development Programme plays am important and unique role. At present this organization too is facing critical resource constraints. There is am urgent need to provide the UNDP with the necessary resources on a more predictable and assured basis.

8. Greater financial flows would permit countries to adopt a less contractionary approach to adjustment which could both meet medium-term balance-of-payments objectives and minimize costs in terms of human suffering. In low income countries especially, conventional adjustment through deflation creates considerable hardship and is generally ineffective in increasing exports because of the inelastic demand for the commodities of these countries.

9. The debt situation in developing countries was largely caused by the very rapid accumulation of debt during the 1970s, increasingly incurred at variable interest rates, which with high interest rates has led to a very heavy debt-servicing burden. Debt rescheduling to date have been *adhoc* and have generally increased the medium term cost of debt, raising repayments, and often resulting in further rescheduling. There is need, therefore, for some orderly and systematic process of restructuring debt, when needed, so as to ease the stifling constraints on development efforts. A range of proposals to this end has been made, some involving the creation of mew institutions, some the use of SDRs, some the application to the international situation of practices already standard in domestic banking. It is imperative that all of these proposals be seriously investigated and some solutions be found that reduce the burden of past debts and distribute the costs of so doing among borrowers, lending institutions, and developed countries, all of which bear some responsibility for the current situation. Special provisions should be made to deal with the particular problems of the poorest countries, many of which suffer from serious debt crises.

10. For the poorer countries, additional Concessional resources are essential. These could come from extra aid and from distributing a higher proportion of existing aid flows to these countries. In this connection, it is necessary for the development community to give a very high priority to the question of IDA replenishment. IDA is now the largest single source of Concessional finance to low income countries. The present problems with replenishing IDA are essentially related to lack of adequate support from its principal donor. Accordingly, it may become necessary to supplement IDA funds during its seventh replenishment period with a special account to be finance able by donors other than the U.S. The fact that two countries, the U.S. and U.K., are reducing aid flows has not prevented the rest of the industrialized world from increasing its aid. It is imperative that the level of aid increase and that pressures be put on those who are lagging behind. Industrialized socialist countries should also make a proportionate contribution to Concessional flows.

11. The evident deficiencies in the current international financial system do not necessarily flow from institutional inadequacy, but come rather from the underlying political realities. The IMF has played a crucial role in difficult circumstances in preventing the breakdown of the international financial system. The world recession is not due to international institutions, but rather to the economic policies of the major countries. Nevertheless, since the institutions are important in defining minimum codes of behavior for member countries, in permitting a fuller exchange of information, and in generating pressures for change, institutional reform may make a significant contribution to the process of adjustment and development. There is a need for an enlarged role of the IMF in providing short-and medium-term finance. There is also a need for a considerable expansion of the World Bank and other multilateral financial institutions. However, deficiencies remain in the performance of various institutions: notably in functions such as lender of last resort; smoothing interest rate and exchange rate variations; liquidity creation and distribution; monitoring international bank practices; and facilitating debt rescheduling. Reform of existing institutions is one possible way to secure improved performance in these functions. Another long-term, possibility is the creation of a world central bank; but it is yet to be determined whether this would be technically and politically feasible. All of these proposals should be investigated in depth.

12. One of the underlying, though not visible, obstacles to economic progress is the insufficient attention given to the development of human resources. The "capacity and management gap" has not been bridged by official development assistance (ODA). which has been predominantly used for physical capital formation. Solutions which do not take the human dimension and human resource building into account will fail to provide an enduring answer to the world's financial and monetary crisis. Until human resources needed for sustained economic growth are developed, real development will remain a dream.

13. In our fervent search for economic recovery, for monetary and financial restructuring and for appropriate institutional responses, let us not forget that people must be at the center of all our concerns. In the last analysis, we must judge all adjustment processes, all policy options, all institutional alternatives by the same yardstick: the impact they have on human welfare. This has been the basis of our deliberations in Istanbul and will continue to guide us in our future search for a viable international system.

CORE GROUP REPORT TO THE ISTANBUL ROUNDTABLE'

1. Diagnosis

1. In the last 30 years there have been important changes in the world economy. The United States, which was responsible for more than 40% of world GNP in the '50s, now accounts for about one-quarter of it, while the European Economic Community, Japan and a number of developing countries have substantially increased their participation in the total. Currencies like the Japanese yen and the German mark now play an important role in international trade and capital movements, even though their role is substantially less than proportionate to the relative significance of their economies in the world.

2. These changes have economic and financial implications for the world economy. The increasing importance of currencies other than the dollar has generated a multi-currency system which enhances exchange rate instability. The expansion of Euro-markets has introduced an additional degree of volatility in capital and money markets. Since most countries are not willing to accept the exchange rate fluctuations that would result from a free market, they tend to dampen them, making use of interest rates, directly or indirectly, in the process. Thus, exchange rate fluctuations are transmitted to interest rates and volatility becomes contagious.

3. The oil crisis added a new element to this general environment of change. Between 1974 and 1981 oil-exporting countries accumulated a surplus of roughly $500 billion, with annual rates fluctuating between zero and $100 billion over the period, becoming negative in 1982. The oil-surplus countries became important suppliers of funds to banks operating in international markets. The external assets of these banks grew at a rate of 20% per year during this period, providing ample supply of financing to the world economy.

4. For much of this period, interest rates in international markets were very low or negative in real terms so that deficit countries found cheap access to the financial resources they needed in the private international banking system. At the same time there was a sharp decline in domestic demand for commercial funds within the developed countries. In many developing countries fighting inflation, domestic interest rates became higher than foreign rates, giving additional impetus to the demand for foreign loans. Some countries made use of the opportunity to increase government expenditure, while the concomitant deficit in the balance of payments was financed through borrowing. In other cases foreign loans financed increases in private sector expenditures.

'This report is based on the deliberations of a Core Group assembled in Islamabad, Pakistan, from August 21 to 25, 1983.The purpose of this report was to offer various ideas and proposals to estimate discussion at Istanbul rather than to present any individual or collective position on international monetary and financial issues.

5. The banks accommodated these demands and encouraged them with frequent visits to borrowing countries to promote their business. New and smaller banks joined their larger colleagues, and made use of the opportunity to expand their total operations. Thus, the level of external debt of LDCs grew at a rate of over 20% per annum. But the world economy was expanding fast. Trade and exports were increasing, so that debt-service ratios and debt-GNP ratios, while growing slightly, gave no reason for concern. World liquidity was increasing through the expansion of the commercial banks' operations.

