

ESSAYS IN INTERNATIONAL FINANCE

No. 193, July 1994

---

ECONOMIC ASSISTANCE  
TO LOW-INCOME COUNTRIES:  
SHOULD THE LINK BE RESURRECTED?

---

GRAHAM BIRD



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS  
PRINCETON UNIVERSITY  
PRINCETON, NEW JERSEY

## ESSAYS IN INTERNATIONAL FINANCE

ESSAYS IN INTERNATIONAL FINANCE are published by the International Finance Section of the Department of Economics of Princeton University. The Section sponsors this series of publications, but the opinions expressed are those of the authors. The Section welcomes the submission of manuscripts for publication in this and its other series. Please see the Notice to Contributors at the back of this Essay.

The author of this Essay, Graham Bird, is Professor of Economics and Director of the Surrey Centre for International Economic Studies at the University of Surrey, England. He has published widely in the area of international finance and developing economies and is the author of a forthcoming study, *IMF Lending to Developing Countries: Issues and Evidence* (forthcoming 1995). The following Essay formed the basis for the inaugural Sir Arthur Lewis Memorial Lecture given by the author at the University of the West Indies, Cave Hill campus, on April 11, 1994. It is Professor Bird's second contribution to the Section's publications.

PETER B. KENEN, *Director*  
*International Finance Section*

ESSAYS IN INTERNATIONAL FINANCE

No. 193, July 1994

---

ECONOMIC ASSISTANCE  
TO LOW-INCOME COUNTRIES:  
SHOULD THE LINK BE RESURRECTED?

---

GRAHAM BIRD



INTERNATIONAL FINANCE SECTION

DEPARTMENT OF ECONOMICS  
PRINCETON UNIVERSITY  
PRINCETON, NEW JERSEY

INTERNATIONAL FINANCE SECTION  
EDITORIAL STAFF

Peter B. Kenen, *Director*  
Margaret B. Riccardi, *Editor*  
Lillian Spais, *Editorial Aide*  
Lalitha H. Chandra, *Subscriptions and Orders*

**Library of Congress Cataloging-in-Publication Data**

Bird, Graham R.

Economic assistance to low-income countries: should the link be resurrected? /

Graham Bird.

p. cm. — (Essays in international finance, ISSN 0071-142X ; no. 193)

Includes bibliographical references.

ISBN 0-88165-100-1 (pbk.) : \$8.00

1. Economic assistance—Developing countries. 2. Special drawing rights. I. Title.

II. Series.

HC60.B523 1994

338.9'11724—dc20

94-29473

CIP

*Copyright © 1994 by International Finance Section, Department of Economics, Princeton University.*

All rights reserved. Except for brief quotations embodied in critical articles and reviews, no part of this publication may be reproduced in any form or by any means, including photocopy, without written permission from the publisher.

Printed in the United States of America by Princeton University Printing Services at Princeton, New Jersey

International Standard Serial Number: 0071-142X

International Standard Book Number: 0-88165-100-1

Library of Congress Catalog Card Number: 94-29473

## CONTENTS

1	INTRODUCTION	1
2	THE FINANCING PROBLEMS OF LOW-INCOME COUNTRIES	5
3	THE BENEFITS OF A LINK FOR LOW-INCOME COUNTRIES	12
4	THE COSTS TO OTHER COUNTRIES	19
5	CONSIDERATIONS OF INTERNATIONAL POLITICAL ECONOMY	22
6	CONCLUDING REMARKS	25
	REFERENCES	26

## TABLES

1	Developing Countries' Balance of Payments on Current Account	7
2	Developing Countries' Reserves	10

## ECONOMIC ASSISTANCE TO LOW-INCOME COUNTRIES: SHOULD THE LINK BE RESURRECTED?

### 1 Introduction

The Special Drawing Right (SDR) was established at the beginning of the 1970s for the purpose of acquiring greater control over the amount of international liquidity in the international monetary system. It was believed that there was an optimum quantity of international reserves. If this quantity were exceeded, there would be global inflation; if it were not reached, there would be recession and unemployment. The late 1960s had been perceived as a period during which international liquidity was inadequate. Moreover, the way in which international reserves were created under the Bretton Woods system relied heavily on the state of the U.S. balance of payments, and this was generally perceived to be unsatisfactory. SDRs seemed to offer a more centralized and controllable mechanism. It was intended that the SDR would eventually take over as the principal reserve asset in the international monetary system.

SDRs were allocated to participants—essentially the member countries of the International Monetary Fund (IMF)—in relation to their IMF quotas. The theoretical basis for this was the assumption that the resultant pattern of supply would match the pattern of long-term demand for reserves. As a consequence, no long-term unrequited resource transfers were envisaged, and the scheme was intended to be neutral with respect to permanent resource flows, thereby ensuring that all participants would gain a liquidity yield by enjoying an increase in their owned reserves, an increase they were not obliged to earn by giving up resources or by borrowing. This demand-based method of allocating SDRs was not, however, the only one possible. SDRs could be allocated with other objectives in mind, just as seigniorage from money creation could be used by national governments for varied purposes (Hawkins and Rangarajan, 1970; Grubel, 1972).

Developing-country representatives quickly suggested that the SDR offered a chance to change the distribution of benefits associated with

---

Thanks are due to Tony Killick and an anonymous referee for comments on an earlier version of this essay. The usual disclaimer applies.

the older methods of reserve creation, benefits they felt had been distributed mainly to industrialized and relatively rich countries. They argued that there should be a “link” between SDR allocations and the provision of financial assistance to developing countries.

There were various versions of the link proposal. The “inorganic” link envisaged voluntary contributions by developed countries in the form of currencies or SDRs either to development agencies or directly to developing countries at the time of each SDR allocation. Under some circumstances, these contributions would be tied to expenditure in donor countries. A central advantage of the inorganic link was that it required no change in the IMF’s Articles of Agreement.

The “organic” link, by contrast, involved changing the distribution formula for SDRs so as to increase the proportion of any given allocation going to developing countries, either directly or through the intermediation of development agencies. A key argument for an organic link was that, whereas quotas were taken to reflect the demand for reserves to hold, developing countries should be expected to spend the SDRs they received. Per capita income, balance-of-payments instability, and adjustment costs were put forward in this context as more relevant criteria on which to distribute SDRs to developing countries.

Variations on the basic theme included proposals to use newly created SDRs, either directly or through contributions from developed-country recipients, to finance a subsidy account that would then redirect those SDRs to developing countries. The account might make grants, in which case contributors would pay the charges on using SDRs, or provide interest-bearing credit lines, in which case the ultimate recipients would pay the charges. An extension of this idea was to use SDRs to finance a special account that would then support stabilization and adjustment programs approved by the IMF. In effect, developing countries that successfully negotiated a program with the IMF would receive additional resources in the form of SDRs. Such a scheme, however, would change the nature of SDRs in that the receipt of the SDRs would depend on the acceptance of IMF conditionality.

The basic link proposal led to much official and academic debate (summarized, for example, in Park, 1973, and Bird, 1982c). Those opposed to the proposal prevailed, however, and the link was not introduced. The deciding factor seems to have been the antagonists’ claim that the link would be inflationary, because it represented a net increase in world aggregate monetary demand with no matching increase in real aggregate supply. But there was also the related concern that recipients would be allowed to squander unconditional SDRs.

When the developing countries did not get the link, they took some consolation in the addition of the Extended Fund Facility (EFF) to the array of IMF lending windows in 1974. The EFF was intended to be of particular relevance to developing countries, because it provided financial assistance in support of longer-term and structural balance-of-payments adjustment. Moreover, even under the existing SDR scheme, developing countries took advantage of an “informal” link, for they were heavy net users of the new reserve asset, which carried only a nominal charge and only limited reconstitution provisions requiring participants to maintain over a five-year period an average balance of SDRs of at least 30 percent of their net cumulative allocations (Helleiner, 1974; Bird, 1976, 1979). The abrogation of this reconstitution requirement in 1981 would, other things being constant, have increased the value of the informal link, but other things did not stay constant. The interest rate and charge on SDRs were simultaneously raised to a market-equivalent rate, and the effect was to increase the cost of net use of SDRs (as well as to increase the return to net acquisition).<sup>1</sup> The developing countries, as net users, undoubtedly lost out.

