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DEVELOPMENT AND INTERNATIONAL ECONOMIC CO-OPERATION

Current international monetary issues

Report of the Secretary-General

CONTENTS

CONTENTS (continued)

Annexes

I. INTRODUCTION AND SUMMARY

1. The main pressures on the international monetary system during the period under review continued to be those which have been at the centre of policy makers' concerns since 1985. Outstanding among these pressures are the large external imbalances of major OECD countries, and the debt and adjustment problems of developing countries. Since the autumn of 1985, policy approaches to external imbalances in the OECD area have reflected the belief that the determination of exchange rates should not be left to markets alone, and that the adjustment of trade imbalances could not be achieved solely through movements of exchange rates. However, a notable feature of the actions taken so far on the basis of these beliefs has been their ad hoc and partial character. As a result, despite some progress towards a more sustainable pattern of external-payments positions in the OECD area, and the attainment of relative levels for major exchange rates in closer accordance with fundamentals, imbalances are still large, and financial markets continue to be vulnerable to sharp fluctuations in interest and exchange rates. In the seventh year since the outbreak of the debt crisis, the debt problems of developing countries remain unresolved, as is explained in detail in two recent United Nations studies. 1/

2. The Plaza meeting of September 1985 witnessed an important shift in the perceptions of major OECD Governments as to the respective roles that should be played by official intervention, on the one hand, and market mechanisms, on the other, in setting exchange rates and in correcting external imbalances. Within the framework of the more co-ordinated approach to policy that resulted from this shift, primary emphasis was placed on monetary policy and intervention in exchange markets. In the context of a substantially deregulated régime for international capital movements in the OECD area, and of the huge amounts of mobile financial assets at the disposal of the private sector, there were limits on the ability of Governments to influence exchange rates through official intervention. Furthermore, the heavy reliance on monetary policy tended to lead to conflicts between external and internal policy objectives. In the first place, a conflict may arise between the use of monetary policy as a means of influencing the exchange rate, on the one hand, and as a tool for achieving targets for internal macro-economic balance, on the other. Furthermore, gearing monetary policy to exchange-rate objectives is capable of leading to conflicts with financial stability, because the required changes have to be imposed on markets for financial and closely related assets (such as real property and certain commodities) which have demonstrated propensities for large and on occasion self-perpetuating fluctuations in values. A notable example of the sensitivity of financial markets to outside shocks was provided by the world-wide collapse of equity values in October 1987.

3. Various aspects of the consequences for both developed and developing countries of the policy stances of major OECD Governments and of the measures employed in this context are examined in section II of this study, which also surveys recent developments involving the main statistical magnitudes under the heading of the international monetary system. The discussion points to various shortcomings of policies affecting the international monetary system, including the failure to reactivate growth more widely in developing countries as part of the

management of global demand, and the failure to extend to such countries the principle of an equitable sharing of the burden of payments adjustment between surplus and deficit countries, a principle which is now increasingly accepted as regards the external imbalances of major OECD countries. It also points to the extent to which the large increase in international reserves during 1987 was concentrated in a small number of surplus countries, and was closely associated with intervention in exchange markets to protect the value of the dollar.

4. Section III begins with a brief account of the major causes and consequences of the volatility of exchange rates. This account serves as a backdrop to a survey of various proposals for improved methods for the co-ordination of the macro-economic policies of OECD countries. The first of these proposals involves the use of a set of indicators for major policy targets and instruments. Since the Tokyo Summit of May 1986 the utility of such indicators in this context has been accepted by the Group of Seven, but the precise relationship of such indicators to the process of policy co-ordination remains ill-defined. Among the indicators that have been put forward is an index of commodity prices, which could serve as an early warning of the level of inflationary or deflationary pressures in the world economy. In the discussion of such an index in this study, it is noted that the consequences of taking it as the basis for judgements for demand management would depend crucially on the decision as to what level of the index was considered correct. Recent official intervention by major OECD countries in the exchange markets has been based on a somewhat loose system of bilateral reference ranges for their currencies. Various proposals for target zones and adjustable pegs for exchange rates, discussed in section III, aim to establish tighter connections between macro-economic policy and exchange-rate management. The section concludes its survey of proposals for improved policy co-ordination with a discussion of some of the difficulties involved, including that of establishing common goals and priorities, that of achieving a mutually consistent interpretation of indicator signals, and that of distributing responsibility for macro-economic adjustment among participating Governments.

5. The discussion in section III of improved policy co-ordination and exchange-rate management also takes up the issues of surveillance by the International Monetary Fund (IMF) and the regulation of international capital movements. Attention is drawn to the potential contribution of IMF surveillance to these goals by facilitating agreement on the distribution of responsibilities for macro-economic adjustment, and by increasing countries' awareness of the international repercussions of their policies. Under the heading of the regulation of capital flows, mention is made of the role that restrictions on, or taxation of, such flows can play in supplementing the effects on behaviour in financial markets of improved macro-economic policies.

6. Section IV takes up prerequisites for growth-oriented adjustment in developing countries. These prerequisites include improvements in the design of IMF-supported programmes through such changes as making greater allowance for the specific characteristics of individual borrowing countries and ensuring that financing from multilateral financial institutions is provided on a scale sufficient to enable such countries to grow in line with their economic potential. The Fund's resources are not currently strained, and there has recently been progress in strengthening its facilities. Nevertheless, a reorientation of IMF assistance to developing

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countries to take account of the changes in conditionality and programme design proposed here would be likely to require a substantial increase in the IMF's resources. This increase could be usefully supplemented by a new allocation of special drawing rights which would not only contribute to easing external financial stringency in developing countries, but would also relieve pressures for potentially counter-productive competition for current-account surpluses among countries not belonging to the small minority that have recently enjoyed large increases in reserves.

7. Closely associated with the increased scale of international capital movements and the accompanying volatility of exchange rates have been the progressive expansion and articulation of a world-wide network for financial transactions carried out by institutions that have been subject to a substantial measure of deregulation during recent years. In view of the risks associated with these trends, there are currently widespread efforts to strengthen prudential supervision of banks and other financial institutions. Some of the initiatives in question are national in scope, but they also include the Basle Agreement of July 1988 among the central bank governors of the Group of Ten countries concerning a common, risk-based standard of capital adequacy for international banks. This agreement is also intended to reduce competitive inequalities among international banks stemming from divergences in the regulatory régimes under which they operate.

II. RECENT DEVELOPMENTS IN THE INTERNATIONAL MONETARY SYSTEM

A. Recent performance of the system

1. Exchange rates

8. Although the decline of the dollar, which had begun in early 1985, continued in 1987, after the Louvre meeting of the Group of Seven countries in February 1987 its depreciation was slow, the effective rate of the dollar falling by about 3 per cent between February and October (see table 1). However, in the course of 1987, it proved increasingly difficult to keep the dollar within the ranges agreed at the Louvre meeting. The phase of relative stability of the dollar lasted until exchange rates lost priority as a target of monetary policy after the stock market collapse of October. The nominal effectiv exchange rate of the dollar continued to decline between October 1987 and April 1988. In April 1988 the real effective exchange rate of the dollar was 36 per cent below its February 1985 level, while the real value of the yen was higher by one third and that of the deutsche mark by 20 per cent. The pound sterling also appreciated in real terms, while there was practically no change in the real effective rate of the French franc.

9. The cross rates of the main non-dollar currencies were also subject to some notable changes. In the second half of 1986 there had been devaluations of the French franc and the pound sterling. The DM/yen rate fell by some 15 per cent between February 1987 and April 1988. The pound rose by nearly the same rate against the deutsche mark in early 1987 before attempts were made to keep it in line with the European Monetary System currencies. March and April 1988, however, saw again a rising pound in the presence of a favourable interest rate differential

Table 1. Selected exchange rates of the United States dollar, 1985-1988

(Percentage change)

	July 1988	April 1988	September 1987	July 1988
	Since February 1985 a/			Since 1980 b/
$US nominal effective rate	-33.5	-37.1	-31.1	-0.2
$US real effective rate c/	-32.5	-36.3	-30.3	-2.0
$US real effective rate, broad d/	-27.7	-30.9	-25.1	2.8
$US nominal, against:				
Japanese yen	-48.9	-52.0	-45.0	-41.3
Deutsche mark	-44.0	-49.2	-44.9	1.6
French franc	-38.2	-43.6	-39.9	47.0
British pound	-40.4	-41.3	-32.9	26.5
Canadian dollar	-2.8	-8.7	-3.2	11.9
Republic of Korea won	-13.1	-11.5	-3.6	19.7
Singapore dollar	-10.0	-11.2	-7.2	-5.2
New Taiwan dollar	-26.5	-26.5	-23.2	-18.6
Hong Kong dollar	0.0	0.0	0.0	56.8

Source: IMF, International Financial Statistics, various issues; Morgan Guaranty Trust Company of New York, World Financial Markets, various issues; UNCTAD secretariat estimates.

a/ Monthly averages.

b/ 1980, annual average.

c/ Against currencies of 15 other industrial countries.

d/ Against currencies of 18 other industrial countries and 22 developing countries.

and a reorientation of British macro-economic management away from foreign exchange rate stabilization.

10. The most recent period was again marked by a high degree of instability on foreign exchange markets, this time accompanied by a rising dollar exchange rate. By late August 1988 the dollar was up 14 per cent against the deutsche mark and 8 per cent against the yen, compared to the trough in April 1988.

2. Interest rates

11. Both short-term and long-term interest rates in the United States rose substantially between March and October 1987, while monetary relaxation in Europe and Japan served to hold interest rates down; thus, interest differentials widened in favour of dollar assets (see table 2). However, during the second half of the year there were rises in interest rates in Japan and the Federal Republic of Germany, long-term rates rising substantially faster than short-term rates. The pattern of movements in nominal interest rates was similar in most other industrialized countries.

