

# Balance of Payments Problems of Developing Countries — a Call for Action to the World Bank Group

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Addressing the annual meetings of the World Bank IMF in Belgrade in October this year Sri Lanka's Finance Minister, Mr. R. J. G. de Mel made a strong plea before this premier financial assembly for action to improve the balance of payments problems of the developing countries. He said these countries particularly the non-oil producers were victims of exchange rate fluctuations and of a consistent deterioration in their terms of trade which reflected external forces for which these countries were not responsible and had no control of. He drew attention to the instability of exchange rates, debt service burdens and the possibilities of stagnation in their real per capita growth which these countries face. Sri Lanka's Minister called for a more firm surveillance of exchange rates and lasting solutions which would require a redirection of capital movements rather than mere refinancing. Action, he said, must serve the spirit of the Fund's Articles and it was time for the community to accept the need for structural adjustment in both developed and developing countries; all other remedies would be only palliatives.

The current situation in industrial countries is characterised by persistently lower rates of growth and higher rates of unemployment and inflation. The moderate progress that we made through a co-ordinated growth strategy has been seriously undermined by instability in exchange rates and by recent developments in the field of energy. The prospects, regrettably seem to be for the continuation of low rates of growth in the coming years.

As it happens all too often in this era of interdependence among nations, the position of the developing countries is even worse. Although as a group they have sustained growth rates higher than those of industrial countries, this has been at the cost of large deficits on current account. From \$21 billion in 1977 and \$32 billion in 1978 the combined deficit of developing countries is projected to rise to \$47 billion this year (1979) and well over \$50 billion next year (1980). Of course, these deficits get financed

ultimately, but it is mainly through recourse to recycling, that is to say, banking credits. These have severe limitations as regards their impact. On one hand, the loans are of short maturity while the development problems are long lasting. On the other, these credits carry the international market rate of interest which is affected by the anti-inflationary policies adopted by industrial countries and are hence costly. These factors considerably worsen the debt profile and increase the burden of debt service for the developing countries.

It is thus increasingly clear that unless policies change radically and soon enough, we would be overcome by another set of events. The world economy will find itself trapped in a vicious circle of slow growth, unemployment, inflation and instability in monetary and financial fields. In particular, developing countries will find themselves unable to sustain even the inadequate growth levels of recent years with

the possibility of stagnation in real per capita growth. Unless the international community accepts the need for structural adjustments in both developed and developing countries all other remedies I am afraid will be only palliatives.

These international developments have had serious consequences on Sri Lanka.

In my statements to this distinguished gathering during the previous 2 years I have an insight into the radical new measures adopted by Sri Lanka to rehabilitate our run-down economy and place it on a path of self-sustaining growth. Through drastic action on consumer subsidies dating back to the 1940s and aggressive monetary policies, a substantial volume of domestic savings was mobilised for investment and development. Effective demand management policies, realistic prices and appropriate incentives were adopted to strengthen the balance of payments. As a result, our growth rate last year leaped to 8.2%—over double the average for the previous 5 years. Investment as a percentage of GNP rose from 15+ in 1977 to 20% in 1978 and domestic savings reached 15%.

I need not dwell on the difficulties caused in our effort to pull ourselves up by the boot strings. No government in Sri Lanka has had the political courage to take these bold decisions. We took them. But having taken them we are helpless spectators to recent international developments which will reduce our savings ratio by half with all its implications for our balance of payments, our domestic investment and our growth. It is frustrating to feel one's efforts negated in the fashion by world events outside our control.

In each of the past several years, we were primarily concerned with balance of payments adjustment. The amended articles of the Fund now seek to redress the previous inequity by spreading the burden of adjustment over both deficit and surplus countries. To have the desired effect, however, it should be implemented in a manner that reflects the true spirit and intent of the articles. Action which results in a redistribution of the surplus among industrial countries can scarcely contribute to adjustment. Rather, we would expect such action

to improve the balance of payments of developing countries.