Of course, the developing countries stood to gain most from the link if the SDR became a widely accepted (if not the principal) international reserve asset and an important source of reserve growth. To the extent that an increase in the interest rate on SDRs was needed to achieve this objective, it might have been seen as a price worth paying. Moreover, many developing countries were deemed uncreditworthy by private international capital markets and either encountered an effective availability constraint or could borrow only at a rate significantly above average market rates; in these circumstances, SDRs continued to confer benefits on developing countries. Indeed, the combined short-term effect of dropping the reconstitution requirement and raising the interest rate was to raise the benefits of SDRs to developing countries (Bird, 1981, 1982b). The general view, however, was that the increase in the charge on using SDRs destroyed the benefits of the link, and so the proposal, which had already been downplayed by the developing countries in order to win support for other reforms such as the EFF, now practically disappeared from the reform agenda.

<sup>1</sup> Under the SDR scheme, recipients holding 100 percent of their allocation in effect pay and receive the same amounts. Net users of SDRs, however, pay a charge on their net use, and net acquirers of SDRs receive interest on their net acquisitions. The charge and interest rate have conventionally moved in tandem. In principle, the two could be different, although a difference would have implications for the financial status of the SDR account within the IMF.

The increase in the interest rate on the SDR was intended to make it a more attractive asset to hold and thereby to assist in establishing it as the system's principal reserve asset, but it did not have this effect. The system moved away from SDRs altogether and toward multiple reserve currencies. No new allocations of SDRs have been made since 1981, and they have come to be viewed by some as largely irrelevant (Chrystal, 1978, 1990b).

It is not difficult to see how the attractiveness of the SDR could be enhanced by improving its properties as an international medium of exchange and financial asset, (Bird, 1985; Coats, 1990), and some authors have continued to argue that moving toward the SDR would represent a systemic improvement (Coats, 1990). Periodically, a call comes for a new allocation of SDRs (Williamson, 1984), and the IMF's managing director, Michel Camdessus, has argued strongly for a new allocation as well as for a voluntary redistribution of SDRs from industrial countries to low-income countries (LICs) and to the countries of the former Soviet Union (FSU) and the Council for Mutual Economic Assistance (CMEA).<sup>2</sup>

At a press conference held on April 20, 1993, to launch the new Systemic Transformation Facility (STF) for economies in transition, Camdessus is quoted as saying:

How is an SDR allocation relevant to the problem of these countries? Are there grounds for an SDR allocation now in the membership? My answer is yes, with a personal conviction I try to have shared by the membership. Why? Because to allocate SDRs you need to demonstrate that there is a long-term global need for reserve supplementation. And this need is there. At present, 40 percent of our membership has reserves accounting to less than ten weeks of imports.

Second, for the small low-income countries, the situation is one of true catastrophe . . . the case for the SDR allocation is very strong. It would allow us to correct a factor that for me is embarrassing—the fact that 37 of our members, particularly the countries of the former Soviet Union, have never been allocated SDRs, while other members of the IMF have allocated

<sup>2</sup> The IMF classifies forty-five countries as *small low-income countries*. Excluding China and India, these are countries in which GDP per person, as estimated by the World Bank, did not exceed the equivalent of \$425 in 1986. They are Afghanistan, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Equatorial Guinea, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Haiti, Kenya, Laos People's Democratic Republic, Lesotho, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Pakistan, Rwanda, Sao Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Sri Lanka, Sudan, Tanzania, Togo, Uganda, Vanuatu, Viet Nam, Zaire, and Zambia.

to themselves, in much less pressing circumstances, a significant amount. So I think an allocation would help us to correct some of this imbalance.

I encourage the membership to consider voluntary schemes for a redistribution of SDRs, particularly the SDRs that would be allocated to industrial countries that do not need them. Then you would have extraordinary positive leverage to help industrial countries do more, not only for Russia but for all countries where the problem of external financing comes with a severe acuity. (*IMF Survey*, May 3, 1993)

Is Camdessus' "personal conviction" well founded?

This essay asks whether, in the circumstances of the early 1990s, there is a case for a limited allocation of SDRs specifically and exclusively to low-income countries. Undeniably, such countries face acute financing problems, and it is worth examining the extent to which these might be overcome by receiving SDRs. From the viewpoint of international political economy, a proposal of this type might encounter fewer objections than one that confers benefits on poor countries merely as a coincidental feature of a more general SDR allocation. Moreover, it will emerge that the effectiveness and efficiency of a limited allocation of SDRs to low-income countries can be enhanced if one is not at the same time too concerned about the SDR's systemic role within the international financial regime. In this regard, the irrelevance of the SDR as an international reserve asset may be an advantage.

The layout of the essay is as follows. Section 2 briefly reviews the balance-of-payments problems that are encountered by LICs. Section 3 enumerates the benefits that an allocation of SDRs to LICs would confer on them and makes some approximate quantitative estimates of those benefits. Section 4 looks at the potential costs for other countries not receiving SDRs and examines the implications for the international monetary role of the SDR. Section 5 discusses the international political economy of a limited allocation of SDRs to LICs and investigates whether such a proposal would receive the international-community support (or acquiescence) necessary for its adoption. The final section offers brief conclusions.

## **2 The Financing Problems of Low-Income Countries**

Apart from domestic economic mismanagement, balance-of-payments difficulties emanate from a number of sources. First, there may be secular changes in exports, imports, and long-term capital flows. For example, a country producing and exporting goods that have a low income elasticity of demand and importing goods that have a higher

elasticity of demand will tend to encounter balance-of-payments problems. Such factors reflect payments deficits and surpluses as essentially structural phenomena. In addition, when demand and supply are themselves unstable, low price elasticities of demand and supply will tend to result in instability in the terms of trade. This instability in part reflects vulnerability to exogenous shocks. Both of these factors influence the incidence of payments deficits and surpluses.

Other important aspects of the balance of payments relate to the speed and efficiency with which deficits may be financed or corrected. The capacity of a country to finance a payments deficit depends on the level of its international reserve holdings and the availability of finance from the private international banks and the Bretton Woods (and other) institutions. The capacity for adjustment within the economy depends, in turn, on a number of factors. These include the extent to which domestic consumption goods may be switched into exports, and, more generally, the scope for short-term export expansion and efficient import substitution, the degree of money illusion, the flexibility of domestic economic policy, the level of infrastructural investment, and, related to these, the values of the price elasticities of export supply and import and export demand.

With low elasticities and a high degree of real-wage resistance, the scope for balance-of-payments adjustment will be strictly constrained. To the extent that the adaptability of an economy is positively related to its level of economic development, it is likely that developing countries will encounter more difficulty in coping with balance-of-payments problems than do developed countries. An important feature of the 1970s, 1980s, and 1990s, however, has been the growing irrelevance of grouping all developing countries together. Disaggregation is vitally important. This may be based on various economic indicators including per capita income, the degree of export diversification, the nature and pattern of trade, and geographical location. Against this background, a number of indicators may be assembled to reflect the size and nature of a country's or countries' payments problem. Examination of such indicators suggests that the balance-of-payments problems of low-income countries are particularly pronounced.