Table 2. Short-term nominal interest rates a/ in selected OECD countries, 1984-1988

		United States	Japan	Fed. Rep. of Germany	United Kingdom	France	LIBOR
1984		10.4	6.3	6.0	9.9	11.7	10.9
1985		8.1	6.5	5.4	12.2	10.1	8.4
1986		6.5	5.0	4.6	10.9	7.7	6.9
1987		6.9	3.9	4.0	9.7	8.2	7.2
1987	1st quarter	6.0	4.1	4.2	10.6	8.3	6.4
	2nd quarter	6.8	3.8	3.8	9.1	8.1	7.2
	3rd quarter	6.9	3.7	3.9	9.7	7.9	7.2
	4th quarter	7.6	3.9	4.1	9.2	8.5	8.0
1987	October	8.0	3.9	4.7	9.9	8.3	8.4
	November	7.2	3.9	3.9	8.9	8.7	7.5
	December	7.7	4.0	3.7	8.7	8.5	8.0
1988	1st quarter	6.7	3.8	3.4	9.0	7.9	7.0
	2nd quarter	7.0	3.8	3.5	8.3	7.8	7.5

Source: Federal Reserve Bulletin, various issues; IMF, International Financial Statistics, various issues; IMF, World Economic Outlook, April 1988.

a/ National rates are for three-month interbank loans, except for the United States Certificate of Deposit rate and Japan's Gensaki rate. US real rates have been calculated as (i-p)/(1+p), where i is the nominal rate of interest and p is the consumer price inflation. LIBOR is for three-month Eurodollar deposits.

12. The collapse of stock markets in the middle of October 1987 led to an easing of monetary policy, and interest rates were lowered almost everywhere as central banks provided additional liquidity, and inflationary expectations made way for fears of recession. Official short-term interest rates were cut in several European countries and the United States. Only in Japan did short-term rates remain almost unchanged.

13. However, interest rates ceased to fall in most countries during March or April 1988, and by the middle of the year interest rates were tending to rise against the background of a general perception that the deflationary impact of stock market losses on the real economy was weaker than originally expected. Real long-term rates in early 1988 were substantially above their long-term historical level, though well below their peak levels of 1984. The inadequate policy response to the persisting trade imbalances, which will be discussed in more detail below, caused a high degree of uncertainty and instability on financial markets, which was reflected in considerable volatility in financial asset prices.

3. International reserves

14. A striking development during 1987 was the increase in the value of international non-gold reserves by about $205 billion, or 40 per cent as compared with 1986, the biggest rise since the introduction of floating exchange rates (see table 3). To some extent this resulted from a revaluation of foreign exchange reserves denominated in currencies other than the dollar; the main part of the increase was, however, due to central bank intervention in foreign exchange markets, in order to stabilize the dollar. Up to September 1987, the volume of exchange market intervention by the Group of Seven central banks was between $70 and $90 billion, 2/ reflecting, in large part, the increased need for official financing of the United States current-account deficit because of insufficient private flows at existing exchange rates.

15. Exchange rate policies within the European Monetary System also contributed to reserve accumulation, particularly in the Federal Republic of Germany, where the Bundesbank tried to contain the strong upward pressure on the deutsche mark in relation to other currencies of the system resulting from shifts from assets denominated in United States dollars to those in deutsche marks. British and Spanish foreign-exchange reserves increased by more than 100 per cent during 1987, as a result of intervention to keep these countries' currencies stable in relation to the European Monetary System currencies, particularly the deutsche mark. Moreover, some central banks appear to have increased international reserves on a large scale, not as part of exchange-rate management but in order to benefit from the relative strength of their currencies against the dollar and the deutsche mark. 3/ In the first half of 1988 there was a reversal of the situation in some European countries as large amounts of dollar reserves were released by central banks to counter the pressure for dollar revaluation.

16. In developing countries, the increase of foreign exchange reserves was highly concentrated on a very small number of countries. With its large current-account surplus, Taiwan Province of China accounted for almost 60 per cent of total reserve

Table 3. Changes in official reserves a/ in selected countries, 1987-1988, and stocks in mid-1988

	1987		First half of 1988		Stock mid-1988
	$US (billion)	Percentage change	$US (billion)	Percentage change	$US (billion)
United States	-2.7	-7.3	-4.8	-13.7	30.0
Japan	38.7	91.6	5.9	7.3	86.9
Federal Republic of Germany	26.9	52.1	-14.0	-17.8	64.8
United Kingdom	22.9	124.7	-1.3	-3.1	40.4
Italy	10.1	50.8	-3.1	-10.3	27.1
France	1.6	5.0	-1.5	-4.7	31.4
Canada	4.0	123.9	8.1	111.0	15.4
Spain	15.9	107.7	3.1	10.1	33.8
Switzerland	5.7	26.1	-3.1	-11.3	24.4
Other developed market-economy countries	28.9	40.4	5.1	5.1	105.5
Developing countries and territories	53.0	27.1	2.0	0.8	251.5
Taiwan Province of China	30.4	65.7	-1.7	-2.2	75.0
Mexico	6.8	119.8	1.5	12.0	14.0
China	4.9	42.2	2.7	16.5	19.0
Other developing countries	10.9	8.3	-0.5	-0.3	143.5
Total	205.0	40.4	-3.6	-0.5	711.2

Source: Bank for International Settlements, 58th Annual Report (Basle, June 1988); IMF, International Financial Statistics; UNCTAD secretariat estimates.

a/ Includes ECU positions, but excludes gold.

accumulation by developing countries and territories. Unusually for a highly indebted developing country, Mexico more than doubled its foreign-exchange reserves, by $6.8 billion. A number of countries in Africa and the Middle East, where non-dollar currencies accounted for a larger share of total reserves than in Latin America, benefited from a revaluation of their reserves.

4. Balance-of-payments adjustment in the developed countries

17. With respect to the correction of the trade imbalances among the major industrialized countries, little progress was visible up to autumn 1987 (see table 4). The trade figures of the United States continued to deteriorate during 1987, showing the largest ever quarterly deficit in the third quarter of the year (when trade is valued at current prices). Import volumes reached record levels in the second and third quarter. Real exports were some 10 per cent during the first nine months of 1987 but still remained substantially below their 1980 level. Over the whole year both the current account and trade deficits increased to reach $160 billion, or 3.6 per cent of gross domestic product (GDP). The main surplus countries were also very slow in correcting their trade imbalances, the size of the trade surpluses of both Japan and the Federal Republic of Germany increasing in 1987.

18. It was only towards the end of 1987 that signs of a correction of trade imbalances became apparent in both nominal and real terms. The United States trade deficit narrowed, mainly on account of a substantial increase in export volume between October 1987 and March 1988. Japanese import volume also increased, so that there has been a moderate decline of its trade surplus after late 1987. But the trade surplus of the Federal Republic of Germany has continued to grow. The bilateral trade balance of the United States improved in the first quarter of 1988 with Japan and the newly industrialized countries, mainly due to a marked rise in United States exports (see table 5). While the deficit with the Federal Republic of Germany showed a slight improvement, the United States trade balance with the other European countries swung from deficit to surplus in the first half of 1988, mainly on account of sharply increased exports to the United Kingdom.

19. The impact of the depreciation of the dollar on the United States trade balance was dampened and retarded for various reasons. One factor often mentioned in this context is the so-called J-curve effect, the adverse initial effect on the nominal trade balance of currency depreciation resulting from the fact that the response of trade volumes to changed trade prices is usually slow. However, various evidence suggests that the slow response of trade deficit can be accounted for more by the sluggishness in the response of trade prices to changes in exchange rates than by the slow response of trade volumes to price changes. The decline of the dollar was reflected only partially in higher import prices in the United States, because European and Japanese firms were able to reduce export prices in their home currencies by cutting wage costs and switching production to low-cost countries. 4/ These firms had also been able to build up substantial profit cushions during the period of the rising dollar up to 1985, which subsequently allowed them to secure market shares by cutting profit margins. Moreover, a considerable part of the United States trade deficit results from its trade with

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Table 4. Balance of payments on current account, exports and imports in United States, Japan, Federal Republic of Germany and selected countries in Asia, 1985-1988

(Billions of dollars, unless otherwise specified)

	1985	1986	1987	1988 a/
United States:				
Current-account balance	-116.2	-141.5	-160.7	-179.8
Trade balance	-122.2	-144.3	-159.2	-141.0
Merchandise exports	215.9	224.4	250.8	313.3
Merchandise imports	338.1	368.7	410.0	454.3
Per cent changes				
Export volume	3.7	5.9	15.3	20.0
Import volume	5.8	13.5	5.6	5.8
Japan:				
Current-account balance	49.2	85.8	86.7	85.0
Trade balance	56.0	93.8	96.5	95.0
Merchandise exports	174.0	205.6	224.4	257.7
Merchandise imports	118.0	112.8	128.0	162.7
Per cent changes				
Export volume	3.7	-0.6	1.2	4.0
Import volume	-0.1	10.6	9.0	14.5
Federal Republic of Germany:				
Current-account balance	17.0	39.8	45.2	46.7
Trade balance	28.6	55.7	70.2	75.0
Merchandise exports	173.7	231.0	278.8	311.7
Merchandise imports	145.1	175.3	208.6	236.3
Per cent changes				
Export volume	5.9	1.3	2.9	4.5
Import volume	4.2	6.1	5.4	6.0
Newly industrialized countries and territories in Asia: b/				
Current-account balance	10.0	22.9	32.6	29.0
Trade balance	8.3	18.7	25.8	23.5
Merchandise exports	108.5	130.2	172.3	221.0
Merchandise imports	-100.2	111.5	146.5	197.5
Per cent changes				
Export volume	4.1	20.8	21.4	20.0
Import volume	-0.1	17.7	23.9	26.0

(Source and footnotes on following page)

(Source and footnotes to table 4)

Source: IMF, _International Financial Statistics_, various issues; IMF, _World Economic Outlook_, March 1988; OECD, _Economic Outlook_, No. 43, June 1988; and sources cited in these publications.