6. Then the recession came. Perhaps the first indication was the sharp increase in interest rates registered in the United States and Europe in 1980-1981. The world economy had never fully adjusted to the changed circumstances of the 1970s; one consequence of the recovery that had taken place was upward pressure on inflation rates.

7. The authorities of the economically more important countries were facing simultaneously large deficits in their government sector, inflationary pressures, and difficulties in their external sector, so that a policy of restraint seemed clearly advisable. Major emphasis was placed on monetary policies to do the job. As a consequence, real interest rates shot upward, reaching unprecedented levels. The world economy slowed down rapidly, and prices of commodities and

other exports of LCDs deteriorated to such an extent that in 1982 the terms of trade of the non-oil-exporting less developed countries reached levels as low as-and in some cases even lower than-those registered during the great depression of the'30s. The combination of unemployment and difficulties in the external sector led industrial countries to take protectionist measures which produced further negative effects on LDCs. Sharp fluctuations in exchange rates introduced an additional destabilizing effect.

8. Many developing countries, particularly those in Latin America, found themselves in a situation where the stock of foreign debt had grown dramatically, most of it with private banks and subject to floating interest rates, so that an increase in interest rates affected most of the total stock of debt, rather than the flow of new borrowing alone. Fluctuations in interest rates became a new mechanism for the transmission of international disequilibria. This new mechanism aggravated the negative changes in terms of trade, complicating the situation further.

9. Furthermore, private bank financing slowed down dramatically. The drying-up of the capital surplus of OPEC in 1982 stopped the inflow of resources from this source into the banking system; and high interest rates and the recession itself weakened the quality of banks' portfolios, making them very reluctant to lend. Most smaller banks tried to withdraw completely from foreign operations.

10. A few illustrative figures may give a clearer view of the situation. For 21 major LDC borrowers, the deficit on current account in 1982 was $61 billion, while total debt was $514 billion. Bank lending to non-oil LDCs in 1982 was only about one-third of the current account deficit. It is estimated that a 1% increase in interest rates increases LDC current account deficits by roughly $2 billion, while a 1% increase in the OECD growth rate would reduce the current account deficit by $15 billion.

11. The fact that the level of debt for some countries would be sustainable under "normal" conditions of the world economy is not intended to justify the policies followed by debtor countries during this period. Some countries followed expansionary policies that were not sustainable in the longer run; some followed insufficiently outward-oriented policies with over-valued exchange rates and protectionism, which distorted resource allocation; and in some cases, the development of human resources was inadequate. Country responsibility for such policy deficiencies should be recognized. But the world recession has created a much greater need for adjustment than imprudent policies would have required.

12. The preoccupation of the international community with the problem of Third World debt has resulted in some shift away from the emphasis that was being given to the problems of development in the low income countries of Sub Saharan Africa and mainland Asia. One manifestation of this change in emphasis is the problem encountered by the soft windows of multilateral banks-in particular the World Bank's IDA-in replenishing their resources.

13. The multi polarization of economic power which has emerged over the past thirty years is in sharp contrast to the nearly monolithic system which obtained at the time of Bretton Woods. Then, the agreement and support of the U.S. was sufficient to secure international reform. Today, the support of a number of countries is needed, countries which have divergent views and interests. Hence, despite the need for reforms, the political problems and obstacles to reform are intrinsically greater than in 1946.

11. Current Responses to the Situation

14. The combination of the developments analyzed above has given rise to a series of major debt crises. Twenty-four countries have renegotiated their debt since 1980, with the renegotiations of Poland, Mexico and Brazil dominating in magnitude and potential implications. But the crisis of debt has not been confined to the middle income countries; in 1981 and 1982 eleven Sub-Saharan African countries had to have their debts rescheduled, some of them repeatedly. The international response to these crises-by each of the major actors, governments, international institutions and the commercial sector-has been ad hoc. On each occasion a package has been patched together to ease the immediate crisis. But no long-term solution to the underlying problems has been developed. In some respects the crisis measures have added to burdens in the medium term, by increasing the costs of the funds rescheduled by the commercial sector; in others they have resulted in a sharp decline in the levels of net transfers. The IMF programs have required major deflation and cuts in imports of around one-third in the cases of both Mexico and Brazil. Conditionality associated with restructuring of debt in the poor countries has also had deflationary consequences. Achieving the sects, therefore, would release foreign exchange for debt servicing, but at a heavy political and economic cost.

15. In this context, the aggregate effects of policies which are being recommended to deficit countries have not been duly considered. While devaluation by one country may improve its external balance, devaluation by a large group of countries would produce a negative effect in their terms of trade and very little improvement in trade balance. Restrictive economic in one country

may help balance its external accounts, both reducing imports and expanding exports; restrictive policies applied by many countries at the same time would leave little room for export expansion, so that the major burden of adjustment would fall upon a reduction in imports and economic activity all-round.

16. The response to the crises has been largely directed at securing adjustment by the debtor/deficit countries. Inadequate attention has been paid to securing adjustment in surplus countries through increased growth and/or increased long-term lending. The burden of adjustment in developing countries has been made heavier by the lack of sufficiently expansionary policies in surplus countries. Moreover, lending by the private sector to non-oil developing countries is decreasing significantly, falling from $50 billion in 1981 to $21 billion in 1982. At the same time, growth in development assistance is declining. Agreement was reached to increase the Fund's resources (although by an inadequate amount in relation to the size of the problem), but this might yet be thwarted by resistance in the U.S. The same problem of less-than-adequate response from the U.S. made it difficult to refinance IDA.

III. Consequences of Present Responses

17. While a reduction in spending and efforts to bring imports and exports into better balance must be part of any collective effort, the continued slow-down in private sector lending and the inadequate response of governments and international institutions mean that many LDCs have had to adopt sharply deflationary policies. At present, GNP in Latin America is falling for the second year in a row (the first time since the'30s), while unemployment levels can only be compared to those of the great depression. For the fifth year running, Sub-Saharan African countries have experienced negative growth in their GNP per capita. Growth in developing countries as a whole was 2% in 1981 and 1982, two-fifths of the rate of the 1970s and below the growth in population. With an adjustment effort of this magnitude the current account deficit of Latin America has been cut to less than half that of 1981 and the trade account will be in surplus in 1983, so that Latin America as a whole will have a net outflow of real resources. Estimates for all non-oil LDCs show a significant reduction in the current account deficit, on the order of $35 billion. Since LDCs account for nearly 40% of U.S. exports and 28% of OECD exports, these measures have had a sizable impact on world demand. This has accentuated the trend towards protectionism in developed countries, induced by their high levels of unemployment. In general, throughout the world, the crisis has produced a retreat from multilateralism.