Data presented in Table 1 show that, although many developing countries (with the exception of the newly industrializing Asian economies) experienced quite persistent current-account deficits, the size of the deficits expressed as a percentage of exports of goods and services was significantly greater for LICs than for other groups. From 1984 to 1993, for example, the deficit measured this way was on average more

TABLE 1  
DEVELOPING COUNTRIES' BALANCE OF PAYMENTS ON CURRENT ACCOUNT

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
	<i>In billions of U.S. dollars</i>										
All developing countries	-33.6	-27.5	-46.9	-4.7	-24.9	-16.9	-11.6	-87.9	-67.1	-104.6	-106.2
Africa	-7.9	-0.5	-10.2	-4.5	-9.8	-7.3	-3.0	-4.6	-7.5	-8.3	-4.1
Asia	-3.6	-13.8	4.0	22.1	9.6	0.8	-2.7	-2.7	-4.5	-25.1	-28.3
Middle East and Europe	-19.9	-9.1	-24.3	-11.9	-12.9	-1.8	—	-61.1	-20.3	-27.8	-27.1
Western Hemisphere	-2.1	-4.1	-16.4	-10.4	-11.7	-8.6	-6.0	-19.6	-34.8	-43.3	-46.6
Sub-Saharan Africa	-3.1	-3.5	-6.0	-6.5	-7.9	-6.7	-8.6	-8.3	-8.8	-8.4	-7.0
Four newly industrializing Asian economies	7.2	10.4	23.2	30.9	28.3	24.4	14.3	9.7	10.0	4.5	0.8
Small low-income countries	-7.2	-7.4	-7.4	-8.3	-9.8	-9.9	-11.1	-10.0	-10.5	-10.9	-10.0
	<i>In percent of exports of goods and services</i>										
All developing countries	-5.2	-4.5	-8.1	-0.7	-3.1	-1.9	-1.1	-8.1	-5.7	-8.3	-7.7
Africa	-10.1	-0.7	-14.8	-5.7	-12.0	-8.3	-3.0	-4.7	-7.6	-8.6	-4.2
Asia	-1.5	-5.7	1.5	6.5	2.3	0.2	-0.5	-0.4	-0.7	-3.3	-3.4
Middle East and Europe	-10.7	-5.4	-18.3	-7.9	-8.2	-1.0	—	-29.5	-9.2	-12.7	-11.8
Western Hemisphere	-1.6	-3.3	-14.9	-8.4	-8.4	-5.6	-3.5	-11.5	-19.5	-23.1	-23.1
Sub-Saharan Africa	-12.0	-13.4	-23.3	-22.9	-26.9	-21.2	-25.3	-25.1	-27.3	-26.0	-20.9
Four newly industrializing Asian economies	5.3	7.7	14.5	14.5	10.6	8.1	4.4	2.6	2.4	1.0	0.2
Small low-income countries	-31.8	-33.0	-32.2	-33.2	-35.9	-34.5	-35.5	-30.8	-31.3	-30.5	-25.4

NOTE: Includes official transfers

SOURCES: IMF, *World Economic Outlook*, 1992, 1993, 1994.

than seven times greater for LICs than for developing countries. Declines in trade, and particularly in import volumes, have also been more common in LICs, and such reductions in volume may be a useful indicator of underlying balance-of-payments constraints; these constraints may, through economic policy, be transformed into declines in trade. For developing countries as a group, import volumes have risen persistently since 1987, with summed annual percentage increases amounting to 60 percent. For LICs, summed import volume growth was only just over 11 percent, with import volumes falling in 1987, 1990, and 1991 (IMF, 1992, table 25A, p. 119).

The statistical state of the current-account balance of payments is, however, an imperfect guide to the size of payments problems. Disequilibria may be temporary and self-reversing, capital flows may allow a current-account deficit to be sustained, but, at the same time, *ex post* payments data may conceal the extent to which other macroeconomic policy objectives have been subjugated. Overall, however, there appears to be evidence of a secular deterioration in the balance of payments of LICs.

To some extent, this deterioration is associated with the downward trend in the price of primary commodities relative to manufactures. For the countries of Sub-Saharan Africa, the sum of annual percentage declines in terms of trade over the 1985-92 period was 38.5 percent; for the small low-income countries as a group, it was 29 percent. This compares with a decline of only 20 percent for all developing countries taken together.

The fall in the relative price of primary products is particularly relevant for LICs because they have a relatively high degree of export concentration on such products. Data from the United Nations Conference on Trade and Development (UNCTAD) for 1982 to 1984 reveal that, whereas primary products made up more than 50 percent of total exports for 58 percent of developing countries, 71 percent of low-income countries experienced this degree of concentration.

The problems created by such secular deteriorations are exaggerated by short-term instability around this trend. Although better-off developing countries are not exempt from such instability (Love, 1990), the least-developed countries appear to experience the greatest instability in their terms of trade as well as in the purchasing power of their exports and in their import volume (Helleiner, 1983b).

What all this implies is that LICs are more likely than other countries to encounter balance-of-payments deficits. How can they respond? A first possibility is that they can run down their international reserves.

But are their reserves adequate?

One, albeit imperfect, indicator of reserve adequacy is the ratio between reserves and imports, with a very approximate “rule of thumb” being that reserves are inadequate if they stand below 25 percent of imports or, in other words, are insufficient to finance imports for more than three months.<sup>3</sup> Data on reserve ratios are presented in Table 2, where it may be seen that low-income countries persistently fail this test. The theory of the demand for reserves suggests that demand is a positive function of the incidence of balance-of-payments deficits, the costs of adjustment, and national income, and a negative function of the degree of access to international credit, the degree of exchange-rate flexibility, and the opportunity cost of holding reserves.<sup>4</sup> On balance, these factors suggest that LICs will have a relatively strong demand for reserves and that low reserve ratios are indicative of reserve inadequacy rather than of a low need for reserves.

With inadequate reserves, countries may be forced to adjust. It is reasonable to presume that most poor countries possess a relatively low degree of structural flexibility. Markets may often be ill-developed and price elasticities low, with the result that the scope for switching resources rapidly into the production of traded goods will be strictly limited. In a global economic environment that is hostile to export expansion, developing-country governments frequently possess few alternatives to a deflationary program of balance-of-payments stabilization. The cost of such programs on economic growth, at least in the short term, and on future export growth may also be significant. In addition, such economic costs have been shown to put considerable strain on fragile democratic political systems, and it is therefore important not to lose sight of the political costs of adjustment.<sup>5</sup> The capacity for short-term adjustment is likely to be particularly constrained in LICs, where economies are inflexible, per capita income is low, technical competence is limited, and political support for the government is often tenuous.

<sup>3</sup> A brief critical analysis of the ratio of reserves to imports as a measure of reserve adequacy may be found in Williamson (1984) and Bird (1985).

<sup>4</sup> Bird (1982a) contains a review of the empirical evidence and a more detailed analysis of the theory of the demand for international reserves as it applies to developing countries. More recent analyses include Frenkel (1984), Lizondo and Mathieson (1987), and Chrystal (1990a).

<sup>5</sup> Discussion of the political costs of stabilization may be found in Bienen and Gersovitz (1985), Haggard (1985), Nelson (1984, 1989), Kaufman (1988), Haggard and Kaufman (1989), and Stallings and Kaufman (1989).

TABLE 2  
DEVELOPING COUNTRIES' RESERVES

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
	<i>In billions of U.S. dollars</i>										
All developing countries	164.6	188.2	195.8	255.2	249.6	271.5	319.9	388.0	408.6	448.1	446.6
Africa	7.2	9.7	9.3	11.0	10.8	12.7	17.5	21.2	18.3	19.3	21.7
Asia	67.4	79.4	104.6	148.4	158.6	168.5	194.2	237.5	236.8	246.9	241.2
Middle East and Europe	49.4	57.8	48.3	57.5	49.1	57.0	59.9	63.4	64.8	71.8	69.3
Western Hemisphere	40.5	41.2	33.7	38.3	31.1	33.3	48.3	65.9	88.7	110.0	114.4
Sub-Saharan Africa	3.1	4.1	5.1	6.0	6.5	7.2	8.5	9.8	9.8	10.2	11.1
Four newly industrializing Asian countries	29.0	43.5	67.8	102.8	111.4	117.7	126.3	143.6	152.7	161.8	161.1
Small low-income countries	4.6	4.9	5.4	5.5	5.7	5.7	6.2	7.3	7.2	8.0	8.6
	<i>Ratio of reserves to imports of goods and services</i>										
All developed countries	23.8	28.5	30.1	35.1	29.3	28.7	30.2	33.1	31.7	32.1	29.5
Africa	7.9	11.4	10.5	11.8	10.5	11.9	14.9	18.4	15.3	16.3	18.9
Asia	25.8	29.7	37.8	45.0	37.4	34.9	35.6	38.3	33.6	31.3	27.3
Middle East and Europe	24.1	32.7	30.6	34.7	28.7	30.2	28.0	26.8	27.0	29.0	26.9
Western Hemisphere	30.2	31.4	26.0	27.8	20.0	19.8	26.5	33.2	39.7	45.9	44.5
Sub-Saharan Africa	9.3	12.2	13.9	14.7	14.9	15.9	17.3	20.1	19.8	20.9	22.7
Four newly industrializing Asian countries	22.6	35.1	49.2	56.3	46.7	43.2	40.5	39.7	37.5	36.1	32.0
Small low-income countries	11.9	12.3	13.0	12.2	11.5	11.1	11.4	13.1	12.5	13.3	13.8

NOTE: Official holdings of gold are valued at SDR 35 an ounce. This convention results in a marked underestimate of reserves for countries that have substantial holdings of gold. Valuing gold at the market price would further accentuate the *relatively* weak reserve position of low-income countries because they hold little gold.

