# INTER ACTION COUNCIL

*Established in 1983*

Report on the Conclusions and Recommendations

by a High-level Expert Group on

**MONETARY, FINANCIAL AND DEBT ISSUES**

Chaired by: Mr. Helmut Schmidt

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## Introduction

The world economy faces a daunting legacy from world-wide inflation especially since the breakdown of the Bretton Woods system, and from two oil price increases, and a deterioration of terms of trade for most other commodities and manufactured goods, enormous surpluses and deficits in most countries, current accounts, a process of unprecedented international financing and of integration of financial markets by commercial banks. The world economy also faces the consequences of past economic policy failures of both developing and industrial countries. It continues to be threatened by dangerous developments resulting from shifting commitments, and by lack of mutual understanding and insufficient communications among the main economic powers. Cooperation among central banks and the skillful responses of BIS and IMF have succeeded in containing thus far the debt crisis. The Executive Committee of the InterAction Council asked the Working Group to think about the problems of the world monetary system.

The Working Group has come to the conclusion that on the way to better worldwide monetary cooperation it is necessary to deal with some other urgent issues. Restoration of world prosperity on a sustainable basis will require responsible and concerted action of all: North and South, market and socialist economies, oil-exporting and oil-importing countries, debtor and creditor countries, least-developed, and other developing countries, governments, international organizations and private sectors, banks in particular.

This report is, in the main, geared to provide advice for economic operations in 1984 and 1985. It outlines the political parameters that the Working Group concluded are needed to secure a revitalization of the world economy under the broad headings of debt, development, trade and protectionism, policy co-ordination and international monetary reform.

The Group believes that the InterAction Council is well positioned to explain to government leaders and peoples of the world:

- that economic policies should be guided not just by short-term concerns but also by its long-term consequences;

- the need to sustain and reinforce the institutions of international economic, financial and monetary co-operation;

- the economic waste involved in current global levels of military expenditure, where developing countries alone spend around six times as much on armaments as they receive in official development assistance;

- the crucial role of improving the skills and management abilities of developing countries as a prerequisite for economic and social progress;

- the ominous long-term economic implications posed by a depletion of natural resources and by ecological deterioration;

- the recognition that the ultimate aims of economic activity should be an enhancement of welfare and the respect of human rights in order to benefit the individual.

## I. DEBT CRISIS AND DEBT MANAGEMENT

Conscious that the debt problem was jointly created by the actions of all parties, the Group emphasized the joint responsibility of all to seek solution: the world must not repeat the disasters that flowed from the demands for unrealistic resource transfers in connection with reparations and interallied war debts during the interwar years. The Group recognized that give the gravity of the economic situation of developing countries and of a number of commercial banks in the developed countries, special emphasis needs to be given to proposals for practical action related to development and debt issues.

1. Debtor countries should seek early advice from the IMF and pursue realistic adjustment programmes agreed with it. Such programmes need to combine a sustained improvement in the balance of payments with a resumption of economic growth. Countries should create favourable conditions for the return of flight capital, which has reached staggering dimensions in a number of countries in recent years and which contributes significantly to the debt problem.

Likewise they should try to attract more direct private investment. This above all entails realistic exchange rate policies (no overvaluation), the avoidance of artificialities in domestic pricing and the removal of bureaucratic restrictions on foreign investment.

On the other side it is politically intolerable that debtor countries do not know the maximum debt service payment that they will have to make in dollars for just one year ahead. This would provide some degree of protection against fluctuating interest rates.

2. The essential, even if unpopular, role of the IMF is that of negotiating adjustment programmes with countries confronting balance of payments or debt-servicing problems. There must be conditionality, otherwise fresh credits will not flow.

Given the economic situation faced by debtor countries, an element of austerity is inevitable in effective adjustment programmes but austerity should not be pushed beyond the level essential for successful medium-term adjustment.

The principles and conditions of the debt rescheduling should be listed in a new concept, a "General Agreement to Lend".

3. The contribution of the commercial banks should be to provide fresh money and interest relief in instances where a debtor country is making a good faith commitment to adhere to an IMF programme, and to devise mechanisms that will cap the debt

service payments that countries have to transfer. These mechanisms, which will need to be tailored to the situation of different creditors and agreed on an individual country basis with each debtor, may include:

- the consolidation of short-term debts to medium-run fixed interest bonds;
- multi-year rescheduling instead of present-day shortest term practice;
- the restriction of debt service payments to an agreed maximum percentage of the export earnings of a debtor country;
- interest capitalization.

4. The governments of creditor countries should provide comparable relief through the Paris Club. They also have a duty to take account of the vital interests that especially debtor countries have in a lowering of world interest rates and trade expansion when they formulate their macro-economic policies. Greater parts of deposits of OPEC and other central banks and governments should be consolidated into medium-term bonds. The international financial institutions must be furnished with a level of financial resources commensurate to their tasks. Banking legislation should be harmonized, particularly with regard to required capital ratios, among the major creditor countries. Governments of creditor countries will also expect lower tax revenues due to the losses of commercial banks.

## II. DEVELOPMENT

Policies to help promote development have to be differentiated and tailored according to the degree of development and the economic situation of individual countries.