18. A few developing countries have been able to adjust through expansion of exports (for example, South Korea), but this does not appear to be a feasible option across the Third World, unless world demand recovers significantly and developed country protectionism diminishes. In the present situation and with the current responses of the international community, deflation is the main option for most LDCs, especially those countries whose past inward-looking policies have made it difficult to achieve a rapid increase in exports. But sustained deflation is, of course, costly in social and political terms, as well as economic. In some countries, political stability is at stake as a result of the continued application of these policies.

19. For some countries, then, default my become a tempting alternative. Countries which have to run a substantial trade surplus in order to meet their debt service obligations may see default as a way to increase their immediate import potential, since at present some are transferring resources to the rest of the world in net terms. Morgan Guaranty estimates that net financial transfers to the 21 major LDC borrowers will be negative in the near future. Default would, of course, have serious consequences for the countries as well as for the international financial community. But in the present situation, this course of action may be seen as a possible response for some countries. This possibility underlines the urgency of developing constructive long-term solutions. The short- and long-term implications of default for countries and financiers need detailed exploration to avoid miscalculations. Here we note it as a further and urgent reason for requiring new responses from the international community.

IV. The Preferred Outcome

20. Above we have briefly described the situation that has emerged and recent responses to it. The outcome is clearly not a desirable one from the point of view of any of those involved. The political fabric of many countries is being strained; their people are facing reduced incomes, rising unemployment and cuts in social services. Investment in human resources, vital for the long-run development effort, is being eaten into. While the international banks' immediate viability has been sustained and their short-run profits increased, they remain highly vulnerable to further crises. The world has lurched from crisis to crisis and the dynamic multilateral system established after the Second World War has been greatly weakened. The present situation does not make full or efficient use of the world's economic potential, nor does it contribute to the alleviation of pressing social needs.

21. The preferred outcome would involve a steady and sustained expansion of world demand, output and income. This outcome would require an appropriate expansion and distribution of world liquidity, to sustain such growth and help offset cyclical fluctuation. Expansion in trade and output could be expected to be accompanied by renewed multilateralism in trade and payments.
22. To achieve such an outcome, symmetry would be needed in the adjustment process, with adjustment by surplus countries as well as deficit, and with a special responsibility on surplus counties to expand when world demand is cyclically low and unemployment is high. Large economies not constrained by inflation or balance-of-payment conditions should also pursue growth-oriented policies. Deficit countries need to undertake adjustment policies, and in some cases restrictions in demand would be appropriate. But in a growing world economy, many countries would adjust primarily through expansion of supply and exports, rather than by excessive restriction of demand.
23. This picture of the desired outcome may sound somewhat overly optimistic. However, it is helpful to have such a clear goal in mind when assessing required changes in the international financial system.

V Low Income Countries

24. In this overall environment, the situation of nations with very low incomes deserves special attention. These countries have been hard hit by the weakness in commodity prices and have very limited capacity to adjust. Access to commercial markets is meager, and prospects for sufficient increases in aid appear poor. First, the low income countries need increases in concessional assistance to make progress in attaining some of the vital goals in levels of health, education, nutrition and housing of their populations, and to establish the infrastructure needed for further economic development. While some donor governments clearly face pressure to reduce their budgets, the proportion of budgets devoted to official development assistance is very small-on the order of 1% for all developed countries taken together. As already indicated, the response of the donor community to the present crisis in low income countries has not been very generous. For instance, severe limits on IDA funds are being imposed, while major increases in IDA are entirely justifiable on the grounds of the effectiveness of its use and its benefits to development.
25. The retreat from multilateralism, which is manifest in reduced donor support to multilateral concessional flows, would result in reversing a very favorable trend. From 1970 to 1982, the share of multilateral concessional flows in total ODA increased significantly. Since some 90% of multilateral ODA is provided to the poor countries, this meant that by 1982 there was more focus on low income nations than ever before. At present about 50% of all ODA-multilateral and bilateral goes to poor countries. However, the move away from multi literalism will change this trend, since bilateral ODA is concentrated on the middle income countries.
26. As the low income countries attempt to develop their human capital, support for their efforts is necessary, both from bilateral sources and through the UNDP. In many nations improvement in human skills and education are needed to strengthen development prospects in many sectors of their economies and to distribute more broadly the benefits of growth. Yet during periods of crisis, this area of need tends to be neglected. Both developing nations and donor governments must avoid this tendency.
27. There is need to formulate a special proclaim of action for Sutr Saharan Africa that would channel in larger amounts of ODA flows under conditions more appropriate to the situations of these countries. In addition, the bilateral aid agencies should formulate programs of quick disbursement, along the lines of a program already initiated by the World Bank.
28. Finally, while in industrialized countries, protection against manufactured exports is of major concern, distortions in agricultural trade-in particular through production and export subsidies-present an even more serious problem to poorer countries, most of whose exports are in the form of commodities. Much development assistance to these nations is negated by the hum done to the exports by such distortions. An urgent effort must therefore be made to reduce and ultimately remove these protections, or at least to put a "standstill" on new ones. An extension of the size of the IMF's Compensatory Finance Facility for commodities would provide a significant source of assistance to poor countries where commodity prices are especially low.

VI. Institutional Issues

29. As the international economy has been subject to a growing number of intense pressures, questions are often raised as to the ability of existing institutions to cope with the broad range of problems. In this environment it needs to be seriously considered whether key objectives are being met by the existing institutional structures; whether and what types of improvements are necessary; and, ff existing institutions cannot meet certain needs nor be improved in order to be able to do so, whether new arrangements are necessary. It is clearly undesirable to introduce new institutions when improvements in existing ones would suffice, particularly in light of the extremely time-consuming and uncertainty-causing nature of the effort. But it is necessary to consider the creation of new institutions if existing ones cannot be improved adequately to achieve important objectives.