SOURCES: IMF, *World Economic Outlook*, 1992, 1993, 1994.

Low structural flexibility and low response elasticities will also weaken the impact of exchange-rate changes; for this reason, it is in the context of LICs that most resistance to devaluation has been encountered. At the same time, pegging exchange rates to a major currency, as have thirteen Sub-Saharan African countries belonging to the franc zone, runs the danger of encountering the “third-currency phenomenon,” under which inappropriate exchange-rate changes associated with changes in the world value of the major currency impose additional balance-of-payments problems on the countries tying their currencies to it. It is not surprising to find that researchers claim that the adoption of generalized flexible exchange rates actually raised the demand for reserves in such countries (Heller and Khan, 1978; Aghevli, Khan, and Montiel, 1991).

Faced with adjustment difficulties and high adjustment costs, it may be tempting for LICs to borrow from international capital markets to finance balance-of-payments deficits, but in this they encounter a problem in the form of credit rationing and the existence of an availability constraint. Moreover, no risk premium that they would be prepared to meet would help unlock commercial finance, because commercial lenders, aware of the problem of adverse selection, would accurately conclude that the LICs could not afford to pay such high rates and that the higher default risk would more than offset any expected profits from an increase in the interest rate. It is not surprising to find that only very small amounts of short-term commercial lending have been directed to LICs, the access of which to bond finance is yet more impeded.

Notwithstanding their low level of commercial borrowing, LICs have failed to avoid debt problems and the need to renegotiate their debts through the Paris Club. Although many simple debt indicators can be misleading, and although, in the main, LICs have acquired official debt, their debt-service ratio was nevertheless more than ten percentage points higher than the average ratio for developing countries in 1992. Indeed, for low-income countries such as those in Sub-Saharan Africa, the debt problem has become progressively more pronounced. By 1990, the ratio of total external debt to exports for Sub-Saharan Africa was 370 percent, compared with 255 percent for developing countries in the Western Hemisphere. The ratio of total debt to GDP in the Sub-Saharan countries was more than twice that in the Western Hemisphere developing countries. LICs therefore encounter the problem of “debt overhang,” with its negative adjustment incentives, that Latin American debtors experienced in the 1980s. Moreover, large

debt-service ratios and low adjustment incentives will do nothing to enhance future creditworthiness.

All of the above evidence suggests that LICs have experienced structural weakening in their balance of payments, instability associated with export concentration, low levels of both reserves and access to finance, and severe adjustment difficulties. But their problems do not end with these.

LICs have frequently been compelled to turn to the IMF for financial assistance. Some analyses suggest, however, that the IMF's conventional wisdom of devaluing the national currency in question, and of deflating domestic demand is at its least relevant in the context of LICs. This is reflected in the high failure rate for IMF-supported programs in LICs and the fact that LICs account for almost all cases of arrears within the IMF.<sup>6</sup> Faced with an *ex ante* financing gap, LICs have had to close it *ex post* by lowering growth and by accepting a significant fall in living standards.

There is clearly no easy solution to the complex economic problems of LICs, but could it be that an appropriately sized allocation of SDRs to them would at least help?

### 3 The Benefits of a Link for Low-Income Countries

An allocation of SDRs to LICs would surely help to correct the problem of reserve inadequacy. The benefit may be represented by the costs of reserve acquisition that would thereby be avoided. Reserves may, in principle, be acquired by borrowing or by sacrificing the consumption of real resources by running a balance-of-payments surplus. Low-income countries have low creditworthiness, are credit rationed, and are unable to borrow from private capital markets at any interest rate. Under these circumstances, the benefits of receiving SDRs are perhaps more appropriately viewed in terms of the interest rate the countries would have been *willing* to pay in private capital markets. They can, however, borrow from the IMF, but this would involve them in having to accept and implement a range of conditions, therefore incurring a "cost" in terms of loss of sovereignty. The reluctance of countries to borrow from

<sup>6</sup> By 1992, at least seven of ten countries in arrears could be classified as low income. The data suggest, moreover, that low-income countries more than any other group have quasi-continuous drawings from the IMF over protracted periods of time. Critical analyses of the IMF's role in LICs may be found in, for example, Helleiner (1983a), Loxley (1984), and Zulu and Nsouli (1985).

the IMF unless unavoidable and to use it only as a lender of last resort (which may also be the *only* resort in the case of LICs) suggests that this cost is perceived as being high; as a cost avoided, however, it would be a benefit conferred by SDR allocation.

The cost of sacrificing real resources may in one sense be interpreted as the value of the goods that are exported rather than consumed domestically and the value of the imports that are foregone. But it is also instructive to consider the means by which imports are reduced. Taking the simplest of import functions,  $M = mY$ , where  $M$  equals the total value of imports,  $m$  is the propensity to import, and  $Y$  is national income, it may be seen that reducing imports will involve a sacrifice in terms of income that varies inversely with the value of  $m$ . If imports are further assumed to be made up of capital goods with a high marginal productivity, it follows that the long-term sacrifice will substantially exceed the short-term sacrifice. If, in addition, income is assumed to be subject to diminishing marginal utility, it follows that the receipt of SDRs will confer significant benefits.

It has to be recognized, however, that LICs may perceive the benefits of receiving SDRs as being rather less than the above discussion would suggest. Prior to receiving SDRs, LICs had the opportunity to increase reserves by pursuing appropriate policies, such as deflating domestic demand. The fact that they did not reveals something about their preferences. Assuming rationality, they would have been expected to substitute reserves for income for as long as the benefits of additional reserves appeared to exceed the costs of lost income. The benefits of receiving additional SDRs *gratis* would therefore be perceived by LICs as having a value that is less than the resource cost of acquiring reserves; moreover, the benefit per SDR would decline at the margin.

Viewing the benefits of SDRs purely in terms of the liquidity yield on additional international reserves is theoretically legitimate, but it may be unrealistic. Given the instability of their payments balances, their high adjustment costs, and their lack of access to other forms of international credit, LICs may need the additional insurance that would be provided by a larger inventory of reserves. But insurance is a luxury good, and LICs may not be able to afford it. If they were to receive a windfall in the form of additional SDRs, there might be other uses that would generate greater marginal utility for them than would be associated with using SDRs to increase reserve holdings. In short, LICs might be expected to spend any additional SDRs. Not only is this what would be expected, it is what has happened. Poor countries have been the heaviest net users of SDRs.

For some observers, this heavy net use has called into question the whole rationale of the SDR as a *reserve* asset. But it clearly means that we need to modify our analysis of the benefits of SDRs to recipients. Furthermore, it becomes necessary to establish a sharp distinction between the short-term and the long-term benefits, as well as between benefits and resource transfers. The benefits will tend to exceed the value of the real resource transfers that are financed by spending SDRs.

SDRs may be spent on imported consumer goods or imported capital goods. Alternatively, they may be used to service outstanding debt obligations. In a neoclassical general-equilibrium world, the marginal benefits of any of these forms of expenditure will be equal. It needs to be recognized, however, that, whereas buying imports of consumer goods confers short-term benefits, cancelling or reducing debt, or purchasing capital imports, generates benefits over the longer term. As soon as we pass into the long term, we need to start discounting in order to come up with a present-value estimate of benefits. We also need to estimate the marginal productivity of imported real resources. Assuming, however, that the marginal productivity exceeds the rate of discount (and this would be the rationale behind using SDRs this way in the first place), the long-term benefits will exceed both the short-term benefits and the value of the initial resource transfers associated with spending SDRs.