The time is also opportune for the Fund to act more firmly in its surveillance of exchange rates. In spite of significant changes that have occurred in exchange rates and relative prices, current account imbalances have been slow to adjust themselves. Exchange rate instability among industrial countries has meant that developing countries have encountered serious problems in reaching and maintaining appropriate exchange rate levels. In addition, reserve management policies have been rendered difficult. The erratic behaviour of exchange rates has also caused sharp declines in the value of reserve assets held by them.

It is evident that the deficits of non-oil developing countries largely reflect external forces for which the deficit countries were and are not responsible. I have already touched on the terms of trade effect of increasing prices for imports of manufactured goods and oil. Recession and rising protectionism in developed countries have also undermined exports from developing countries. Great emphasis has been placed on exchange rate policies as a means of correcting external imbalances. But protectionist measures continually erode the efficacy of these policies by preventing the price mechanism from functioning.

The policies of multilateral financial institutions should now take account of these factors if a meaningful solution to balance of payments adjustments is to be found. As an urgent step:

The Oil Facility in the Fund should be reactivated or alternatively a new Facility should be set up.

Access to this facility should not attract conditionality any higher than that applicable to drawings in the first tranche.

The repayment period should at least be 10 years.

The interest on such borrowings by the Most Seriously Affected Countries should be offset through an Interest Subsidy Account.

The Fund guidelines on conditionality provide that the Fund will pay due regard to the economic priorities and circumstances of members including the causes of their balance of payments problems. We expect that as a result, programmes for assistance will contain identifiable action to reflect this concern. We welcome the recent decision of the Fund to increase to 100% of quota the amount which a member could draw in a single year under the Compensatory Financing Facility for Export Fluctuations. But under this facility financing is limited to export shortfalls. I would, therefore, urge that access to this Facility be liberalised to compensate for import fluctuations and the deterioration of the terms of trade of developing countries.

We also welcome the recent activity in the Bank to direct programme lending with the specific objectives to contribute to the adjustment process. Even though a limit of 10% was set as far back as 1971, for programme lending the volume of lending has fallen well short of this. The Bank's Articles permit programme loans only under exceptional circumstances. I am sure that recent international developments can be easily accommodated within this definition. The size of the balance of payments problems and the erosion of domestic savings would warrant that we revise the target to at least 25%. More important, the funds should be committed. Once the overall priorities are known, the quick disbursing character of programme loans should also help to step up the overall rate of disbursements.

Simultaneously, the Bank should look afresh at its record in local cost financing. Today external developments outside our control have seriously jeopardized efforts at mobilising domestic resources. Together with the shift in lending to projects aimed at the poorest segments of the population where the local cost content is high, the need exists for a larger local cost component to supplement internal resources.

With respect to co-financing undertaken by the Bank, two points are topical. The Bank should continue each programme

without reducing allocations to countries merely because they had succeeded in obtaining other support in the form of co-financing. Secondly, co-financing is a burden sharing operation and if cost overruns and other liabilities were incurred in a project the Bank should not leave the additional financing entirely to the country concerned and the other co-financiers. Over and above all this, however, the Bank should seek support for co-financing from capital surplus countries on a substantially wider scale. It scarcely needs emphasis that new arrangements should be additional to the normal flow of bilateral and multi-lateral assistance.

These matters that I mentioned are of course extensions of facilities and arrangements already accepted and adopted. But as most adjustments require structural changes, new facilities should be conceived within the Bank and Fund. In this connection, attention should be given to a long term facility for financing purchases of capital goods by the poorest developing countries. This facility could promote high levels of activity in the industrial countries and thus the international adjustment process by stimulating the external demand for their capital goods.

There is also a clear case for long term financing by the Fund for balance of payment support over periods of 5-10 years. This mechanism would help to make less demanding the adjustment of the balance of payments of developing countries by lengthening the period of adjustment. This facility should be managed by the Fund and provided to members with large payments imbalances which originated due to external factors.