a/ Projections.

b/ Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Table 5. United States bilateral trade balances, 1982-1988

(Billions of US dollars, monthly averages)

	1982	1985	1986	1987 1st half	1987 2nd half	1988 1st quarter	Swing 1986-1987	Swing 1987 (1st quarter)-1988 (1st quarter)
United States trade balance with:								
Japan	-1.4	-3.8	-4.6	-4.7	-4.7	-4.1	-0.1	0.5
Federal Republic of Germany	-0.2	-0.9	-1.2	-1.3	-1.3	-1.0	-0.1	0.1
Other European countries	0.9	-1.0	-1.1	-0.7	-1.0	0.2	0.2	0.4
Canada	-0.5	-1.8	-1.9	-0.9	-1.0	-1.2	0.9	-0.1
Newly industrialized countries and territories in Asia a/	-0.6	-1.8	-2.3	-2.7	-3.0	-2.1	-0.6	0.3
Other non-oil developing countries	-0.2	-1.2	-1.1	-1.5	-1.4	-1.7	-0.3	-0.3
Oil-exporting countries b/	-0.5	-0.7	-0.6	-0.7	-1.2	-0.7	-0.3	-0.1
World	-2.6	-11.0	-12.7	-12.2	-13.3	-10.4	-0.1	1.3

Source: OECD, Monthly Statistics of Foreign Trade, various issues.

a/ Including Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

b/ Including Algeria, Bahrain, Indonesia, Islamic Republic of Iran, Iraq, Kuwait, Nigeria, Qatar, Saudi Arabia, Venezuela and United Arab Emirates.

developing countries, whose currencies have appreciated much less against the dollar than those of major OECD countries. While United States imports from a small number of newly industrialized countries in Asia increased very sharply between 1980 and 1987, the country's exports suffered from the continuing import compression in many developing countries facing debt problems and payments difficulties.

5. The balance-of-payments and debt situation in the developing countries

20. Developing countries have experienced a marked change in their current-account situation since the beginning of the 1980s (see table 6). While the current account of oil-exporting countries was in deficit in 1987, both the trade and current accounts of the non-oil exporting countries have moved into surplus. Apart from the good export performance of some Asian exporters of manufactures, the main reason for this change lies in the balance-of-payments adjustment of the developing countries experiencing financial stringency. For example, for the group of 15 highly indebted countries the current-account deficit was reduced from more than $50 billion in 1982 to less than $10 billion in 1986/87, a swing of about 5 per cent of GDP. In sub-Saharan Africa (excluding Nigeria) there was also a substantial swing.

21. These massive adjustments in external balances were achieved less through increases in export revenues than through import cuts. Indeed, the entire improvement in the trade balance of the highly indebted countries as a whole during 1982-1987 was due to cuts in imports. In sub-Saharan Africa export revenues have actually fallen, and import cuts have exceeded the decline in trade deficits.

22. In most developing countries, adjustment programmes have included substantial currency depreciation. With two exceptions, the real effective exchange rates of the highly indebted countries by 1986-1987 had fallen much below the levels of 1982, the depreciation being on average 35 per cent. At least 10 of these 15 countries have had continuous real depreciations every year. In sub-Saharan Africa, devaluations have more than offset the appreciation in real terms that took place during 1980-1983, and at the beginning of 1987 the weighted average real effective exchange rate was 40 per cent below its 1980 level.

23. The sharp swing in the trade balances of debtor countries has contributed substantially to imbalances in world trade, and since the burden of adjustment has continued to fall on imports, it has added to deflationary forces. The role that the debtor developing countries can play in redressing the external payments imbalance of the United States is illustrated by recent calculations of the UNCTAD secretariat. If importers from the United States had maintained the same shares of its exports in 1986 as in 1980, and if United States exports had grown at the same rate as world trade during 1980-1986, the country's earnings would have been about $50 billion higher than the figure actually achieved in 1986. More than half of the extra earnings would have come from the higher share of developing country markets in United States exports, of which almost two thirds would have been contributed by the highly indebted developing countries. 8/

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Table 6. Balance of payments on current account of developing countries, selected years

(Billions of dollars, unless otherwise indicated)

	1980	1982	1985	1987
Oil-exporting countries: a/				
Current-account balance	104.0	-9.6	3.8	-2.3
Trade balance	170.8	64.4	55.8	36.9
Merchandise export	296.6	214.8	154.9	119.6
Merchandise imports	125.8	150.4	99.0	82.8
Annual average changes (per cent)				
Export volume	-	-18.3	-4.3	6.0
Import volume	-	12.6	-10.7	-18.3
Non-oil developing countries:				
Current-account balance	-73.4	-77.4	-28.1	6.6
Trade balance	-74.4	-56.2	-11.6	12.7
Merchandise export	334.5	332.2	378.4	472.8
Merchandise imports	408.9	388.4	390.0	460.1
Annual average changes (per cent)				
Export volume	-	3.8	7.7	9.3
Import volume	-	-1.5	3.3	3.2
Highly-indebted countries: b/				
Current-account balance	-29.1	-50.7	-0.3	-7.6
Trade balance	5.5	4.0	40.6	27.5
Merchandise export	127.9	112.2	118.8	112.1
Merchandise imports	122.4	108.2	78.2	84.6
Annual average changes (per cent)				
Export volume	-	-3.8	5.0	1.4
Import volume	-	-6.5	-8.1	-1.0
Sub-Saharan Africa: c/				
Current-account balance	-8.6	-8.3	-3.0	-6.7
Trade balance	-3.8	-4.2	0.6	-2.1
Merchandise export	23.8	20.0	20.6	21.6
Merchandise imports	27.6	24.1	20.0	23.7
Annual average changes (per cent)				
Export volume	-	0.5	2.2	3.4
Import volume	-	-2.1	-3.0	-1.3

(Source and footnotes on following page)

(Source and footnotes to table 6)

Source: IMF, World Economic Outlook, March 1988.

a/ Including Algeria, Bahrain, Indonesia, Islamic Republic of Iran, Iraq, Kuwait, Nigeria, Qatar, Saudi Arabia, Venezuela and United Arab Emirates.

b/ Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

c/ Excluding Nigeria and South Africa.

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24. Despite massive adjustment efforts, the over-indebtedness of the developing countries has persisted. The debt strategy that has evolved since the early 1980s has failed to revive growth and to yield an improvement in the main debt indicators (see table 7). Both the ratios of external debt to GDP and debt to exports have deteriorated for major groups of such countries since 1982, especially for the highly indebted countries and sub-Saharan Africa. Nor has there been any significant easing of the debt-service burden. The fall in the ratio of interest service in 1987 was artly due to a decline in interest rates, but mostly to the accumulation of arrears.

Table 7. Principal debt indicators for selected groups of developing countries, a/ 1980-1987

	1980	1982	1985	1986	1987
Debt/GDP ratio:					
Non-oil developing countries	26.9	34.6	40.0	40.1	39.4
Highly indebted countries	32.8	42.3	45.7	47.0	48.9
Sub-Saharan Africa	38.6	49.3	61.4	61.6	69.0
Debt/exports ratio:					
Non-oil developing countries	118.4	157.3	174.1	170.0	165.8
Highly indebted countries	168.2	267.6	287.9	345.5	332.8
Sub-Saharan Africa	147.9	218.5	271.7	296.8	325.1
Interest/exports ratio:					
Non-oil developing countries	8.8	12.6	11.5	11.5	9.8
Highly indebted countries	15.9	30.6	29.6	29.2	25.1
Sub-Saharan Africa	7.6	10.7	12.0	12.7	10.6

Source: UNCTAD secretariat estimates based on IMF and World Bank data.

a/ For definitions, see table 6.

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B. Policies after the Louvre Accord and the global payments situation

1. Policy adjustment in the developed market-economy countries

25. After 1982 the performance of the world economy was governed in large part by differing policy stances in the major industrialised countries; namely, expansionary fiscal and restrictive monetary policies pursued by the United States, and the overall contractionary stance of other major developed market economies. These differences, combined with speculative pressures, caused substantial and persistent misalignments in foreign exchange markets, and trade imbalances that became unsustainable. Because of this, the policy stances were inconsistent. Most major market-economy countries chose to ignore these developmemts for almost half a decade. The stronger dollar caused a very high proportion of the demand stimulus in the United States to be transmitted to other major market economies, and the demand deficiency of the latter to be transmitted to the United States. These policy shortcomings generated large trade imbalances and serious misalignment and instabilities in key international prices such as exchange and interest rates and commodity prices. They also added to protectionist pressures, thereby posing a serious threat of disruption to the international trading system.

26. The Plaza meeting in September 1985 and the actions taken thereafter in the areas of monetary policy actions and exchange-market intervention marked for most Governments a major revision of views regarding the role to be assigned to markets in the determination of exchange rates. The dollar had already begun to decline before this date. It was believed that further devaluation brought about by co-ordinated intervention and monetary measures would play the main part in the adjustment process, and that trade imbalances could be reduced without any need for expansionary fiscal policy outside the United States. However, it became increasingly apparent that the exchange-rate mechanism was much less effective than expected in correcting payment imbalances, given the pattern of demand generation.

27. In the Louvre meeting in February 1987, consensus was reached among Group of Seven Governments that a further depreciation of the dollar should be avoided. The adjustment in trade balances was to be achieved through enhanced co-ordination of macro-economic policies among the participating countries directed at changing the international pattern of domestic demand, and the actions taken in pursuit of this objective were to include fiscal policies. This implied a restrictive monetary policy and budget cuts on the part of the United States, and the pursuit of more expansionary management of domestic demand, partly through a stronger fiscal stimulus, on the part of the Federal Republic of Germany and Japan. Thus, it was broadly agreed that the trade adjustment required was not attainable solely through exchange-rate management.