Up to now, the discussion implies that LICs will receive substantial benefits from an allocation of SDRs; but there is some overestimation. Net use of SDRs also currently carries a rate of interest (or more accurately in a technical sense, and as noted earlier, a rate of charge). The benefits of net use vary inversely with the rate of interest. Including the interest rate in the analysis again means that the time profile of benefits will vary; instantaneous use of SDRs will result in short-term and long-term benefits depending on how the SDRs are used, but it will also carry with it interest obligations that will move forward in time. For long-term benefits to be positive, the marginal rate of productivity net of the interest rate must exceed the rate of discount.

Furthermore, if SDRs were to be allocated on a regular basis, the time could eventually arrive when the interest payments associated with previous net use of SDRs would exceed new allocations, and the related resource transfers associated with the scheme would at that point turn negative for net users (Bird, 1982b). If the intention is to maximize the benefit of SDRs for net users, an easy way of doing this is to reduce (or eliminate) the rate of charge on using them; this issue is discussed further in Section 5.

There are, however, other ways in which LICs might benefit or perceive themselves to benefit from receiving SDRs. First, to the extent that SDRs are added to international reserve holdings or are spent in such a way that the future performance of the economy can be expected to be improved, the SDRs can raise the recipient's creditworthiness. Credit rationing will then be relaxed and the interest rate at which the country can borrow from international capital markets will fall. In fact, most LICs are so far from enjoying access to capital markets that it is difficult to see this as a practical benefit for them. It would be much more relevant for developing countries just on the wrong side of the margin of creditworthiness.

More pertinent in the case of some LICs would be the potential use of SDRs to clear arrears with the IMF. As mentioned earlier, arrears have become a significant problem for a number of LICs, for they remain ineligible to draw resources from the IMF while in arrears. Thus, although receiving SDRs would not relax the availability constraint that applies to commercial borrowing, it would relax the constraint that applies to borrowing from the IMF.

Another factor relating to the quality of SDRs as perceived by recipients is that, in contrast to drawings from the IMF through standbys and extended arrangements or through structural-adjustment facilities, the net use of SDRs carries no conditionality. It is reasonable to assume that the objective function of an LIC government in its dealings with the IMF has utility positively related to the volume of resources and negatively related to the degree of policy conditionality. Presenting LICs with additional and zero-conditionality financial resources would, in these circumstances, unambiguously raise their utility. Whether LICs can *actually* gain from being able to escape IMF conditionality depends on its net effectiveness.

Whereas recipients will view the lack of conditionality as an advantage, the IMF's major shareholders may be expected to view it as a serious weakness. To them, conditionality represents a means of encouraging countries receiving IMF support to modify policy both macroeconomically in terms of the management of aggregate demand and microeconomically in terms of establishing price incentives that, by increasing aggregate supply, will alleviate the underlying macroeconomic disequilibrium. In circumstances in which economic adjustment is badly needed, unconditional SDRs will be seen as enabling low-income countries to avoid adjustment and to substitute external financing that may itself allow the disequilibrium to worsen. For these reasons, the trend has been to make aid more conditional rather than less conditional.

Furthermore, a public-choice analysis of IMF lending predicts hostility from the IMF's management as well, because it is conditionality that confers on the managers their power and influence. Their utility according to such models will be a positive function of both lending *and* conditionality. Camdessus' position apart, why would they support expanding unconditional finance in the form of SDRs?

A more measured approach seeks to assess the effectiveness and efficiency of IMF conditionality. Where it works and works well, allowing LICs to avoid it may be seen as a weakness of SDR allocation. Where it does not work or works badly, allowing LICs to sidestep it should not be cause for concern. Indeed, when IMF conditionality has a negative effect on the countries that accept it, avoidance can be seen as a benefit. There is now a large literature dealing with the design and effects of IMF-supported programs. Studies differ in terms of the methodology used and the detailed results discovered, but generally they suggest that, although there may be a small positive effect on the current account of the balance of payments, there are no significant effects on very much else.<sup>7</sup> Thus, Mohsin Khan (1990, p. 222) concludes that "one would be hard-pressed to extract from existing studies strong inferences about the effects of Fund programs on the principal macro economic targets."

Empirical evidence suggests that it is quite frequently external shocks (and not economic mismanagement alone) that force countries to turn to the IMF in the first place, and additional shocks that then blow adjustment programs off course. Lack of commitment by governments may clearly be a factor in causing programs to remain uncompleted, but most studies suggest that it makes little difference whether or not the negotiated program is fully implemented. Furthermore, commitment may be encouraged by adequate financial support. Significantly, the completion rate of IMF-supported programs tends to increase as the amount of finance provided by the IMF (relative to the country's balance-of-payments deficit) rises.

There is also a (perhaps growing) view that a greater commitment to adjustment can be induced if governments feel a stronger degree of

<sup>7</sup> A major study of the IMF and developing countries that incorporates a detailed investigation of the effects of IMF programs has been completed at the Overseas Development Institute by the author and Tony Killick. For a full presentation and interpretation of the results relating to conditionality, see Killick and Malik (1992) and Killick, Malik, and Manuel (1992). The statements made in the text here draw empirical support from these studies.

“ownership” of the program they are implementing. This might suggest that less emphasis should be placed on conditionality imposed from outside and more emphasis on policy designed by the country itself. If structural economic adjustment takes a relatively long time to achieve, increasing the amount of external financing through SDR allocation will enable more appropriate adjustment policies to be pursued in preference to those that focus on the short-term deflation of domestic aggregate demand. Macroeconomic stabilization is clearly important, but there is the danger that excessive reliance on deflating domestic demand will squeeze out strategic developmental imports and compress investment, with adverse long-term consequences for aggregate supply. To the extent that the optimal *speed* of adjustment tends to be lower in LICs than elsewhere, an additional allocation of SDRs will help provide the international finance that is the counterpoint to longer-term and more gradual adjustment.

A residual concern for LICs is that additional allocations of SDRs will merely crowd out other financial aid, as well as nonfinancial aid that has a monetary value. To the extent that crowding-out occurs and SDRs fail to provide *additional* finance, the benefits from receiving SDRs will be reduced. The calculation will, however, need to be a little more subtle than this, for different types of aid are seen by recipients as being of different qualities. If high-quality assistance associated with SDR allocation were to crowd out an exactly equivalent value of other lower-quality financial aid, recipients would retain positive net benefits. Again, however, if the objective were to maximize the benefit from an allocation of SDRs to LICs, the solution would be to ensure that it had no adverse effect on other aid flows.

Can we more formally use the variables above to estimate the welfare benefits of SDRs to recipients? Much depends on how the SDRs are used and on the values assumed for the marginal productivity of resources, the interest rate on net use, the social discount rate, and the marginal propensity to import.

As noted, the benefit from holding SDRs may be seen as the associated liquidity that is thereby derived. This may be measured either by the opportunity cost of acquiring a similar quantity of reserves by alternative means or by the opportunity cost of the adjustment that is avoided. These two measures of the benefit from holding SDRs will, however, differ. Taking the former measure, and assuming that the alternative method of reserve acquisition is through the pursuit of expenditure-reducing policies, the size of the related income loss varies inversely with the value of the marginal propensity to import. For

those imports that are of producer goods, this initial estimate of the impact on national income will have to be multiplied by the value of the marginal productivity of real resources. This approach to the measurement of benefit may also be used to estimate the benefit derived from using SDRs to pay off debts. Taking the latter measure, the benefit will further depend on the probability of a deficit occurring to the value of the accumulated SDRs.

The benefit from spending SDRs depends, in the first instance, on the way in which they are spent. If they are spent on consumer goods, the SDR value of the goods, exclusive of interest on the net use of SDRs, gives an approximate indication of the size of the benefit. If, however, they are spent on producer goods, the size of the benefit derived will depend on the rate of return on real resources, after deduction of the interest paid on the net use of SDRs and deflated by the social discount rate.

Calculations based on a more formal version of the above (Bird, 1979, 1988a) suggest that the welfare multiplier for LICs could reasonably be expected to exceed 1.5. At the very least, the value of the welfare gain may be significantly greater than the value of the SDR allocation itself.