While the debt crisis is the main cause of the recent setback to development in the middle income countries, the terms of trade deterioration has been more critical in many low income countries. Natural disasters and negative climatic effects have also further aggravated the desperate situation of many developing countries. The continuing excessive population growth in many areas means that per capita income has been falling even in places where overall growth has remained positive. A resumption of development will again demand contributions from all the parties involved. Given the will, there is no reason why development could not be successfully advanced during this decade in a similar way as other success stories in the past.

1. Developed countries, of both East and West, have a singular responsibility to increase trade and aid and to encourage the transfer of technology. Recent measures that have curtailed the future magnitude of contributions by multilateral organizations to the cause of development are misguided and run counter to the very interests of developed countries. The IDA replenishment should be concluded rapidly and at the level proposed by the World Bank management. This should be done whether or not all countries will live up to their previously held shares. Initiatives by the management

of the World Bank Group to strengthen and enlarge its operations should be strongly supported. Mainly, there should be a substantial increase in World Bank capital.

The UNDP, as the central agency for multilateral technical assistance, deserves support in view of the critical role of improved human skills in economic development.

2. The developing countries at all levels of development have a high responsibility to help themselves. The experience of a number of East Asian countries has demonstrated the beneficial effects of policies emphasizing human resource development, population planning, exploitation of the possibilities offered by international trade, and encouraging direct private investment, which is the most efficient way of transferring technology. In addition, developing countries stand to gain substantial dividends from helping each other in a more systematic way.

## III. TRADE AND PROTECTIONISM

1. The resolution of the debt crisis depends to a considerable extent on the existence of free trade arrangements. Yet, a large proportion of world trade, perhaps even more than 50 per cent, is now restricted by protectionist measures or distorted by subsidies. The observed trend towards protectionism has to be reversed. Developed countries should reduce tariff and non-tariff trade restrictions, particularly from developing countries and should do so on a non-discriminatory basis. In addition, they should reduce overproduction in certain sectors, such as agriculture, textiles and steel, and refrain from engaging in barter trade.

2. Efforts towards regional integration might be an effective approach to reduce gradually the inhibiting effects of protectionism, especially in circumstances such as those currently prevailing in Latin America.

3. Determined efforts should be made to restore the effectiveness of GATT and to reinforce its principle of open markets for non-subsidized exports, which was the key for postwar economic prosperity in many countries.

4. Since the oil crisis, the terms of trade for those developing countries dependent on the export of one or few commodities or raw materials have deteriorated substantially. Such trends need to be checked through effective international schemes, such as a widened STABEX type arrangement.

## IV. POLICY CO-ORDINATION

The beneficial effects of the recent US economy recovery and the high levels of US budget deficits are fully recognized, particularly in terms of increased exports to the US, by other countries and the resulting export-lead growth. The Group concluded, however that such recovery has severe disadvantages and is in any event unsustainable in the longer run. Extremely high real interest rates magnify the debt problem and restrain productive investment and thereby employment around the world. They induce large amounts of capital inflows to the richest country on earth, which are not tolerable on the present scale over extended periods.

There is an ever-present danger that a loss of confidence in the dollar will precipitate a depreciation that would oblige the Federal Reserve Board to raise interest rates further, risking renewed deep recession. Prompt action to reduce the US budget deficit substantially is therefore imperative for a sustainable revitalisation of the world economy.

Present mechanism for effective co-ordination of the economic policies of the major industrialized countries, including summit meetings have recently proved ineffective. Clearly, there is an urgent need to achieve more reliable and responsive intergovernmental co-ordination of economic policies. To help accomplish this goal, non-governmental channels, such as the InterAction Council might be able to impress upon present government leaders the merits and urgency of such systematic co-ordination and especially the prompt adoption of responsible fiscal policies by all major powers.

## V. INTERNATIONAL MONETARY REFORM

Present monetary arrangements, embodying as they do fluid constellations, have not proved generally satisfactory. However, a return to the Bretton Woods system is precluded by the fundamental changes in the world economy over the past 15 years. Discussions of reform are in progress in many fora; no one at present has an overview of the thrust of all these discussions. However, there is as yet, no sign of the emergence of a new consensus even among the major economic powers of the West.

The Group therefore limited itself to flagging several issues to which it attaches importance, without claiming that these are exhaustive. Other groups could usefully proceed similarly.

The issues identified are:

1. The need for greater stability between the dollar, ECU and yen, without a freezing of their exchange rates. This must, however, not be achieved at the cost of unsatisfactory domestic performance in the countries involved.

2. The need for an annual allocation of a limited quantity of SDR's for several years.

3. Provisions for a future increase in IMF resources might be achieved by arrangements for increased borrowing from governments, so as to allow the financing of medium-term adjustment programmes.

Given the present economic crisis and the lack of consensus on the outlines of international monetary reform, the Group concluded that there was currently no chance for a constructive outcome of an international monetary conference. On the other hand, the Group perceived a clear need for a continuing study of all issues involved and for constructive interim steps to be taken so as to ameliorate the present unsatisfactory situation. In the long run, a greater degree of stability of exchange rates and much greater discipline of governments in orienting their monetary and fiscal politics by their balance of payments situation is clearly desirable.

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