28. Although a major characteristic of the international approach to payments adjustment was the recognition that it required policy actions by surplus countries as well as by the deficit country, during the months following the Louvre announcements the policy reorientation agreed upon was translated only to a limited extent into actual measures, and did not have a strong impact on the international pattern of domestic demand. It also became evident during 1987 that there was no clear agreement among Governments on the distribution of the relative burden of

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adjustment among the participating countries. 6/ It was expected that the major adjustment effort would be made by the United States. The surplus countries, especially the Federal Republic of Germany, did not show a clear determination to play their role in a symmetric balance-of-payments adjustment. Moreover, since fiscal policy adjustment after the Louvre Accord lacked vigour, particularly in the United States and the Federal Republic of Germany, the divergencies in domestic demand management, which had been the principal source of payments imbalances in the first place, were not reversed.

29. Consequently, doubts spread fairly soon after the Louvre meeting as to the determination of the participating Governments in pursuing the objectives of the strategy, and the pressure on the dollar intensified again as the United States trade deficit failed to improve, with the result that heavy intervention in foreign-exchange markets was required by the United States, the Federal Republic of Germany and Japan. Thus, monetary policy had to bear the brunt of adjustment and soon became overburdened. Intervention and the consequent monetary expansion by surplus countries gave rise to concerns that exchange-rate management would undermine their efforts to maintain price stability and contain inflationary expectations. As a result, monetary policy was tightened in the course of the year, and caused rises in interest rates in the major OECD countries.

30. However, this created a situation of fragility in financial markets. Rising long-term bond yields were accompanied by dividend yields increasingly depressed by the rise of stock prices to unsustainable levels. On the other hand, the weak impact of the lower value of the dollar on the United States trade deficit gave rise to concerns that downward pressure on the dollar would increase and interest rates in the United States might thus have to be raised further. Fears that such developments would cause a drop in activity and profitability were the driving force behind the collapse of stock prices in October 1987.

31. While monetary policy eased immediately after the stock market crash in all countries with a view to stabilizing the situation in financial markets, the fiscal response has continued to be constrained by fears of growing budget deficits. In the Federal Republic of Germany, a fiscal package was launched in December 1987 on top of earlier announced tax cuts for 1988, but the overall fiscal stimulus remained very modest. In the United States, the fiscal stance is expected to be neutral in 1988, as no further reduction in the budget deficit will take place in addition to that resulting from substantial increases in revenue during 1987. 7/ In Japan, changes in fiscal policy implemented earlier in 1987 contributed to rapid growth in domestic demand in the second half of 1987 and the first half of 1988.

32. There are currently some signs of a reduction in world trade imbalances as demand picks up in surplus countries. However, the differentials in the growth rates of domestic demand in the United States and other countries are unlikely to lead to a speedy and orderly reduction of trade imbalances. At the onset of the recent economic recovery, the rates of demand growth in the United States were higher than those of its trading partners by as much as 3.7 percentage points in 1983 and 5.6 percentage points in 1984. But in 1988 the growth of domestic demand in most of the surplus countries is not expected to exceed that in the United States by more than 2 percentage points. 8/

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33. Faster expansion in other major countries is the more necessary, particularly in the Western European surplus countries, because an improvement in the United States payments position will be reflected in a worsening of the payments position of many of the European developed market economies which were already in deficit in 1987. These growing payments imbalances have been reflected in the recent strains in the European Monetary System in which both the French franc and the Italian lira came under selling pressure and weakened vis-à-vis the deutsche mark, especially towards the end of the first quarter of 1988. Unless the pace of demand expansion in the Federal Republic of Germany accelerates, upward pressure on the deutsche mark within the system may emerge as the weight of the United States' adjustment effort is brought to bear on the external accounts of the other European economies. If this were to result in a revaluation of the deutsche mark within the European Monetary System, by forestalling possible external constraints on expansion (and therefore imports) in those economies, it could contribute to the overall adjustment of external imbalances between Western Europe and the United States.

34. During 1988 rising exports and an expansion of domestic activity have raised the concern of authorities in the United States over inflationary pressures, and thus led to expectations in financial markets of a more restrictive monetary policy stance. International interest-rate differentials have again widened in favour of United States dollar assets. In May the absolute gap between the nominal short-term interest rates of the United States, on the one hand, and Japan and the Federal Republic of Germany, on the other, was the largest since 1984 (before the dollar started its long descent). However, tighter monetary policy in the United States can explain only part of the revaluation of the dollar since April despite heavy intervention by European central banks. There also appears to have been a revival of speculation on a rising dollar owing to improvements in figures for United States trade and a widespread perception that the dollar had become undervalued. Under these circumstances, interest rates may need to be raised in surplus countries to check the rise of dollar and to avoid a slowdown in the trade adjustment of the United States. However, higher interest rates also serve to check the pace of domestic demand in these countries, with adverse consequences for this adjustment.

2. The impact on developing countries

35. The failure of the international monetary system to provide a working mechanism for correcting trade imbalances among the industrialized countries has repercussions for the world economy as a whole. To the extent that the United States trade deficit has to be corrected by internal deflation rather than by expansion of domestic demand in the surplus countries, achievement of economic recovery by troubled economies in the developing world is rendered more difficult. Most adjustment strategies for developing countries aim at export growth. However, such growth requires an increase of global demand which, under present conditions, can be expected only if the demand of surplus economies and developing countries expands over and above the amount required for a reduction of the trade deficit of the United States. On the other hand, an improved pattern of trade between the United States and the Asian surplus countries (including Japan) could lead the

latter to seek larger trade surpluses with other countries, particularly developing countries. Hence, an increase in the import capacity of the latter is not only imperative for a revival of development but could also contribute significantly to a correction of trade imbalances, and thereby alleviate recent strains on the exchange-rate system.

36. Another obstacle to recovery in many developing countries is the persistence of high real interest rates. With the exception of a brief period after the stock market crash when exchange rates lost priority in the conduct of monetary policy, attempts to stabilise the dollar since the Louvre meeting have had a ratchet effect on world interest rates. When the dollar was under pressure in 1987, interest rates in the United States were raised first, these rises being subsequently followed by increases in the surplus countries as part of efforts to check monetary expansion resulting from attempts to stabilise the dollar. More recently, the upward pressure on the dollar, combined with renewed fears of overheating and inflation in the United States, has triggered increases in interest rates in the surplus countries, particularly in Western Europe. Indeed, in the absence of policy action, short-term interest rates are expected to rise over the next couple of years to reach the 1985 level by the end of 1989, with adverse consequences for debtor developing countries.

37. In recent years, international monetary management has created foreign-exchange reserves on a huge scale, primarily through United States current-account deficits, but the international monetary and financial system has not directed reserves to those countries which suffered most from liquidity shortages and were most restricted in their access to foreign lending. The large increase in foreign-exchange reserves and its regional distribution are both a reflection of the unsolved adjustment problems among industrialised economies, and between them and large parts of the developing world. 9/

III. CURRENT ISSUES IN THE MANAGEMENT OF THE INTERNATIONAL MONETARY SYSTEM

38. It is now generally accepted that progress in balance-of-payments adjustment cannot be left solely to the exchange-rate system but requires a high degree of compatibility in macro-economic management across countries, which, in turn, seems unlikely to evolve without a strengthening of international policy co-ordination. Moreover, a reduction of the exchange-rate volatility and misalignment (which is reflected in the large swings of the United States dollar since 1982) cannot be expected without certain improvements in the way the international monetary system functions. A wide debate is currently taking place concerning the contributions that can be made towards the achievement of this objective by the development of a system of targets and indicators to arrive at a more coherent international policy mix, by the application of more binding rules for managed floating, and by the introduction of regulatory instruments to reduce the impact of speculative influences on foreign exchange markets. These issues will be discussed in what follows.

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A. Aspects of international policy co-ordination

1. Targets and indicators

39. The notion that the use of "objective indicators" and "targets" should play a major role in the management of interdependence has found increased acceptance in the recent discussion of policy co-ordination among the industrialized countries. The Group of Seven at the Tokyo Summit of 1986 decided to institutionalize regular meetings of finance ministers and central bank governors in order to review policy objectives and to examine their mutual compatibility, a commitment that was reaffirmed at the Toronto Summit in 1988. The indicators mentioned in the Tokyo Economic Declaration included growth rates of gross national product (GNP), inflation rates, interest rates, unemployment rates, fiscal deficit ratios, current-account and trade balances, rates of monetary growth, foreign-exchange reserves and exchange rates. However, there is a certain degree of ambiguity about the nature and purpose of these indicators and targets. It may thus be useful to review them briefly in order to clarify the context in which they can be used.

40. The purpose of economic policy is to influence ultimate target variables deemed to be important to social well-being, using the instruments at the disposal of policy authorities. The volume of output, the level of employment and the rate of inflation are generally regarded as the ultimate targets of policy. There are trade-offs among these, and the mix and stance of policies often reflect the preferences of policy makers among various outcomes with respect to ultimate objectives. Policy instruments are those variables that can be precisely controlled by policy makers and include open-market operations, currency interventions, short-term interest rates, tax rates and discretionary fiscal spending. Most economic variables are, however, intermediate between ultimate objectives and policy instruments. These intermediate variables influence each other and the ultimate objectives, and are influenced by the latter as well as by policy instruments. They are not pursued in their own right as final goals of policy, and cannot be precisely controlled by policy makers. These include various monetary aggregates, fiscal balance, exchange rates, and external balances and net foreign asset positions. Economic indicators are accordingly classified under three types: those related to ultimate objectives, instruments of economic policy, and intermediate variables.

41. National policies, particularly monetary policy, in the major market economies in the 1980s have increasingly focused on the targeting of some intermediate variables, rather than targeting the ultimate objectives directly. The strategy of intermediate targeting has found support largely on the grounds that intermediate variables are more visible than the ultimate ones. The success of the intermediate-target strategy, however, has depended on two assumptions that have not always been valid; namely, that intermediate targets can be closely controlled by the adjustment of policy instruments, and that they are reliably linked to (or in a stable and predictable relation with) the ultimate objectives. 10/ Moreover, in many cases, the substitution of a surrogate objective for ultimate objectives has proved counter-productive, leading to the subordination of the latter to the achievement of surrogate intermediate objectives, as exemplified by excessively deflationary monetary and fiscal policies in some countries.