If we now assume that an allocation of SDRs is made to LICs phased over five years, which, other things being constant, is designed to increase their reserve ratio up to 25 percent, an annual allocation of about SDR 1.6 billion is implied.<sup>8</sup> The annual welfare gain could, however, exceed SDR 2.5 billion annually.

These quantitative estimates are achieved on the assumption that the LICs' imports will continue to increase at approximately the same moving average rate as over the 1984-93 period, which would imply a 25 percent increase over the next five-year period, and that the addition to global expenditure implied by LICs spending extra SDRs has no discernible impact on world inflation. It is also assumed that the LICs' reserves do not change for any other reason.

It should also be noted that the estimates given above for the size of the SDR allocation assume that they are all added to reserves and not spent, whereas the estimate of the welfare gain mentioned earlier assumes that about half of them are spent. To this extent, the allocation

<sup>8</sup> Here and throughout, "billion" is a thousand million. Note also that some of the numbers in this and the next paragraph reflect calculations made with preliminary reserve data for 1990 to 1993, rather than the data given in Table 2. Use of the more recent data would alter the calculated outcomes, but not by significant amounts.

discussed here would not lead *ex post* to a 25 percent reserve ratio. Assuming that there were to be no restriction imposed on net use, such as the reestablishment of the reconstitution clause, achieving a specific reserve-ratio target would mean that the size of the SDR allocation would have to move positively with the propensity of recipients to spend it. If LICs were to spend, say, 50 percent of the SDRs they received, and if the policy objective were specifically to raise their reserve ratio to 25 percent, the size of the annual allocation would need to be twice that mentioned earlier.

An annual allocation of about SDR 1.6 billion would represent, even so, a significant financial contribution to the LICs, approaching 21 percent of their current-account balance-of-payments deficit in 1992. In dollar terms, it would represent an annual inflow from the IMF equivalent to about \$2.25 billion. In contrast, and taking the entire 1984-91 period, LICs received negative net credit from the IMF's other accounts amounting to -\$1.8 billion, an annual average *return* flow of \$225 million. Although SDR allocations of the size discussed here would be large relative to the size of LIC balance-of-payments problems and other financial flows from the IMF, they would be extremely small relative to total global financing. Such allocations would represent a mere 0.2 percent of total official reserve holdings on an annual basis, with the percentage being lower if gold is valued at its market price.

But would the benefit to LICs from the SDRs they received be at a cost to others, or would it represent Pareto-efficient international financial reform? The answer to this question will have an important bearing on the political acceptability of an LIC link to the international community.

#### **4 The Costs to Other Countries**

One might suppose that, if LICs gain real resources from spending an allocation of SDRs, other countries must be meeting the cost by losing resources. In a static sense, this is true, but a number of additional observations need to be made. First, to the extent that the marginal productivity of resources in LICs exceeds that in the countries releasing them (which may or may not be the countries acquiring the spent SDRs), world output will increase. This is no more than one of the conventional arguments for foreign aid. Second, and in the same vein, if the countries receiving the resources value them more highly than the countries that release them, world economic welfare will rise.

Third, the countries that eventually acquire the SDRs spent by the LICs accumulate an asset that is a claim on resources in the future. Let us assume that it is indeed the country providing the real resources to the LICs that acquires their SDRs. Provided that the inflation-adjusted rate of interest equals the rate of discount, no sacrifice has been made in present-value terms, and, in this sense, there is no *permanent* resource transfer. There will still, however, be a net welfare gain. This follows because the LICs enjoy the benefit of additional resources now, and the countries that provide the resources are compensated by receiving SDRs, which are themselves a claim on future resources to an extent that the receiving country regards as equivalent. The LICs are better off and other countries are no worse off.

Instrumental in this analysis is the interest rate that is carried by the SDRs acquired. Just as an increase in the interest rate reduces the benefit from using an allocation of SDRs, so a fall in the interest rate shifts more benefits to net users but imposes costs on countries acquiring the SDRs. If the risk-adjusted interest rate on SDRs is equivalent to that on other reserve assets, other countries will be indifferent to how they hold their international reserves. As the interest rate on SDRs falls, however, countries holding SDRs rather than other reserve assets will incur an opportunity cost. They may be prepared to acquire low-interest SDRs from LICs as a way of assisting the LICs (psychic income may replace money income), but that is an issue of international political economy. Additionally, because the value of the SDR is determined by the weighted average value of a basket of five currencies, risk-averse countries may be prepared to trade off interest in return for the greater stability in value.

It must also be recognized that, although existing global real resources will be redistributed by allocating SDRs to LICs that then spend them to acquire real resources, redistribution will occur with any scheme that provides real aid to the LICs. If one of the basic purposes of the scheme is to provide help in the form of additional real resources to the LICs, it is hardly a criticism of the scheme that it does precisely that.

It is interesting that, when the link was discussed and rejected in the 1970s, its unacceptability to developed countries arose, not from the implications for the distribution of global resources, but from fears that it would prove inflationary. Related to this, but to a somewhat lesser extent, was the fear that the link would undermine the integrity of the SDR as an international reserve asset and would therefore prevent the SDR from becoming the principal reserve asset in the international

monetary system. The erosion of monetary integrity, it was felt, would be associated with the excess creation of SDRs that would result from lobbying by developing countries anxious to ensure that SDRs were regularly created, as well as from the noncompetitive interest rate that SDRs would carry, which, it was assumed, developing countries would not want to see increased. What of these arguments now?

An allocation of SDRs linked as described above would be so small in terms of the total amount of international liquidity that it could not conceivably have any discernible impact on world inflation. In any case, one of the main routes through which SDR allocation was seen as inflationary was through the monetary relaxation in industrialized countries that would be induced by an increase in reserves; this mechanism does not apply in the case of an exclusively linked version.<sup>9</sup>

In a world in which international liquidity has become privatized and exchange rates have become flexible, critics of the SDR facility argue that official international reserves are completely unimportant. If so, how much less important will be a linked and limited allocation of SDRs to LICs. The logic of the argument that having fewer official reserves is not a problem—because private financing, financial innovation, and exchange-rate flexibility can adjust—may be turned around to say that having a small amount of additional reserves in the form of SDRs is equally insignificant.

In such a world, furthermore, the concern that the LICs will in some way cajole the IMF into creating excessive amounts of SDRs is nonsensical. To assume that the LICs have the sort of leverage that would persuade the IMF to create “excessive” amounts of SDRs credits them with a bargaining power that one suspects they only wish they had.

Within the LICs themselves, the receipt of SDRs would, in fact, be a less inflationary method than others of adding to reserves, because it would not affect the quantity of base money. A limited allocation of SDRs to LICs would not be significantly inflationary even in circumstances in which all linked SDRs were spent by LICs (which they would not be), the world economy were at full-capacity utilization of

<sup>9</sup> Although early studies appeared to find a causal connection running from international reserves to inflation (Heller, 1976), later studies have discovered “no significant relationships” and have found no support for “international reserve monetarism” (Chrystal, 1990a). If this is true for international reserves in total, it will be even more true for a small allocation of SDRs in which the total stock of SDRs accounts for less than 5 percent of the world’s international reserves. Although allocating SDRs to the LICs may lead to some relaxation in LIC domestic monetary policies, it will not have a significant impact on global inflation.

resources (which it is not), and the global aggregate supply schedule were perfectly inelastic (which it is not). With more realistic assumptions, the nonexistent threat of inflation recedes still further!

If inflation does not increase as a result of the link, it cannot damage the integrity of the SDR. In any case, we no longer need to worry much about its integrity, for the world long ago gave up the objective of establishing the SDR as the world's principal reserve asset.

It can be argued that abandoning this objective is in many ways unfortunate, but it is a *fait accompli*. Moreover, it releases the international community to use SDRs for other purposes (Bird, 1992), one of which could be to assist LICs. Unencumbered by the constraints of financial conservatism, the SDR becomes a more adaptable international financial instrument. But will the opportunity be grasped?