Notwithstanding the financial facilities of the Fund and support from the Bank group, it is inconceivable that deficits of the order of \$40-50 billion for non-oil developing countries without compensating movements of long-term capital can last for any length of time. The situation will surely lead to tremendous financial burdens and deadlocks. Lasting solutions will require a redirection of capital movements rather than mere refinancing.

The current level of ODA assistance of one-third percent of GNP is clearly insufficient. While the countries that have reached or exceeded the target of 0.7% should be congratulated, there is an urgent

need for those falling behind to establish their assistance programme on a firm basis and make binding commitments for at least the next 3 years. This is particularly necessary in the current international situation.

On the role of long term capital, I have heard with much interest the stress placed on developing countries following appropriate policies to encourage private direct investment. At the same time, however, let us also place in perspective the realities of the situation from the point of view of a small economy at a low level of development. We have left behind the era where a pool of private savings seeks a profitable investment outlet overseas. Today investible savings are concentrated in corporate hands. These funds are available for investment elsewhere only in lines of activity similar to those in which they are already engaged. Not all the incentives in the world would move them into a high priority area of a developing country if their interests do not coincide. This is by no means to detract from the catalytic role direct investment has played in the economic development of many a nation. Rather, to draw attention to its limitations in particular though not infrequent situations.

To return to Bank matters, the Sixth Replenishment of IDA should be effected without delay so as to result in a significant increase in real terms. Reflecting the shift of wealth among the regions of the world, contributions to IDA should come from a wider group of countries. The additional contribution from new donors, it should be stressed, should not prejudice the increase in real terms of the contributions of the traditional donors.

At a time when non-economic factors stand in the way of increased bilateral assistance, multilateral institutions can fill the void to some extent. In this context, and at a time when some certainty is necessary with respect to aid flows, it is unfortunate that the doubling of the Bank's capital has been delayed. Political support was pledged 2 years ago. It is urged that member countries speedily approve and accept the capital increase.

The present opportunity should be grasped also to use the SDR mechanism to promote the flow of real resources to developing countries. After a lapse, SDR allocations have been resumed. The condition, therefore, exists and arrangements should be devised to consciously

channel such created liquidity to fulfil the developmental needs of developing countries. More than any of the recent improvements which affect the characteristics of the SDR and enhance its usability, only regular and adequate allocations will enable progress towards making SDRs the principal reserve asset.

One final word is apposite. It is not nearly enough to review the policies and procedures of the Fund and Bank Groups in the context of our needs and aspirations. Policy making and implementation will be more effective if representation at the level of Executive Directors and the professional staff is broad-based and take account as much as possible of the diversity of economic environments. Only then would the spirit of the Articles be best served.

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**Gold Boom....** (continued from p. 17) determined for the private trade. The country depends on imports to obtain new gold supplies for industrial and ornamental uses. During the last two decades imports of non-monetary gold have been around Rs. 2 million per annum with the exception of 1975 when the import level rose to Rs. 7 million. Balance of payments statistics do not show any import or export of monetary gold by the Central Bank for recent years. Besides ornamental uses, gold has been traditionally used as a store of value and a means of hoarding wealth by the people.

The local gold prices have closely followed the trends in the London market. The local price which was around Rs. 1600 per ounce at the beginning of 1976 had doubled to reach a level of nearly Rs. 3,200 in February 1978, and at the beginning of 1979 the price was nearly Rs. 4,000. Since then the price rise had been very rapid, a 68 per cent increase during January-October this year. The price stood at Rs. 6,732 in October, and this represents an increase of over 270 per cent above the price level of three years back. In Sri Lanka, however, the prices of other assets, in particular urban and property land values, have recorded much higher increases in the past two years. With gold prices reaching such high levels, pure-gold jewellery will become out of reach for all but the very rich. Other customers will have to turn to jewellery with lower gold contents such as the nine-carat gold commonly used in most Western countries.