30. There are a number of areas in which important institutional questions have been raised.

1) The adequacy and distribution of global liquidity: In the discussions which led to the creation of SDRs there was considerable debate over the role of international institutions in creating and distributing international liquidity. The SDR was designed to permit the Fund to augment liquidity with an instrument which would also reduce dependence on the reserve role of the dollar. But this asset has been created only in limited amounts. There has been constant pressure to provide developing nations with a larger proportion of new SDR issues (either directly or through "the fink"). In the near term, a decision will have to be made as to whether there is a need to create additional SDRs at this time, which we believe there is, and if so, how many. In the longer run, it will be important to address institutional questions such as: Can the IMF play a more active role in creating additional liquidity when appropriate? Are changes needed to make the SDR a more broadly used international asset? Are new instructional arrangements needed or desirable.?

2) Exchange rates: Exchange rate volatility and misalignments which distort trade have had a major impact on the economies of a number of countries and on key sectors involved in international trade. There is a general desire for greater exchange rate stability, and a major debate is under way as to how to achieve it and avoid major misalignments. Exchange rate intervention has been advocated to avoid, or to moderate, temporary aberrations in the market; but intervention cannot correct major movements in rates, especially when private participants in the market have far more funds with which to intervene than have governments. In the final analysis, convergence of underlying economic conditions presents the best likelihood of reducing exchange rate volatility; yet this goal has proved elusive, as sovereign governments resist coordination which reduces their policy flexibility. Are new arrangements or patterns of cooperation needed to deal with the underlying causes of misalignment? Can better means for coordinating exchange rate intervention be found? Are current institutional arrangements adequate to facilitate it?

3) Lender o) last resort: A debt problem involves both creditors and debtors and is the more intractable the later its detection. Is there any early warning system for debtors, for creditors, or for both? When difficulties arise, should support be provided? To whom: creditors or debtors or both? By whom: national authorities, present international institutions or a new institution? If in the present liquidity crisis, countries facing large debt burdens cannot obtain sufficient assistance from the IMF, how can or should necessary funds be provided bilaterally or through international entities (e.g. the Bank for International Settlements)? Or are new institutional arrangements appropriate to supplement the efforts of the Fund or the BIS? The absence of an acknowledged lender of last resort in the world economy is one factor slowing down bank lending to LDCs. However, any such instrument would have to be carefully designed to avoid imprudent borrowing and lending.

4) Debt rescheduling: At present most public debt is rescheduled in the context of the Paris Club, and most private debt (held by commercial banks) is rescheduled through ad hoc arrangements, usually coordinated by lead banks. Growing attention is being given to finding ways of smoothing out the rescheduling process in order to reduce uncertainties and delays which trouble both lenders and borrowers. Should improved arrangements be made in such a way as to maintain the informality and consequent flexibility which characterize the present process, or are new arrangements needed (e.g. a more formal secretariat or internationally agreed procedures)?

5) Balance-oil-payments adjustments: The international adjustment process has been criticized for its lack of symmetry, i.e., the probability that deficit countries will be forced to adjust to avoid a further weakening of their currencies or negative employment effect of large trade deficits, while surplus countries generally feel less pressure to adjust because of the employment and exchange rate benefits of large trade surpluses. The lack of symmetry is demonstrated in the pressures the debtor countries are currently facing while surplus countries bear no parallel pressure. This lack of symmetry raises the question as to whether there are ways of providing new incentives for both deficit and surplus countries to adjust. Ideally, incentives should be devised to encourage such adjustment before imbalances present major problems.

6) Growth strategy: As countries formulate their domestic economic policies, there is a need to understand better both their impact on others and the impact of others' policies on their efforts. For example, one country's policy to reduce its growth slightly to avoid overheating can be turned into recession, if at the same time other countries pursue highly restrictive policies with the effect of dramatically curtailing that nation's exports. Likewise, common efforts by many countries to reduce balance-of-trade deficits or to run surpluses can lead to an unexpectedly large slow-down in

global growth, reducing prospects for recovery and complicating balance-of-payments adjustment for many countries. Among industrialized countries, the OECD tries to forge understandings-it not coordinated policies-to reduce over- or under-shooting. But it has rarely succeeded. Moreover, with many non-OECD countries now playing an active role in the world economy, it should be considered whether a broader effort to institutionalize exchange of information and to assess aggregate policy impact is desirable. Can this be done in the 9,'IF, the Bank, or a UN agency; or are new arrangements required? The need is not only for exchange of information; it is a matter of country eficalaction. This could take the form of adjusting the nature of IMF conditionality according to the state of world demand and employment. For this to be possible, the Fund would probably need greater resources. Another possibility is to adjust the creation of international liquidity to offset cyclical fluctuations in world demand.

7) Interstates: Because interest rates have such a large impact on domestic economies and on payment flows (due in large part to the increased use of floating-rate debt), there has been considerable attention devoted to ways of bringing rates down in real terms to normal levels. Yet methods of achieving this goal have eluded governments and economists. Therefore it is useful to discuss why real rates have remained so high, whether it is a cyclical or structural problem, and whether governments, individually and collectively, can improve upon recent performance. The burden of fluctuating interest rates has been accentuated recently by the coincidence of high interest rates with poor terms of trade. Various measures have been suggested for reducing the burden of these fluctuations. One proposal is to relate interest payments to commodity prices. Another is for the creation of an interest compensation account at the IMF. Intermediary financial institutions might also perform a role in undertaking some of the risks of fluctuating rates.

8) Involving new lenders: During the last decade there was an increase in the proportion of overall lending to developing countries coming from commercial banks. Now, banks are becoming more cautious. It is therefore important to explore new ways of encouraging the banks to continue lending, to involve new potential lenders (e.g. insurance companies), perhaps by creating a secondary market for bank credits, and to encourage equity investors to play a greater role. Much of this will be a function of the profitability and security of investments and of the receptivity of countries to them. But the process can be facilitated by institutional arrangements which minimize risk and combine government or multilateral institution funds or guarantees with private financing. World Bank, ADB and IADB co financing has been an important step in this direction, but other institutional arrangements also should be explored. Several proposals have been advanced recently, involving both public and private sectors and new financial instruments.