## 5 Considerations of International Political Economy

A number of conditions must be fulfilled to make the link a practicable possibility rather than a theoretical abstraction. First, there has to be a general *awareness of the problem* to be solved. Not only do the facts speak for themselves, but it seems that richer countries are beginning to listen and to recognize that the economies of LICs are in a fairly desperate state.

Second, there has to be a *recognized need for action*. If the performance of LICs has been poor over recent years, there is little prospect that it will improve in the short to medium term. The relative price of primary commodities is likely to continue to decline, export instability will continue to be a problem, LICs will not suddenly become credit-worthy, and the structure of their economies will continue to make adjustment costly, even though necessary. More narrowly in the context of the above discussion, holdings of international reserves will not rise to adequate levels. In other areas, the need for special treatment in the case of LICs has been recognized by the Toronto agreement on external debt and the establishment of the Structural Adjustment and Enhanced Structural Adjustment Facilities (SAF and ESAF) in the IMF. Special action has at the same time been taken to assist Central and East European economies in the process of transition to market-based systems. Meanwhile, various indicators imply some improvement in the economic performance and prospects of Latin American economies, which have, in any case, tended to be the principal beneficiaries of Brady-related debt relief. The position of the LICs, however, appears to remain intractable.

Although a perceived need to act has to exist, a third necessary condition is that there is a *means through which action may be taken*. In the case of the link, there are in essence the “inorganic” and “organic” schemes discussed in Section 1. As noted, the advantage of an inorganic link is that it does not require a change in the IMF’s Articles of Agreement but simply an agreement among developed-country recipients to reallocate their SDRs to LICs. It is probably for this reason that Camdessus has emphasized voluntary schemes. However, if the IMF’s major shareholders accept the argument for voluntarily reallocating SDRs to LICs, they may also be prepared to amend the Articles so as to modify the initial distribution of SDR allocations. Principles and pragmatism need not necessarily conflict.

Voluntary redistribution of SDRs could, of course, be limited to existing SDRs and would not then require a new allocation. This would circumvent the potential counterargument that there is no “global need” for additional SDRs. Yet, one of the advantages of much of the IMF’s official language is that it is fairly broad and unspecific and can therefore accommodate a wide range of policies; “global need” can be interpreted to imply correcting global imbalances that exist in terms of the provision of international financing as well as in terms of the distribution of economic adjustment. Moreover, it may be recalled that Camdessus has argued that a global need exists. Where the desire to assist LICs is strong, additional finance could be granted by subsidizing the charge that LICs pay on the net use of SDRs. The subsidy could itself be financed by richer countries or by an income stream generated through sales of gold by the IMF.

A fourth and final condition is a *willingness to act* or, less ambitiously, not to impede the actions of others. Altruism may, of course, exist, but let us assume that the willingness of the IMF’s major shareholders to accept a limited allocation of SDRs to LICs depends on the shareholders’ perception of the direct and indirect costs of such a scheme on themselves. As shown above, the costs on the rest of world would be insignificant and could be adjusted through changing the precise form of link adopted. Although the claim that the 1970s version of the link would be inflationary actually lacked justification and empirical support, the inflationary threat was *perceived* as real, and it therefore affected the positions adopted by the inflation-averse industrial countries and the decisions finally taken. The situation now is fundamentally different. Again there is no prospect that the link will cause any discernible additional inflation; the difference now is that this is generally perceived to be true. Furthermore, the success that the industrial

countries have had in reducing inflation since the 1980s, and the increasing preoccupation with global recession has had the effect of reducing the degree of inflation aversion.

The political and economic paradigms that underpin policies have also changed significantly in a number of influential economies. There is now less emphasis on completely free markets and more emphasis on (limited) intervention and economic management—as is reflected by the preference of the U.S. administration for greater international coordination of macroeconomic policy. Consistent with this trend, the adjustment programs supported by the IMF have begun to emphasize more heavily than in the past the protection of “vulnerable groups” and the provision of “social safety nets.” Similarly, within the national welfare system of the industrial countries, there is growing concern with “targeting,” endeavoring to concentrate assistance on those groups whose need is greatest (although this may clearly also be a means of reducing government expenditure on social security). In such an environment, the IMF’s major shareholders may perceive LICs as an internationally vulnerable group and the link as a form of targeted social safety net.

A further global development that may make the international political economy of reform more conducive to the adoption of the link is changing East-West relations. Evidence suggests that, historically, much of the pattern of aid distribution can be explained in political, military, and strategic terms. Although it is unrealistic to assume that such considerations will suddenly evaporate (even though their precise configuration will change), it is realistic to assume that governments will reassess their aid policies and may, as part of this process, be persuaded to increase the relevance of economic and humanitarian factors.

Although there may be less opposition to the link now than in the early 1970s, there may still be resistance to its unconditional dimension—in spite of the observations made earlier in this essay. Clearly, the link should be seen as a complement to policies that aim to improve conditionality and to make it more effective and efficient with respect to LICs. But there are various ways in which an element of conditionality can be attached to the link. Most straightforward would be to make the receipt of SDRs itself conditional upon the negotiation of a regular program backed by the IMF (or World Bank). Under this scheme, SDRs would represent a kind of financial “top up” to LICs. Although the SDRs would lose some attractiveness to recipients, they would involve no incremental conditionality. LICs would therefore receive more finance for the same conditionality, and this would surely

be regarded as beneficial. Indeed, with additional finance, conditionality might be modified in ways that are more appropriate for LICs. To the extent that programs fail because they are inadequately supported financially, the link could, in this guise, have a positive impact on the completion rate of IMF-backed programs and could act as an incentive for countries to pursue policy reforms aimed at economic adjustment. Moreover, the “price” LICs would pay in having to accept conditionality could be offset by granting them a subsidy on their net use of SDRs. They could be offered a package of conditionality and reduced charge and, indeed, could be individually offered some choice in terms of the details of the package they accepted; some element of subsidy could be sacrificed to gain a lower degree of conditionality. The details of the scheme that emerged would depend on the bargaining strengths of “donors” and “recipients,” but it seems feasible that arrangements deemed satisfactory by both parties could be reached.

## 6 Concluding Remarks

The conclusion drawn from the above analysis is that an affirmative answer should be given to the question posed in the title of this essay. In a narrow and specific form, the link should be resurrected.

Low-income countries face massive economic problems that they are exceedingly unlikely to resolve on their own in the near to medium term. In their case, Keynes’ dictum should perhaps be modified to read, “in the *medium run*, we are all dead.” If the international community is not prepared to allow the financing gap to become an effective constraint condemning many millions of people to low, stagnant, and even falling living standards, some international action is needed.

The link provides a convenient and economically satisfactory mechanism through which action can be taken. The benefits to the recipients of SDRs would be substantial and the costs to others minimal, irrespective of whether one looks at the direct costs or the indirect costs through the link’s systemic consequences. The link therefore meets both efficiency and equity criteria. An analysis of international political economy further suggests that the introduction of a link targeted on LICs would be acceptable to those governments the acquiescence of which would be needed; it also strongly confirms that the chances of adopting an LIC link now are very much higher than when the much broader version of the link was proposed in the early 1970s.