42. Regardless of the strategy used, economic policy requires continuous monitoring of indicators regarding ultimate and intermediate objectives, with a view to actions involving the use of policy instruments. International policy co-ordination necessitates agreement on certain objectives, and on the policy actions needed when outcomes differ from the agreed targets. This can be done by using two sets of targets and indicators to address two different issues:

(a) First, an agreement may be reached regarding certain objectives for each country concerned. These may include exchange rates, current-account balances and even the admissible rates of growth of domestic demand. External targets should be mutually consistent since the number of exchange rates or current-account balances that can serve as independent targets is less than the number of countries. If national growth targets are chosen independently, they have to be compatible with the desired pattern of current-account balances, exchange rates, or both. There should be a clear understanding about the allocation of the burden of adjustment, and about monetary and fiscal policy actions in the participating countries when outcomes persistently deviate from the agreed targets.

(b) Secondly, a set of global targets and indicators may be used to provide a basis for global action by all the countries concerned. A typical example of this would be when countries agree to keep the rate of growth of aggregate (world) demand within a certain range in order to avoid world-wide deflationary or inflationary pressures. This would entail continuous monitoring of the state of world demand either directly or by using some intermediate indicators such as an aggregate (world) money supply or an index of commodity prices such as that examined below. Collective policy action would then need to be taken, and might include changing the average level of world short-term interest rates, the availability of liquidity, or the overall stance of fiscal policy.

43. Policy co-ordination in such a framework does not necessarily mean that certain developments in certain indicators should automatically trigger a pre-determined policy action by a certain country. Rather, policies may be discretionary and based on extensive consultations, allowing policy makers greater flexibility to adjust their instruments and targets in accordance with changes in their perceptions of how the world economy operates. Nor does it mean that every aspect of national policies will need t be co-ordinated. However, policy co-ordination implies a certain degree of constraint on national policy-making, and requires consistency of a broad range of policies with agreed objectives.

44. Recent experience has indicated that policy co-ordination may not be very successful if based solely on agreement to review the evolution of certain economic variables. The main policy achievement so far has not been the application of the aforementioned indicators, since these variables have implicitly or explicitly always been used as measures of macro-economic performance and policies. Moreover, the use that has been made of them has remained _ad hoc_ and partial. That achievement rather consists in the fact that agreement has been reached concerning the need in a system of floating exchange rates to review national economic variables in the context of balance-of-payments requirements - an agreement that appears to be an important step in improving the management of the international monetary system. There remains the need to establish the minimum necessary framework for effective policy co-ordination based on the use of a specific set of

targets and indicators for well-defined purposes, taking account of the state of knowledge on the complex relationships among instruments, intermediate targets and final goals of economic policies.

2. The use of a commodity-price indicator

45. The most recent proposal in policy co-ordination is that of introducing a commodity price index as an indicator to help in "monitoring the performance of the group (of industrial countries) as a whole", 11/ and to serve "as an early warning of potential price trends 12/ in the industrialized countries. Findings of a study by OECD staff confirm that a commodity price indicator could be useful in identifying the future direction of price changes in industrialized countries so long as the commodities entering the basket are appropriately selected. 13/

46. This proposal is based on the assumption that global demand pressures are reflected in movements in commodity prices. Indeed, deflationary policies have played a major role in the collapse of commodity prices in the 1980s. Since commodity prices remain depressed, an important issue in the use of such an indicator is the level of commodity prices to be taken as the basis for assessment of their future movements. If the current level were to be taken as "correct", then the indicator would suggest that no reflationary action would need to be taken. Indeed, upward movements of commodity prices would be interpreted as heralding inflation, suggesting that demand management should be more restrictive. The consequence of such restriction would be that the burden of adjustment between developed and developing countries would remain on the latter. Therefore, a substantial upward adjustment in commodity prices is necessary before embarking on the use of this index as an indicator of inflationary pressures. Once such an adjustment has been achieved, the indicator could help to assure that policy co-ordination is geared towards growth and price stability. 14/ Another idea for linking the stabilization of commodity prices to global macro-economic management is discussed in annex I.

3. Target zones, adjustable pegs and exchange-rate management

47. The principal task currently confronting exchange-rate management is to achieve a set of relative rates capable of making progress towards a more sustainable global pattern of external balances. The main focus of efforts in this direction has to be the large payments imbalance of the United States, and the surpluses of other countries that are its counterpart. Since the required pattern of exchange rates for major currencies cannot be expected to result from market forces alone, its achievement presents a challenge for macro-economic policy at national and international levels.

48. Such a pattern of exchange rates depends on relative movements of prices and costs, monetary and fiscal policies in the countries concerned, and sustainable levels of international capital flows. One of the principal problems facing policy makers in this area is that only part of the fluctuations of major exchange rates during recent years can be explained by such factors as interest-rate differentials, relative rates of growth of demand among countries, and relative

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movements of their prices and costs. Foreign-exchange markets have at times also been strongly influenced by speculative behaviour governed more by the attempts of market participants to forecast each other's actions than by concern with fundamentals. Such behaviour has been an important cause of the large fluctuations of major exchange rates mentioned earlier in this report. Both the fluctuations themselves and the periods of misalignment with which they have been associated seem in many instances to have adversely affected real economic variables such as trade and investment, as is explained in more detail in annex II. Awareness of the need to reduce such fluctuations and to keep relative exchange rates within ranges bearing a sustainable relation to fundamentals has provided much of the impetus behind the recent initiatives to manage exchange rates in the OECD area.

49. The reasons for this move towards managed floating were clearly expressed by the Chancellor of the Exchequer of the United Kingdom of Great Britain and Northern Ireland at the annual meeting of the IMF and World Bank in September 1987: "The belief that markets would provide a stabilising influence, through the operations of medium-term speculators, has not been borne out. ... In particular, we have seen wild gyrations in the dollar that have clearly not been a reflection of economic fundamentals. ... Moreover, these gyrations have damaged growth in world trade. ... And the major uncertainties about exchange-rate movements inhibited risk taking and required a switching of resources at a pace that was totally unrealistic." 15/ The régime of managed floating adopted at the Louvre meeting has worked because countries have "been prepared in practice to give significant weight to exchange rates in the conduct of monetary policy ... and to back up (the) agreement with co-ordinated intervention". Lawson suggested that the experience gained should be used "to build up a more permanent régime of managed floating". 16/

50. The experience with reference ranges has constituted a direct targeting of exchange rates. However, it differs in certain respects from the proposal for target zones that the Group of Twenty-Four endorsed in 1985, but which was regarded by the Group of Ten as undesirable and impractical under the circumstances prevailing at the time. As compared with the target-zone proposal, the ranges pursued by the Group of Ten countries have not been announced explicitly. Instead they have been agreed provisionally with a view to short-term adjustment needs, and not because they represent fundamental equilibrium rates. Moreover, there is no formal rule for policy response when a rate tends to diverge from the reference range. More importantly, exchange-rate management has not been an integral part of wider policy co-ordination involving the management of domestic demand in both surplus and deficit countries. 17/

51. The basic requirement for achieving greater exchange rate stability is a firm commitment among participating Governments. In this context, the question arises as to whether an adjustable peg system with predefined obligations and narrow ranges for exchange rates along the lines of the European Monetary System would be feasible. Such a system would leave much less room for speculative pressures to build up and could thus be more successful in preventing the emergence of misalignments. However, like other proposals for reference ranges and target zones, it would require not only agreed intervention rules but also a framework within which domestic monetary and fiscal management would have to be conducte and thus a greater degree of policy co-ordination than has so far been achieved.

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4. Difficulties in macro-economic policy co-ordination

52. No matter which system of targets and indicators for exchange rates is chosen, there remain various difficulties as regards attaining the required degree of policy compatibility. These difficulties are related to certain pre-conditions without which attempts for international policy co-ordination are unlikely to be successful.

53. First, there is the need for common goals in the co-ordination process and a consistent set of priorities in national economic policies. The definition of a common goal may take various forms such as that of a collective goal. It has been found that where policy co-ordination in the past has been successful, this was mostly in pursuing collective goals. In these cases participating economies were faced with a problem perceived as a collective one, such as the adjustment required by the rises in oil prices in the 1970s for the industrial countries. The Baker-Lawson initiative of October 1987 can be interpreted as a step towards the definition of another type of common goal, under which attention is shifted away from the performance of individual countries and focused on that of industrialized countries as a group.

54. However, policy co-ordination is also required in situations where the precise nature of problems affecting several countries is less obvious or does not command consensus. Thus, in the present situation the problem of trade imbalances has been perceived differently by deficit and surplus countries. Indeed, the trade-balance objectives of these countries do not seem to satisfy the consistency requirement mentioned above.

55. Another difficulty is that different countries have different priorities among ultimate objectives. More importantly, the assumption that "the primary objective of international macro-economic policy co-ordination (is) the achievement of as high a level and rate of growth of output in the participating countries as is possible on a sustained basis" 18/ may not be accepted by all countries. In response to increasing awareness of trade-offs between environmental and certain material objectives, views as to what is sustainable in terms of output growth may increasingly tend to differ. In such circumstances, the best that may be expected from policy co-ordination may be that "national policies be set with proper recognition of policies and objectives in other countries". 19/

56. At a more technical level, there is a need for a mutually consistent interpretation of indicator signals, which requires a common analytical framework for the assessment of causes and effects of changes in the targets and indicators. Experience following the Louvre Accord suggests that such a framework has been lacking so far. An example of the range of disagreement on economic analysis is the lack of consensus as to the causes of the United States trade deficit and the real appreciation of the dollar between 1980 and 1985. Reaching agreement on required policies will be difficult in the absence of agreement on analysis.