9) Trade and *Financed monetary* issues: Until recently there has been little contact between trade and financial monetary policies or policy-makers. Thus the impact of exchange rate misalignments on trade and of trade distortions on debt problems has not been given adequate attention. The current debt situation has resulted in a sharper focus on this subject and discussion as to how to improve the policy dialogue among the IMF, GATT, IBRD, UNCTAD and governments. It is worth considering whether and how further improvements in this area can be realized.

VII. Priority Issues

31. Priority should be given to assisting low income countries. This involves:

- increasing the net flow of resources to these countries, which is largely a matter of increasing their access to official funds; a large replenishment of IDA and timely contributions are of the first priority;
- strengthened commodity prices (which would accompany a sustained expansion in aggregate world demand) and removal of subsidies and other distortions which adversely affect these prices:
- an additional general allocation of SDRs, which would contribute directly to countries' liquidity and indirectly to their prosperity through rising world demand; and
- reduction of protection and subsidies in large trading countries and groups of countries, especially on those products of particular interest to the poorer countries.

These measure would also make a considerable contribution to assisting middle income LDCs.

32. Another priority should be a sustained expansion of world demand, which would strengthen commodity markets and enable countries to adjust through export expansion, raising employment and reducing protectionist pressures. In order to achieve this objective, current deflationary policies in many countries will need to be reconsidered and reversed.

33. A concerted effort should be made to identify and introduce measures to secure new sources of funds and investment for developing countries, e.g. from insurance companies and other institutional investors, and to retain existing lenders. Measures that require exploration include co financing between public and private sectors and the development of secondary markets in loans and financial instruments. There is a need to examine promising new forms of equity investment

and to improve opportunities for obtaining them. Establishment of a Third World Bank through the combined efforts of a few developing countries or through the mobilization of private channels seems a promising idea.

34. We have identified a number of functions that appear to be inadequately fulfilled at present. It has been suggested that many of these might be grouped together and performed by a World Central Bank. The functions could include:

- assisting the management of world liquidity to keep it appropriate to global needs for sustained growth with stability;
- acting as lender of last resort for the international economy;
- facilitating efforts to reorganize external debt when necessary;
- influencing international interest rates;
- improving exchange rate interventions; and
- monitoring international banking practices.

35. There is a need for a study to examine whether and to what extent these function are being performed adequately today; what alternative mechanisms might fulfill such functions, including existing institutions and the creation of one or a number of new institutions; and what transitional arrangements would gradually build momentum towards long-term solutions. Such a study should not, of course, have predetermined solutions, but should prepare the way for the well informed debate on these issues that is urgently needed.

Workshop Discussion on External Debt Problems of Developing Countries

This summary report was prepared by rapporteur Frances Stewart The panel was chaired by Maurice Strong with Carlos Massed, John Williamson, Azizali Mohammed and George Vojta as panelists.

Discussion of the debt problems of developing countries ranged over three categories of issues: diagnosis of the situation, proposed solutions, and the politics of such solutions.

Diagnosis:

On the whole there was agreement on diagnosis, but with some significant differences in emphasis. The state of world demand-in particular the current prolonged recession-was agreed to be critical in lowering LDCs' export potential and reducing commodity prices to very low levels. However there was some disagreement about the precise extent to which an upturn in world demand alone would resolve the problem. In particular, estimates of the relationship between an increase in OECD output levels and improvement in the current account balance of LDCs varied. Some felt that the trade restrictions recently introduced in developed countries were likely to reduce the OECD demand for LDC exports. It was also suggested that there would be no debt crisis if the external environment were normal. For example, high interest rates of 1979 and commodity prices of the 60s and early 70s were major elements in the debt crisis.

Another factor seen as contributing to the crisis was the slow-down in private bank lending. LDC policies were generally agreed to be a further factor in weak current account performance and weak capital account, with overvalued exchange rates causing capital flight and contributing significantly to the crisis.

There was some discussion as to who was being "bailed out" by crisis measures. Was it the banks, whose bankruptcy had been averted and whose profits had been increased? Or was it the countries, which had been unable to repay debts they had freely contracted?

Participants placed considerable emphasis on the fallacy of the country-by-country approach to the crisis taken by the international community. This involved measures (e.g. devaluation, deflation) which would be likely to be successful if taken by a single country, but if put into effect by a number of countries would tend to be self-defeating, leading to worsened terms of trade and increased international deflation. And since one country's imports are another country's exports, adjustment measures which cut imports in one country would make it more difficult for other countries to expand exports.

Proposed solutions:

Any viable solution must meet both intellectual and political requirements. In terms of devising intellectually sound solutions, it was agreed that little advance had been made since Keynes. And in making such advance, political context and political plausibility must ever be kept in view.

Solutions proposed by the panel included new financial mechanisms, institutional changes, changes in LDC and developed country policies, and growth in world demand.

While world demand was agreed to be of overriding significance, there was very little analysis of how a sustained increase in world demand might be achieved. This area requires more investigation.

In reference to private sector finance, it was agreed that the current emergency measures pressuring the banks to increase their involvement could not be sustained for very long. Nor could it be expected that, without special measures, private bank lending would increase on its own. The rapid growth in lending in the 1970s; occurred at a time when the LDC proportion of banks' portfolios was very small. Now that the proportion has risen substantially, lending could not be expected to increase faster than total bank lending.

Suggestions for special measures to increase private sector lending included development of equity investments (e.g. by Third World investment trusts), introducing new types of bond (commodity linked bonds and index-linked bonds), and the development of secondary markets in bank loans. These measures would extend the source of borrowing to institutional lenders and others not now lending to LDCs. There was agreement on the need for extension of equity investments and development of secondary markets but some dispute about the potential role of commodity-finked bonds. It was suggested that the futures markets in commodities left little role for such bonds, and that these bonds would not be attractive to institutional lenders.

Public sector finance should be raised by an increase in SDRs. It was suggested that a special issue of SDRs should be made for a major debt restructuring, in order to eliminate the debt overhang caused by events in the 1970s. There was opposition to this idea; it would require a change in the Articles of Agreement of the IMF which would take too long to serve as a relief in the current crisis. There was also some opposition to the idea of wiping out debts in this way. It was suggested that a new compensatory facility should be introduced at the IMF to meet the burden of fluctuating interest rates. This facility could be added to an enlarged CFF. Also, the IMF was seen to be threatened with a resource gap in the immediate future, with requirements substantially exceeding resources. This emphasized the immediate need for a very substantial increase in Fund resources. It was further suggested that the World Bank should return to a fixed interest policy to help cushion LDCs from interest fluctuations. This would require an increased contribution of paid-up capital in the Bank.

A need was perceived for new private sector institutions, to help in the development of the new financial mechanisms. There was also a need for a new or reformed public institution to coordinate the private decisions and country-by-country negotiations which, when aggregated at a world level, lead to a highly unsatisfactory state of affairs. In particular, the world implications of adjustment packages must be considered, and world liquidity and sustained growth in demand must be assured.

On finance, there was some disagreement about the emphasis on encouraging new lenders rather than focusing on the existing debt situation. Emphasis on new lending involved measures to improve returns to new lenders (as well as other policies), and this could increase the cost of existing debt.

There was some debate about the adequacy of world savings. Some emphasized the problem of low domestic savings rates, while others pointed to the "hidden" savings of $100 billion "lost" in international accounts, investigation of which should be given high priority. Furthermore, it was emphasized that progress toward full capacity utilization would increase savings.

It was agreed that LDC policies should play a significant part in adjustment; these generally involved realistic exchange rates, reduced trade restrictions and increased investment in human resources. These measures should generate international confidence. However, it was held that developed country trade restrictions were playing a major part in limiting LDC adjustment possibilities; their policies towards internal demand were contributing to world recession; and their aid policies were too negative, though this varied among countries. The U.S. and U.K. in particular were responsible for the stagnation in total aid. Other countries had increased their aid.

The politics of the situation:

The discussion contained hints rather than rigorous analysis of political elements in the situation, although it was agreed that analysis would be necessary before effective solutions could be devised. Analysis of the politics underlying Bretton Woods showed the identity of the reforms with the interest of the major actor, the U.S. This was a critical element in bringing about the reforms. It would be necessary to find a similar identity of interests and solutions today, although multi polarization of economic and political power had made this a much more complex task.

Effective interest groups in developed countries were mentioned in the discussion: export lobbies, which might lend support for subsidies on export credit; and the banks with an interest in rescue packages and orderly rescheduling.

The question of political interests in LDCs was also raised. The deflationary packages being promoted currently might be rejected by LDCs in order to ensure political survival. This possibility and the possible adoption of default as an option provide urgent reasons for developed countries to adopt more imaginative long-term solutions that would make default less tempting to LDCs.

Workshop Discussion on
Human Resource Development

This summary report was prepared *by* rapport.. Hans d'orville The panel was chaired *by* Soedjatmoko, with Bradford Morse, S.J. Build, and Ponna wignaraja as panelists.

The participants recognized that while the present discussion on the state of the world economy centers almost exclusively on monetary and financial issues, it is the quality, sophistication and level of skills in the public and private sectors that determine the development, productivity and economic growth of developing countries and their capacity to respond to changing requirements. It was recognized that the lack of adequate trained manpower constitutes a principal constraint on social development and economic growth. This was seen to be true not only for developing but also for industrialized countries, which have to cope with problems resulting from structural change in the industrial sector. There is now a heightened recognition of the essential role technical cooperation plays in the development process, especially in relation to capital assistance. Furthermore, the human and economic capacity of a society to carry out necessary adjustments to a changing economic environment determines its political and social resilience-which is already badly stretched in many countries.

The participants expressed concern that, in a period of worldwide economic recession, the weakening of lenders' confidence and the impact of IMF conditionality could inhibit the process of human capital formation in developing countries and so damage growth and prevent the emergence of a self reliant capacity for further development. To keep this from happening, a strategy should be devised, combining both short- and long-term elements, to insulate human resource development from the negative influences of the upheavals in the monetary system, and to ensure that the available resources would be maximized. Such a strategy would need to take into account the close interrelationship between human capital, financial capital, and the incentive system, focus on action at both the international and national levels, and involve the public and private sectors. Formulation of such a strategy should be under girded by a systematic analysis of the experiences of a number of countries and their respective development approaches.

The participants emphasized, however, that it would not be possible to devise a human resource development strategy *of* universal applicability. Instead, the contents *of* such a strategy would be determined by the individual situation of each country and its specific skill requirements.

Action at the national level

Participants agreed that increased sensitivity to the crucial importance of human resource development is needed among policy-makers and government bureaucrats in industrialized countries, so that they will support it accordingly. A similar consciousness-raising process is required for developing countries. Particular attention should be paid in developing countries to the establishment of a creative educational system, structured to meet prospective needs of a country's economy, avoiding both over qualification and structural skill deficiencies in the available human resources. It is essential that an appropriate balance between different levels of education be struck, in order to allow the emergence of as wide a talent base as possible. Care should also be taken to integrate women fully into the educational and human resource development process; otherwise, 50% of a country's human capital would remain untapped. Developing countries should encourage independent creative efforts at the grass roots level, leading to the formation of appropriate institutions and the acquisition of managerial abilities. It was also pointed out that in the process of development, autodidactic training and management approaches could play a role. The participants emphasized that systematic human resource development programs entail positive distributional effects and that it is important that the programs and educational systems benefit all ethnic and religious segments of a country's population.

Action at the international level

The participants urged that several steps be taken:

(a) IMF conditionality should be linked not only to monetary and financial measures but also to specified levels of output and employment and to a set of physical-quality of-life indicators on which adjustments should be based.

(b) ODA flows should be increased, and a growing share of ODA should be earmarked for human resource development, commensurate with the proportion that developing countries themselves devote in then budgets for that purpose, to meet the increasing needs for human and institutional resources. If sufficient finance is available, human resource development programs stand to benefit. In that context it was suggested that technical cooperation inputs should be doubled over a five-year period to supplement growing capital assistance. Some participants felt however, that the

establishment of a specific target ratio of technical cooperation allocations in ODA funds would be inappropriate, since it is the quality of programs and not the mere quantity of financial inputs that matters. Strong concern was expressed that a lack of sufficient finance prevents the systematic conduct of human resource development particularly in Sub-Saharan Africa.
(c) Closer linkage should be made between technical cooperation and capital assistance, and a broader cooperation between multilateral agencies dealing with technical assistance and those providing capital assistance should be pursued.
(d) There is a need for an annual report on the state of the human condition, to provide for regular monitoring of poverty levels.
(e) The World Bank should increase the total proportion of its lendings in support of improved human living conditions, with appropriate reporting thereon in the annual World Development Report. It was also suggested that the World Bank should reconsider its policy of giving loans for human resource development programs, further aggravating the indebtedness of developing countries. In general it was felt that existing domains and procedures for multilateral technical cooperation should be reviewed, to keep them in step with changing requirements.
(I) Developing countries should also intensify cooperation within regions and among like-minded countries (TCDCECDC), as an alternative to accepting conditionality.