57. To the extent that agreement is reached on certain external variables such as exchange rates and external balances, participating Governments have to be willing to use a wide range of economic policy instruments for achieving these targets.

The need for substantial fiscal co-ordination to avoid "abuse of monetary policy" has, for example, been perceived as one of the weaknesses of the target-zone proposal. 20/ The reluctance of Governments to employ fiscal instruments for balance-of-payments adjustment may be explained by the fact that fiscal variables already have to serve several functions in a national context, such as influencing factor allocation and income distribution and financing public services. Another explanation may be found in a more general reluctance of policy makers, especially in surplus countries, to pursue a policy of deficit spending for purposes of demand management. Indeed, reducing the fiscal deficit and the public sector's share in GDP have become objectives in their own right in many such countries during the 1980s.

58. A major difficulty in successful policy co-ordination seems to lie in the very small weight that the contribution of a Government to international economic co-operation carries in the formation of voters' opinion. 21/ The policy record of a national Government usually takes little account of the contribution of its policies to the development of the international economy, and the external influences on the home economy. A basic requirement for successful policy co-ordination is, therefore, that policy makers and electorates understand that the international orientation of macro-economic management is in their country's own interest and not against it.

B. Surveillance and the role of the International Monetary Fund

59. The use of existing institutions for the surveillance of macro-economic policies in the major industrial countries could be an important step towards inducing Governments to design their policies more in accordance with international requirements. Accordingly, discussions of such policy co-ordination are often related to the question of IMF surveillance. In 1985, the Group of Ten report recognized that IMF surveillance had been inadequate in promoting economic and financial conditions conducive to exchange-rate stability, while also noting that some countries had been able to sustain policies not fully compatible with the goals of international adjustment. 22/ The Group of Twenty-Four report argued that surveillance should not be limited to members' exchange-rate policies, but should also include the international adjustment process. There is a broad agreement that effective surveillance requires assessment of all policies affecting trade, financial flows, external adjustment and the stability of the international monetary system, and that multilateral surveillance should concentrate on countries that have a large impact on the world economy.

60. Within the framework of its responsibilities for surveillance, IMF has contributed to developing the use of economic indicators in a medium-term context, but so far the use of these indicators appears to have been limited to the periodic bilateral consultations with Governments. However, the surveillance function of the Fund may have particular importance for the process of policy co-ordination itself. Since the economic performance of a country does not depend exclusively on its own policies, surveillance should be conducted on a multilateral basis before divergences between targets and indicators, on the one hand, and policy measures needed, on the other, are taken up in bilateral consultations. Within such a

framework, surveillance could facilitate the finding of solutions for burden sharing between deficit and surplus countries in the context of adjustment. Furthermore, multilateral surveillance would need to assure that the co-ordination of macro-economic policy in the industrial countries leads to results for the world economy that are supportive of growth in the developing countries. 23/

61. An important question in this context concerns the role of developing countries in the multilateral framework of policy co-ordination. Macro-economic policy co-ordination has so far taken place predominantly within the Group of Five or the Group of Seven rather than within international organisations, so that developing countries face serious problems in ensuring that their interests are taken into account. The desirability of including developing countries in the process of macro-economic policy co-ordination is also evident from the recent experience of the increased importance of certain newly-industrialised countries in Asia to the process of balance-of-payments adjustment in the major industrial countries. In the current situation, IMF surveillance oriented towards growth, development and stability could contribute to a simultaneous and consistent treatment of the debt problem of developing countries and of the payments problems of industrialised countries.

C. Regulation and international capital flows

62. Relations between the stance of macro-economic policies and international capital movements are subject to considerable unpredictability, especially in the short run. Thus it cannot be assumed that improved co-ordination of macro-economic policies in the OECD area will eliminate the large, destabilising capital flows and the associated volatility of exchange rates frequently experienced during recent years.

63. The relaxation of controls over international capital movements by OECD countries began at the end of the 1950s but accelerated in the 1970s. In many major OECD countries, such movements are now largely or completely uncontrolled. These countries are especially susceptible to the effects of increased tendencies among participants in the financial markets to treat currencies as speculative assets. Such tendencies are now generally a more important influence in these markets than foreign-exchange transactions closely linked to trade or to financial flows for the purpose of real investment.

64. The growth of foreign-exchange transactions for the purpose of portfolio management has been affected not only by the deregulation of financial markets, but also by innovations which have increased both the number of available assets and their substitutability. The latter has been enhanced not only by the characteristics of the new assets themselves but also by the development of techniques and instruments (particularly various types of forward and futures contracts) providing protection against unpredictable changes in variables such as interest and exchange rates. Thus, recent financial innovations have facilitated large movements of money between different financial assets and different countries, and given additional scope to the propensities for speculative behaviour among participants in financial markets.

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65. The difficulties that the resulting instability of financial variables can pose to macro-economic policy may provide the occasion for recourse to regulation of international capital movements or to other steps designed to reduce the scale of speculative financial transactions. The measures available for this purpose include direct restrictions, different exchange rates for transactions on current and capital account, and the application to foreign-exchange markets of the tax on financial transactions originally proposed by Keynes. 24/

66. Efforts to harmonize the regulatory régimes for the financial systems of different countries are also likely to have beneficial effects in this context. An important reason for improving international co-operation in the area of banking supervision is that differences in national regulatory régimes can generate international financial transactions with little or no underlying economic justification. Various evidence indicates that large capital movements frequently take place solely with the aim of circumventing monetary regulations such as minimum reserve requirements, prudential controls regarding capital adequacy and liquidity, and restrictions and rules concerning foreign-exchange transactions. 25/ Moreover, during periods when confidence is adversely affected by financial turbulence, large movements of funds may be triggered from financial centres perceived as "soft" to safer havens, principally the major financial markets in the OECD area. Thus the Basle Agreement of July 1988 among the central bank governors of the Group of Ten countries concerning a common, risk-based standard of capital adequacy for international banks 26/ constitutes a useful step in the process of reducing the incentives to international capital movements associated with divergences in national regulatory régimes.

IV. BALANCE-OF-PAYMENTS ADJUSTMENT IN DEVELOPING COUNTRIES

A. The policy record

67. As was noted in section II.A.5, the large recent improvement in developing countries' trade balances is due in a large number of cases mainly to import cuts, which not only have contributed to the setback to development but also have increased imbalances in world trade. Without a swift and sizeable improvement in the net imports of developing countries, the trade-balance objectives of the major market economies will be difficult to achieve, and the correction of global economic imbalances is in danger of generating further deflation and of triggering protectionism and exchange-rate instability. Thus the questions of debt, finance and development, on the one hand, and global economic imbalances, on the other, should be treated together rather than in separate compartments.

68. Balance-of-payments adjustment in response to the debt crisis has so far been asymmetric, with the burden falling mainly on the deficit countries. The launching of the Baker Plan in October 1985 indicated awareness of the need to conduct adjustment policies in the developing countries in the context of growth and development. Growth-oriented structural policies, which were also urged upon countries without debt problems, received particular emphasis under this plan, but they were to be complemented by continuing macro-economic retrenchment. Three years after the Baker initiative the debt crisis is no closer to being resolved,

and most debtor countries have failed to achieve a return to sustained growth. Indeed, a number of those countries that had begun to do so have relapsed. 27/

69. A key role in the adjustment strategy so far has been assigned to IMF. IMF programmes are designed, inter alia, to ensure that debtors generate a sufficiently improved trade balance to make it possible for them to remain current on their debt service, much of which consists of obligations to commercial creditors. By contrast, the financing role of IMF is often limited, serving for many debtor countries as a "catalyst" to attract private flows rather than as a major source of funds itself. This evolution reflects the reluctance of several countries with an important voice in IMF's decision-making process to enlarge the size of the Fund.

70. Adjustment policies in debtor countries are designed, among other things, to compensate for reduced inflows of external financial resources by increasing domestic savings and improving balances on current account. However, in a large number of cases such policies have been accompanied by acute domestic disequilibria and stagnation. Such unfavourable effects are a reflection of several factors, including shortcomings in other areas of policy and administration, and an unfavourable external environment. But the effects are also due to the magnitude and speed of adjustment required of deficit countries. Central to IMF's policy prescriptions are measures designed to switch resources from the satisfaction of a country's domestic demand to improving its trade balance. These measures, which typically give special emphasis to the retrenchment of domestic demand and to changes in relative prices through devaluation of the exchange rate, generally have to be taken in economies lacking in varying degrees the mobility of domestic resources which would be sufficient to enable such policy prescriptions to achieve their objectives quickly. In the short run the measures frequently contribute to accelerating inflation owing to the rising cost of essential imports and to the effects of sectoral bottlenecks. Other consequences include losses of output and investment cuts, even in export industries. Moreover, the reductions in government spending associated with IMF programmes have in many cases had serious effects on income distribution and have shifted the burden of adjustment onto the most vulnerable groups of the population. 28/

71. While the principle of conditionality in IMF lending to protect the revolving character of Fund resources is generally accepted, the choice of its performance criteria has been subject to strong criticism. A particular focus of the criticism has been IMF's tendency to give insufficient emphasis to the requirements of longer-term economic growth and to non-economic objectives. Other points raised in this context are that the terms of IMF conditionality are not all directly related to the goal of improving the balance of payments, that the adverse impact of external factors is often neglected, and that IMF programmes have frequently entailed reductions in demand sharper than needed for balance-of-payments adjustment. Moreover, some of the critics have stressed that the need for adjustment and the way to achieve it are two separate issues, and that the appropriate choice of instruments may differ from case to case, depending on a country's overall situation and the prevailing economic thinking underlying its economic policy decisions. 29/

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B. Towards growth-oriented adjustment

72. Since the experience of developing countries with Fund-supported programmes has been unsatisfactory, the Group of Twenty-Four has made a number of proposals for improvement of the design of such programmes. 30/ Because there is neither a uniform macro-economic model nor a set of policies applicable to all countries, under these proposals the specific characteristics of the economic structure of each individual borrowing country would govern the design of programmes. In order to reduce the domestic economic and social costs of adjustment to the minimum and to give countries more freedom in the choice of policy instruments, "program targets should be confined to external variables, such as balance on current account and the level of international reserves". Only if these targets are not met should the Fund assess the degree to which performance criteria regarding policy instruments are being fulfilled and the possible need for changes in policy. 31/ However, before performance criteria and conditionality are specified, the external financing needs to achieve a rate of growth close to the country's potential should be assessed, in order to ensure that the programme is consistent with the objective of sustained economic growth. Account would have to be taken of the need to sustain a required level of imports, especially of the capital and intermediate goods required for new investment in the context of structural adjustment. Consequently, creditor countries should "accept an obligation to provide the capital required in accordance with the need for symmetry between creditors and debtors in the adjustment process". 32/

73. In order to protect the execution of adjustment programmes from adverse changes in the external environment, contingency mechanisms would be built into IMF programmes under the proposals of the Group of Twenty-Four. Moreover, shifting the emphasis in adjustment programmes from demand deflation to growth orientation bears on the speed of adjustment. Thus the Group of Twenty-Four notes that a higher degree of flexibility would be required with respect to both programmes' duration and the timing of repayments.

C. International Monetary Fund facilities and resources

74. There has recently been some progress towards strengthening IMF facilities. The review of conditionality completed in April 1988 focused attention on ways of making the Extended Fund Facility more effective as an instrument for supporting medium-term programmes of macro-economic adjustment and structural reform. An enlargement of the Fund's capacity for concessional lending has been achieved through the establishment of the Enhanced Structural Adjustment Facility, which provides balance-of-payments assistance to low-income countries and complements the Structural Adjustment Facility. The Enhanced Structural Adjustment Facility is to be financed from repayments to the Trust Fund and additional contributions by member countries. A second new facility is designed to protect adjustment programmes against unexpected external developments beyond the control of Governments. This Compensatory and Contingency Financing Facility incorporates the Compensatory Financing Facility. The contingency financing element will be provided in association with a stand-by or an extended arrangement. In addition, it may in certain cases also be provided in association with an arrangement under the Structural Adjustment Facility or Enhanced Structural Adjustment Facility. 33/

75. Although Fund resources are not currently strained, a reorientation of IMF assistance along the lines described in section B would require a substantial expansion of its resource base. Improvements in terms of conditionality and programme design of the kind supported not only by the Group of Twenty-Four but also by a number of developed countries would be likely to increase the willingness of deficit countries to make use of IMF assistance at an early stage in the evolution of external payments disequilibria. Moreover, a reorientation of Fund-sponsored programmes towards a greater emphasis on growth needs to be based on more financing in order to avoid compression of imports essential for the support of structural adjustment. Longer duration for IMF programmes and a higher degree of flexibility in their repayment terms would also make additional demands on the Fund's resources.

76. The value of Fund quotas has fallen from about 7.5 per cent to about 4.5 per cent of world imports since the early 1970s. In view of the difficulties over negotiating quota increases, an automatic link between the size of the expansion of the world economy and country quotas has been suggested. 34/ In the case of temporary needs for bridging finance, IMF might increase its borrowing from Governments or even commercial banks. An improvement in the General Agreement to Borrow along these lines could strengthen the catalytic role of IMF. By making borrowed funds available, IMF could help to increase international liquidity for countries with restricted access to financial markets.

D. Allocation of special drawing rights

77. The required support for a new SDR allocation is currently lacking. Although most member countries now favour such an allocation, the Group of Ten remains divided on the issue. 35/ The major industrial countries take the position that it would be possible for deficit countries to obtain additional reserves from financial markets if their credit standing were to be restored. However, this argument neglects Article XXII of the Articles of Agreement of IMF, which envisages that the SDR should become "the principal reserve asset in the international monetary system". There have been no allocations since 1981, and the share of SDRs in non-gold reserves is now less than 4.5 per cent. If this decline is allowed to continue, the role of SDRs in the international monetary system is in danger of being seriously diminished. Moreover, the argument of the opponents of a new allocation also ignores the fact that only a very small number of developing countries have ever been in a position to borrow from financial markets. Most of the few countries which were once able to do so have had their access to such financing restricted since the onset of the debt crisis.

78. The current situation is conducive to potentially counter-productive competition for current-account surpluses among countries needing increases in international reserves. Such competition complicates the process of reducing global payments imbalances. Moreover, efforts to achieve such surpluses on the part of debtor developing countries are capable of depressing commodity prices and giving a stimulus to protectionism in the OECD area. Thus, an SDR allocation would be an important instrument "of assisting countries in their search for international liquidity and of facilitating the international adjustment process". 36/ To the extent that an allocation was used to support growth in debtor countries, it would also contribute to the solution of the debt crisis.

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V. ISSUES FOR THE FUTURE

79. Neither the character nor the relative importance of the future challenges to the successful functioning of the international monetary system can be predicted with any certainty. Nevertheless, the analysis of this and other studies suggests that the issues which will require continuing attention are likely to include the following:

(a) The symmetry of the balance-of-payments adjustment process as between deficit and surplus countries, and the appropriate roles in the process for monetary and fiscal policies;

(b) The roles in the unwinding of developing countries' debt problems of debt relief and reductions of protection against their exports;

(c) The amount and distribution of international liquidity, including under this heading the appropriate roles of private financing and SDR allocations in meeting countries' needs for foreign exchange reserves;

(d) Relations among international capital mobility, the functioning of financial markets and exchange rates.

Another issue likely to need attention is the integration of socialist countries into a universal monetary system on appropriate terms and conditions, and questions of currency convertibility arising in this context.

Notes

1/ *Trade and Development Report, 1988* (United Nations publication, Sales No. E.88.II.D.8), part one, chap. IV, and "Towards a durable solution of the debt problem" - Report of the Secretary-General (A/43/647). See also *World Economic Survey* 1988 (ST/ESA/205) and *Net transfer of resources from developing to developed countries*, Report of the Secretary-General (E/1988/64).

2/ Morgan Guaranty Trust Company of New York, *World Financial Markets*, November/December 1987, p. 10.

3/ See Yoichi Funabashi, *Managing the Dollar: From the Plaza to the Louvre* (Washington D.C.: Institute for International Economics, 1988), p. 192.

4/ *Trade and Development Report, 1988*, p. 71.

5/ *Ibid.*, p. 75.

6/ See Yoichi Funabashi, *op. cit.*, p. 189.

7/ *Ibid.*, p. 80.

8/ *Ibid.*, p. 5.

Notes (continued)

9/ For a more detailed assessment of the sources of reserve growth, see Bank for International Settlements, "Reserves and International Liquidity", BIS Economic Papers No. 22 (Basle), June 1988, p. 53.

10/ R. C. Bryant, Money and Monetary Policy in Interdependent Nations (Washington, D.C.: Brookings Institution, 1980), pp. 303-305.

11/ The statement of the United Kingdom Chancellor of the Exchequer, Nigel Lawson, at the Annual Meeting of the IMF and World Bank in Washington, D.C., September 1987 (as reproduced in Press Release No. 44, p. 6).

12/ The statement of United States Secretary of the Treasury, James Baker, at the Annual Meeting of the IMF and the World Bank in Washington, D.C., September 1987 (as reproduced in Press Release No. 50, p. 3). See also statement of the Ministers of the Group of 7, IMF Survey, 18 April 1988, p. 116.

13/ Martine Durand and Sveinbjörn Blöndal, "Are Commodity Prices Leading Indicators of OECD Prices?", OECD Department of Economics and Statistics Working Papers No. 49, February 1988.

14/ There are also a number of technical issues in the choice of the commodity basket and its valuation. First, there is the question of whether trade or production weights should be applied. Secondly, not all national commodity markets are competitive, and this may have some bearing on the choice of weights to be given to individual commodities. Thirdly, the inclusion of gold may not be compatible with the underlying rationale, since gold prices are subject to speculative influences. Finally, in view of exchange-rate fluctuations, such a commodity basket would need to be valued in terms of a basket of currencies. Since exchange-rate changes affect commodity prices and such effects are commodity-specific, the weights to be given to currencies in such a basket should eliminate the exchange-rate effect.

15/ See Press Release (at the Annual Meeting of the IMF and the World Bank, September 1987), No. 50, p. 3.

16/ Ibid., p. 5.

17/ J. Williamson and M. H. Miller, Targets and Indicators: a Blueprint for the International Co-ordination of Economic Policy, Policy Analyses in International Economics 22 (Washington, D.C.: Institute for International Economics, September 1987), pp. 19-38.

18/ Williamson and Miller, op. cit., p. 4.

19/ Commission of the European Communities, "Convergence and co-ordination of macroeconomic policies: some basic issues", European Economy, No. 20, July 1987, p. 73.

Notes (continued)

20/ Rüdiger Dornbusch, "Flexible Exchange Rates and Excess Capital Mobility", Brookings Papers on Economic Activity, No. 1, 1986, p. 222.

21/ This has been exemplified over many years by the failure of many industrialised countries (with some honourable exceptions) to comply with their commitments for official development assistance and, more recently, for the financing of international organisations.

22/ Report of the Deputies of the Group of Ten, "The Functioning of the International Monetary System", and Report of the Deputies of the Group of Twenty-Four, "The Functioning and Improvement of the International Monetary System", both reprinted in Andrew Crockett and Morris Goldstein, Strengthening the International Monetary System: Exchange Rates, Surveillance and Objective Indicators, IMF Occasional Paper No. 50 (Washington, D.C., February 1987).

23/ Yilmaz Akyüz and Sidney Dell, "Issues in international monetary reform", p. 50 in Compendium of Selected Studies on International Monetary and Financial Issues for the Developing Countries (UNCTAD/ST/MFD/4, United Nations publication, Sales No. E.87.II.D.3).