Private sector

The participants agreed that the private sector has an important role to play in human resource development: through on-the-job training, formal training programs, etc. It was felt that multilateral mechanisms might be needed to channel the technical resources and expertise of the private sector of industrial countries to the public and private sectors of developing countries.
In general it was agreed that full recognition should be given to the need for the developing countries to establish development priorities so as to maximize the integration of the various sources of external aid into national development programs and to maximize the impact of such assistance. The participants agreed on the importance of pursuing a more systematic integration of the human resource development dimension in future discussions on monetary and financial matters.
In concluding, the participants recognized that technocratic solutions which do not take the human dimension into account will fail to provide an enduring answer to the world's financial and monetary problems. Until the human resources needed for sustained economic growth are developed, the development battle will not be won.

Workshop Discussion on Concessional Assistance to Poor Developing Countries

This summary report was prepared by S.J. Burki. The panel was chaired by Mahbub ul Haq with S.J. Burki, Robert Hormats, Green INuankwo and Frances Stewart as panelists.
The discussion can be summarized under the four following headings:
i) the need for ODA flows in the future;
ii) present supply constraints on ODA flows;
iii) new approaches and arrangements on the supply side to meet the current situation; and
v) new approaches on the recipient side.

The need for ODA flows

There was consensus among participants that over the foreseeable future poor countries-countries with per capita incomes of less than $600-will continue to need substantial flows of concessional assistance. These flows will need to increase by 3.5% per annum over the next decade and a half, from $25 billion in 1982 to $80 billion in 1995. The increased ODA needs of these countries are unavoidable for at least the following three reasons:
- The current ODA recipients do not have the creditworthiness to have any real access to non-concessional flows.
- Two groups of ODA recipients-the least developed countries and the countries of Sub-Saharan Africa-have low domestic saving rates, on the order of about 8-10% of their gross domestic product.
- ODA flows have been used and will continue to be used for programs and projects aimed at poverty alleviation and human resource development.
In sum, without adequate flows of concessional assistance, it would not be possible for the low-income countries to obtain a rate of growth in their gross domestic product marginally better than the growth in population. Without such growth they will not be able to address the problem of poverty. According to the latest World Development Report of the World Bank, the gross

domestic product of low income countries could grow at the rate of 5.5% per annum if adequate amounts of **ODA** are made available. Sub-Saharan Africa will need an increase in its ODA receipts on the order of 6% per annum to achieve any actual increase in per capita income.

Present supply constraints

Two important points were made in this context: First, it is possible to exaggerate supply constraints and to apply the problems in the United States and the United Kingdom to all donors. Second, to ease the supply constraints in the U.S. and U.K., it would be most useful for the international development community to reinforce the mandate for aid. This could be done in at least two ways:

- By demonstrating that aid flows in the past have been used quite effectively. It would be useful to focus the attention of the donors on such vivid examples of aid success as the Green Revolution in Asia and decline in infant mortality and child death rates throughout the developing world.
- By demonstrating that aid brings political, strategic and economic dividends to the donors. A major disruption in aid flow child have grave political repercussions in the poor countries. It is in the donors' interest to have political tranquility in the Third World.

New approaches and arrangements on the supply side

Four approaches and/or arrangements for releasing constraints on ODA were identified as deserving consideration by the international development communities:

First, it was agreed that IDA VII replenishment should be given priority. B the United States does not change its present stand-limiting its contribution to only $750 million per year (implying a total for IDA V8 of only $9 billion for the period FY 198486)-serious consideration should be given to the possibility of setting up a parallel account along with IDA to be financed by other donors. This parallel account could be as large as $7 billion. The United States would not have procurement rights from this account, as was the case with the arrangement made for FY 84.

Second, it was agreed that measures such as the following would help to improve the effectiveness of aid:

- Increase the proportion of aid flowing through multilateral channels. Currently some 90% of multilateral aid is focused on poor countries, as against only 30% of bilateral aid. - Untie bilateral aid as far as possible. Currently, tied aid costs about 40% more than untied aid.
- Provide for greater flexibility in the use of aid with a higher proportion going to non-project assistance, especially during periods of financial difficulties.

Third, the question of reviving the idea of SDR-aid link was discussed at length. It was agreed that this idea needed to be pursued even if it meant that some compromises had to be made on the original formulation-compromises such as focusing the "linked SDRs" on the poor countries and providing them through such channels as IDA.

Fourth, there was agreement that the important role played by non-governmental organizations (NGOs) in providing concessional resources to developing nations should be recognized. At present NGOs provide a total of $2 billion or 8% of all concessional resources, much of it spent on programs aimed at poverty alleviation and human resource development.

New approaches on the recipient side

Two points received special attention in this context:

First, it was agreed that there was need to adopt new forms of conditionality aimed at achieving a different set of objectives than those followed by the donors in the countries that are not dependent on ODA flows for their development. The ODA receiving countries would require the use of a different set of instruments for achieving these new objectives.

Second, it was also agreed that the developing countries themselves should make progress in providing technical assistance to each other in such areas as rural development and human resource development.

Workshop Discussion on The Implications of Debt for Regions and Countries

This summary report was prepared by rapporteur Carlos Massad. The panel was chaired by Robert Hormats with Turgut Ozal, Richard Fletcher and Nemir Kirdar as panelists.

The panelists addressed three main questions: the diagnosis of causes of the difficulties experienced by different countries and regions, the approaches that showed no probability of success in solving those difficulties (or "non-solutions"), and what could be done to achieve positive results.

1. The diagnosis

A factor mentioned by most speakers was the price of oil. The two oil shocks created great problems for oil importing countries, and the "shock" of 1982 reduced the income of oil exporters substantially and forced them to adjust their development strategies.

Increased interest rates were also recognized as a source of serious difficulties for borrowers. Some discussion arose regarding the causes of high real interest rates at present. One cause mentioned by several speakers was the budget deficit in the U.S. which absorbs a substantial proportion of domestic savings in that country. It was also pointed out that some other industrial countries suffer from the same problem, and that the public sector exerts such a pressure on financial markets that interest rates should be expected to remain high for an extended period.

There was general agreement that the deterioration in terms of trade, the lack of growth in world trade, and existing protectionist tendencies were other important elements to be considered, the world recession being behind these negative trends.

Here it was pointed out that an improved management of public sector policies could help to pull the world economy out of the recession. However, it was also recognized that mismanagement in the private sector had contributed to the acuteness of present problems in some countries; an increase in private expenditure, if financed by foreign borrowing, could go very far in creating imbalances in the economy. Suitable public policies could be devised to dissuade the private sector from excessive spending or excessive borrowing.

There was general recognition that the symptoms of difficulties had not been recognized at an early stage either by lenders or by borrowers, and that there had been widespread misjudgment of the timing and the magnitude of the problems faced by both borrowers and lenders. In this context, it was pointed out that sustained borrowing could not go on indefinitely, since interest payment burdens would inevitably grow to the point of generating a loss in creditworthiness and a reversal in net financial flows.

It was suggested that some of the present difficulties might be due to efforts by debtor countries to grow at rates that could not be sustained for long periods of time.

The point was made that, under present circumstances, there seems to be some policy incompatibility among industrialized countries. The U.S. budget deficit, by causing high interest rates, has drawn a capital inflow toward the U.S., and as a consequence a sizable current account deficit has developed. But political attention is drawn only towards that deficit, while the surplus on capital account goes unnoticed. As a result, a tendency toward protectionism has appeared. On the other side of the coin, Japan and/or Germany must accept a surplus in their current accounts to produce the necessary capital transfer to the U.S. However, they are subject to pressures to reduce that surplus; and if those pressures are successful, the rest of the world, including LDCs, will have to transfer capital to the United States. Thus it was suggested that a reduction in the U.S. budget deficit would make a major contribution to the smoother working of the world economy. II.

Il .The non-solutions

There was general recognition that in a recessionary world economy it is impossible to expand exports of all debtor countries at the same time. The chief effect of a general devaluation of their currencies would be a negative impact on their terms of trade, while restrictive domestic policies would mainly act through a reduction of imports, income and employment, straining the limits of political tolerance.

It was recognized that there is no guarantee of gaining access to new investors at a time when banks are quite reluctant to continue lending. However, it was pointed out that some oil-exporting countries have reached a point where an international diversification of their investments is in order. And, in the medium term, it will be necessary to tap new investors in order to increase flows of capital toward LDCs.

Despite the fact that some debtor countries have become net capital exporters, it was generally asserted that default or debt repudiation would create more problems than they might solve. Access to financing in the future would be affected, and even short-term trade financing could be injured. Flows of liquidity might be improved by appropriate domestic policy as well as by prudent behavior on the part of lenders-as has been the case in some countries. However, it was pointed out that, unless solutions are soon put into place, default, despite its drawbacks, might be forced upon some countries.

Il l . The solutions

It was generally agreed that if world economic conditions returned to normal, most of the present financial problems would be overcome. However, as this would take some time, some immediate action must be considered, to avoid a situation where a liquidity problem becomes an insolvency problem.

One aspect that needs careful examination is the economic policies of creditor and debtor countries, both of which should contribute to adjustment. In particular, creditor institutions could make a valuable contribution by reducing spreads, while creditor countries could take into consideration the need to reduce interest rates.

It was pointed out that it is worthwhile to explore the possibilities for treating sovereign credits in the same way domestic credit is treated in case of difficulties. In the case of the poorest countries, debt write-off mechanisms could be explored.

Participants agreed on the need for additional flows of official development assistance on concessional terms. Such flows are expected to increase when the governments and public in the creditor countries realize that it is in their own interest to provide such assistance in order to support healthy development in the world economy.

There also was general agreement that a substantial and additional allocation of SDRs is justified at this time in order both to stimulate recovery and to ease the burden on debtor countries. It was stated that SDR allocations could be speedily put into effect, for a prompt alleviation of the present liquidity squeeze.

Workshop Discussion on
Institutional Reform

This summary report was prepped by rapporteur, Goran Ohlin. The panel was chaired by lean Report with Sidney Dell ,Michael Sakbani, Uner Kirdar and Gem, Ohnn as panelists.

In the discussion about the international economic institutions, there was general agreement that the objectives originally laid down for these institutions were still valid. Proposals for reform of the monetary and financial systems could for the most part be accomplished within the charters of existing institutions and did not seem to require the creation of new ones. The severity of the present recession was said to be due to the policies of major countries rather than to the weaknesses of the institutions; it was objected that the purpose of these institutions was among other things to protect the stability and growth of the world economy from policy mistakes in individual countries.

The proposals presented for the enlargement of the IMF along the lines of the Committee of Twenty, resumption of SDR issue, strengthening of the World Bank, and coordination of policies in areas of finance, money and trade did not arouse any controversy. Similarly, the need for an international regime for investment and steps to improve the debt rescheduling process were made without objections.

The proposed strengthening of the IMF would not amount to making it a world central bank although one speaker referred to a "residual world central bank." It was argued that in a multi polar world there was no room for an international central bank; another speaker objected that precisely in such a world there was a need for a central bank to impose consistency on monetary policies.

Mention was made of the proposal that a few key currency countries should coordinate their policies regarding monetary aggregates; this was more important than focusing on reserves, changes in which were reflections rather than causes of the problems.

The need to restore confidence in the banking system was readily agreed to, but it was argued by some speakers that one could not go very far towards the creation of a declared lender of last resort without incurring problems of moral hazard.

Several speakers insisted that fundamental requirements of international solidarity must be reflected in steps to protect the weakest countries against the vicissitudes of the world economy and to support their development. In order to give priority to this, different financial terms should apply to developing countries according to the level of their development. This was also reflected in the proposal that in order to keep the universal character of the UNDP, the services of the Programme should be made available to middle-income and newly industrializing countries on a reimbursable basis, instead of graduating these countries from the Programme. It was also proposed that UNDP should be enabled to cooperate with private organizations and corporations which play an increasing role in human resource development.

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