24/ J. M. Keynes, The General Theory of Employment, Interest and Money (London: Macmillan and Co., 1936), pp. 158-160. For a review of different types of intervention directed at international capital movements, see the UNCTAD secretariat, "The exchange-rate system", sect. D.3, in Compendium of Selected Studies on International Monetary and Financial Issues for Developing Countries, op. cit., and S. W. Black, Floating Exchange Rates and National Policies (New Haven: Yale University Press, 1977), pp. 151-158.

25/ On international capital movements in response to regulatory differences, see R. Dale, The Regulation of International Banking (Cambridge: Woodhead-Faulkner, 1984), pp. 177, 182 and Appendix 2.

26/ Committee on Banking Regulations and Supervisory Practices, "International convergence of capital measurement and capital standards" (Basle, July 1988).

27/ Trade and Development Report, 1988, p. 100.

28/ A. G. Cornia, R. Jolly and F. Stewart, eds., Adjustment with a Human Face: Protecting the Vulnerable and Promoting the Growth (Oxford: Clarendon Press, 1987).

29/ See, for example, John Spraos, IMF Conditionality: Ineffectual, Inefficient, Mistargeted, Princeton University Essays in International Finance No. 166 (Princeton, New Jersey, 1986).

30/ Intergovernmental Group of Twenty-Four on International Monetary Affairs, The Role of the IMF in Adjustment with Growth, Report of the Working Group of G-24 (Washington, D.C., 25 March 1987).

Notes (continued)

31/ *Ibid.*, para. 149.

32/ *Ibid.*, para. 145.

33/ The Group of Twenty-Four had favoured a Compensatory Financing Facility free of conditionality with its coverage "extended to all external sources of disturbance in the balance of payments which are beyond the control of Fund members" (*ibid.*, para. 176). By providing such comprehensive low-conditionality compensatory financing of temporary and self-reversing payments deficits, which do not call for medium-term adjustment, the Fund could also play a more important counter-cyclical role in the world economy. An example of this type of financing was the oil facility of the mid-1970s.

34/ See Intergovernmental Group of Twenty-Four on International Monetary Affairs, *op. cit.*, para. 83.

35/ See Report of Deputies of the Group of Ten, *op. cit.*, para. 73-78.

36/ Report of Deputies of the Group of Ten, para. 74.

ANNEX I

KALDOR'S PROPOSAL FOR LINKING ECONOMIC MANAGEMENT TO THE STABILIZATION OF COMMODITY PRICES

The potential global counter-cyclical aspect of linking decisions concerning macro-economic policy to levels of commodity prices has led to a wider interpretation of the proposal for a commodity link made by Professor Kaldor several years ago. 1/ Here the view that the stabilisation of commodity prices could be an important element in the stabilisation of world economic activity is the basis for the idea of a link between the financing of buffer stocks for certain primary commodities and the issue of SDRs. While these proposals of Baker and Kaldor differ in the type of impulses needed for stabilisation, they "both acknowledge the merits of stabilising commodity prices and recognise that sharp movements upwards and downwards in the general level of commodity prices are indicators of potential economic trouble ahead". 2/

1/ See, for example, Sidney Dell, The Future of the International Monetary System, paper prepared for a Conference on the future of the International Monetary System at Glendon College, York University, Toronto, Canada, June 1988, p. 19; and Nicolas Kaldor, "Inflation and Recession in the World Economy", The Economic Journal, December 1976, pp. 703-714.

2/ Dell, op. cit., p. 21.

ANNEX II

EFFECTS OF EXCHANGE-RATE FLUCTUATIONS ON TRADE AND INVESTMENT

Several attempts have been made to estimate the effects of fluctuations in exchange rates on real economic variables. Special attention in this context has focused on trade and investment. Many studies indicate that exchange-rate fluctuations have had significant adverse effects on trade for a number of both developed and developing countries. Most of these studies are concerned with the impact of increased costs on the demand and supply sides due to the greater unpredictability of the results of engaging in foreign trade caused by such fluctuations. But there has also been some analysis of the extent to which misalignment of exchange rates associated with recent fluctuations has reduced the growth of trade through the impetus which it has given to protectionist pressures. In this case the concern is not with short-term volatility, but with long-term fluctuations that cause exchange rates to deviate for substantial periods from the levels corresponding to fundamentals, and frequently lead in countries with overvalued currencies to the imposition of protectionist measures that are not removed when their exchange rates depreciate.

Conceptually, it is possible to visualise various effects of exchange-rate fluctuations on capital formation resulting from firms' exposure to increased unpredictability of earnings. For example, investment might be depressed as businessmen hesitate to install long-lived equipment and other structures that might become temporarily or permanently uneconomic owing to unexpected movements of exchange rates. Statistical testing of such hypotheses has proved even more difficult than for those just mentioned concerning the effects of exchange-rate fluctuations on trade. Nevertheless, it is of some interest to review some, admittedly incomplete, evidence concerning recent experience in the United States as an illustration of the way in which exchange-rate uncertainty appears capable of slowing the growth of productive capacity.

After an initially slow response to the depreciation of the dollar beginning in the summer of 1985, the growth of the volume of exports of goods and services from the United States accelerated in 1987 to 13 per cent, a rate that seems to have been exceeded in the first half of 1988. 1/ Nevertheless, various evidence indicates that in parts of the manufacturing sector producers were slow to expand capacity and thus to take advantage of the opportunities provided by the lower level of the dollar and a relatively buoyant domestic market.

Thus investment by the United States manufacturing sector remained relatively flat from the second half of 1985 (when the depreciation of the dollar started) until May 1987. It then increased sharply by 13 per cent during the following 10 months to March 1988. These figures were accompanied by relatively low levels

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1/ OECD Economic Outlook (Paris), No. 43, June 1988, p. 75.

for total gross private fixed investment in structures, the totals for 1987 ($134 billion) and for the first quarter of 1988 ($140 billion at an annual rate) falling well short of that of $153 billion attained in 1985. During this period the rate of capacity utilisation for industry as a whole rose only slightly, reaching a level of more than 82 per cent in early 1988. However, the figures at a sectoral level point to tighter positions in cases such as steel and the group, textiles, paper and chemicals.

Surveys of executives suggest that the slow response of investment in manufacturing to tighter demand conditions indicated by these figures was due partly to uncertainty as to whether the lower levels for the exchange rate of the dollar reached in 1987 were likely to continue. This caution is also consistent with the relation between recent trends in investment by the manufacturing sector in equipment on the one hand, and in total gross private fixed investment in structures on the other. The low level for the latter during the period since early 1986 may be due to greater emphasis in investment programmes on improving the productivity of existing operations than on expanding capacity. This caution seems to have been enhanced for several firms by the major exercises in industrial restructuring and capacity reduction undertaken only a short time before, when the exchange rate for the dollar was much higher.

By early 1988, the association of sustained growth in export volume and the rise in investment in equipment by the manufacturing sector in the United States appeared to indicate that the influence of exchange-rate uncertainties was diminishing. However, the sharp rise in the dollar against other major currencies since the beginning of the second quarter of 1988 may revive such uncertainties. If the consequences were to include a fall in the pace of capital formation, the speed of structural adjustment by the United States to the large imbalance in its external payments would also be likely to be adversely affected.

ANNEX III

RECENT PROPOSALS FOR CONVENING AN INTERNATIONAL CONFERENCE ON INTERNATIONAL MONETARY AND FINANCIAL ISSUES

1. As noted in a study 1/ prepared for the forty-second session of the General Assembly, interest in the convening of an international conference on monetary and financial issues has intensified since the onset of global recession in 1982. A survey of proposals under this heading was provided in this study. In response to General Assembly resolution 42/440 of 11 December 1987, the present annex summarises relevant developments since this study.

2. At the 38th and 39th meetings of Ministers of the Intergovernmental Group of Twenty-Four 2/ on International Monetary Affairs, the Ministers "reiterated that an effective reform of the international monetary and financial system requires the convening of an international conference", and also reiterated their call for the creation of a representative Committee of Ministers from developing and industrial countries to consider reform of the international monetary system as an effective step in preparing for such a conference, the suggested form for the Committee being a joint subcommittee of the Interim and Development Committees.

3. At the Conference of Foreign Ministers of Non-Aligned Countries held at Nicosia in September 1988, 3/ the Ministers pointed to the failure of the international monetary and financial system to adopt to the changes which had occurred in the financial markets during the previous 25 years. The Ministers emphasised that reduced control over exchange rates, liquidity creation and interest rates had made the financial and monetary system more asymmetrical and volatile, and had aggravated the difficulties faced by developing countries in acquiring satisfactory levels of reserves and external financing. They noted that, as a result, the international adjustment process had proved ineffective in promoting a sustainable pattern of external payments, and had imposed a disproportionate share of the burden on developing countries. In this context the Ministers "reaffirmed the proposals for the convening of the International Conference on Money and Finance for Development", and expressed their support for

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1/ "The current international monetary situation", report of the Secretary-General (A/42/555), annex, para. 1.

2/ Intergovernmental Group of Twenty-Four on International Monetary Affairs, "Communiqué of the thirty-eighth meeting of ministers" (Washington, D.C., April 1988), paras. 77-78, and id., "Communiqué of the thirty-ninth meeting of ministers" (Berlin, September 1988), paras. 61-62.

3/ Non-Aligned Foreign Ministers' Conference, "Draft final document, Economic Part" (NAC/CONF.8/FM/DOC.2/REV.2) (Nicosia, Cyprus, September 1988), paras. 32-34.

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the call of the Ministers of the Intergovernmental Group of Twenty-Four on International Monetary Affairs for the creation of the representative Committee of Ministers mentioned above.

4. In their declaration issued at the Twelfth Annual Meeting of the Ministers for Foreign Affairs of the Group of 77 on 30 September, the Ministers "reiterated the imperative need for the convening of an international conference on money and finance for development with universal participation", and expressed their support for the call of the Group of Twenty-Four for the creation of the Representative Committee of Ministers mentioned above.