It may also be true that a case can be made, as Camdessus has attempted to do, for an SDR allocation to the FSU and former CMEA

countries. It is certainly true that these countries, as nonmembers of the IMF, did not receive SDRs when they were previously allocated. It is also true that they face substantial financing and adjustment problems, which could be alleviated by receiving SDRs. The problem arises, however, if one is forced to rank needs, as would happen if the size of an SDR allocation were fixed in advance. In such circumstances, the needs of LICs are perhaps more pronounced than those of the FSU and former CMEA states. Would an SDR allocation to the latter countries crowd out SDRs to the LICs? International political economy is here again an important consideration. It may be that there would be greater political support for additional assistance to FSU states on the grounds that what happens in these countries constitutes the greater threat to international stability and the long-term interests of the IMF's major shareholders. At the same time, it might prove difficult to allocate SDRs to Central and East European states without allocating them to LICs as well. If this is true, an SDR allocation to the former would in practice crowd in an allocation to the latter. In this sense, the former CMEA countries would indeed offer "mutual economic assistance" to the LICs.<sup>10</sup>

## References

- Aghevli, Bijan B., Mohsin S. Khan, and Peter J. Montiel, *Exchange Rate Policy in Developing Countries: Some Analytical Issues*, Occasional Paper No. 78, Washington, D.C., International Monetary Fund, March 1991.
- Bienen, Henry S., and Mark Gersovitz, "Economic Stabilization, Conditionality, and Political Stability," *International Organization*, 40 (Autumn 1986), pp. 728-754.
- Bird, Graham, "The Informal Link Between SDR Allocation and Aid: A Note," *Journal of Development Studies*, 12 (April 1976), pp. 268-273.
- , "The Benefits of Special Drawing Rights for Less Developed Countries," *World Development*, 7 (March 1979), pp. 281-290.
- , "The Demand for International Reserves in LDCs," in Graham Bird, *The International Monetary System and the Less Developed Countries*, London, Macmillan, 1978; 2nd ed., 1982a, pp. 82-113.
- , "Developing Country Interests in Proposals for International Monetary Reform," in Tony Killick, ed., *Adjustment and Financing in the Developing World: The Role of the International Monetary Fund*, Washington, D.C.,

<sup>10</sup> If, however, SDRs were to be allocated simultaneously to LICs and to FSU and former CMEA states, it might be appropriate to modify the details of the allocation (in terms, for example, of the extent of the subsidy on net use) to reflect different economic circumstances.

- International Monetary Fund, and London, Overseas Development Institute, 1982b, pp. 198-232.
- , “The Link Between SDRs and Aid,” in Bird, *The International Monetary System*, 1982c, pp. 251-276.
- , “International Reserves: Supply, Demand and Adequacy,” in Graham Bird, *World Finance and Adjustment*, London, Macmillan, and New York, St. Martin’s, 1985, pp. 73-113.
- , “An Analysis of the Welfare Gains from Special Drawing Rights,” *Economia Internazionale*, August-November 1978, pp. 177-185; reprinted in Graham Bird, *Managing Global Money: Essays in International Financial Economics*, London, Macmillan, 1988a, pp. 115-123.
- , “SDR Distribution, Interest Rates and Aid Flows,” *World Economy*, 4 (December 1981), pp. 419-427; reprinted in Bird, *Managing Global Money*, 1988b, pp. 124-133.
- , “Global Environmental Degradation and International Resource Transfers,” *Global Environmental Change*, 2 (September 1992), pp. 229-238.
- , *IMF Lending to Developed Countries: Issues and Evidence*, London, Routledge, forthcoming 1995.
- Chrystal, K. Alec, *International Money and the Future of the SDR*, Essays in International Finance No. 128, Princeton, N.J., Princeton University, International Finance Section, June 1978.
- , “International Reserves and International Liquidity: A Solution in Search of a Problem,” in Graham Bird, ed., *The International Financial Regime: Surrey Seminars in Applied Economics*, London, San Diego, Sydney, and Toronto, Surrey University Press and Academic Press, 1990a, pp. 9-28.
- , “The Role of the Special Drawing Right in the International Monetary System,” in Sidney Dell, ed., *The International Monetary System and Its Reform*, Part 5, Contributions to Economic Analysis No. 197, Amsterdam, Oxford, and Tokyo, North-Holland and the United Nations; New York, Elsevier, distributor, 1990b, pp. 703-727.
- Coats, Warren L., Jr., “Enhancing the Attractiveness of the SDR,” *World Development*, 18 (July 1990), pp. 975-988.
- Frenkel, Jacob A., “International Liquidity and Monetary Control,” in George M. von Furstenberg, ed., *International Money and Credit: The Policy Roles*, Washington, D.C., International Monetary Fund, 1984, pp. 65-109.
- Grubel, Herbert G., “Basic Methods for Distributing Special Drawing Rights and the Problem of International Aid,” *Journal of Finance*, 27 (December 1972), pp. 1009-1022.
- Haggard, Stephan, “The Politics of Adjustment: Lessons from the IMF’s Extended Fund Facility,” *International Organization*, 39 (Summer 1985), pp. 505-534; reprinted in Miles Kahler, ed., *The Politics of International Debt*, Cornell Studies in Political Economy, Ithaca, N.Y., and London, Cornell University Press, 1986, pp. 157-186.

- Haggard, Stephan, and Robert Kaufman, "The Politics of Stabilization and Structural Adjustment," in Jeffrey D. Sachs, ed., *Developing Country Debt and the World Economy*, National Bureau of Economic Research Project Report, Chicago and London, University of Chicago Press, 1989, pp. 263-274.
- Hawkins, Robert G., and C. Rangarajan, "On the Distribution of New International Reserves," *Journal of Finance*, 25 (September 1970), pp. 881-891.
- Helleiner, Gerald K., "The Less Developed Countries and the International Monetary System," *Journal of Development Studies*, 10 (April-July 1974), pp. 347-373.
- , *The IMF and Africa in the 1980s*, Essays in International Finance No. 152, Princeton, N.J., Princeton University, International Finance Section, July 1983a.
- , "Lender of Early Resort: The IMF and the Poorest," *American Economic Review*, 73 (May 1983b), pp. 349-353.
- Heller, H. Robert, "International Reserves and World-Wide Inflation," *International Monetary Fund Staff Papers*, 23 (March 1976), pp. 61-87.
- Heller, H. Robert, and Mohsin S. Khan, "The Demand for International Reserves Under Fixed and Floating Exchange Rates," *International Monetary Fund Staff Papers*, 25 (December 1978), pp. 623-649.
- International Monetary Fund (IMF), *World Economic Outlook*, Washington, D.C., International Monetary Fund, October 1992, October 1993, May 1994.
- Kaufman, Robert R., *The Politics of Debt in Argentina, Brazil, and Mexico*, Institute of International Studies, University of California, Berkeley, 1988, processed.
- Khan, Mohsin S., "The Macroeconomic Effects of Fund-Supported Adjustment Programs," *International Monetary Fund Staff Papers*, 37 (June 1990), pp. 195-231.
- Killick, Tony, and Moazzam Malik, "Country Experiences with IMF Programmes in the 1980s," *World Economy*, 15 (September 1992), pp. 599-632.
- Killick, Tony, Moazzam Malik, and Marcus Manuel, "What Can We Know about the Effects of IMF Programmes?," *World Economy*, 15 (September 1992), pp. 575-597.
- Lizondo, Jose Saul, and Donald J. Mathieson, "The Stability of the Demand for International Reserves," *Journal of International Money and Finance*, 6 (September 1987), pp. 251-282.
- Love, James, "Export Earnings Instability: The Decline Reversed?," *Journal of Development Studies*, 26 (January 1990), pp. 324-329.
- Loxley, John, *The IMF and the Poorest Countries*, Ottawa, North South Institute, 1984, processed.
- Nelson, Joan M., "The Politics of Stabilization," in Richard E. Feinberg and Valeriana Kallab, eds., *Adjustment Crisis in the Third World*, Overseas Development Council, U.S.-Third World Policy Perspectives No. 1, New Brunswick, N.J., Transaction Books, 1984, pp. 99-118.

- , ed., *Fragile Coalitions: The Politics of Economic Adjustment*, Overseas Development Council, U.S.-Third World Policy Perspectives No. 12, New Brunswick, N.J., Transaction Books, 1989, pp. vi, 161.
- Park, Yoon S., *The Link between Special Drawing Rights and Development Finance*, Essays in International Finance No. 100, Princeton, N.J., Princeton University, International Finance Section, September 1973.
- Stallings, Barbara, and Robert Kaufman, eds., *Debt and Democracy in Latin America*, Boulder, Colo., and London, Westview, 1989.
- Williamson, John, *A New SDR Allocation?*, Washington, D.C., Institute for International Economics, March 1984.
- Zulu, Justin B., and Saleh M. Nsouli, *Adjustment Programs in Africa: The Recent Evidence*, Occasional Paper No. 34, Washington, D.C., International Monetary Fund, 1985.



PUBLICATIONS OF THE  
INTERNATIONAL FINANCE SECTION

**Notice to Contributors**

The International Finance Section publishes papers in four series: ESSAYS IN INTERNATIONAL FINANCE, PRINCETON STUDIES IN INTERNATIONAL FINANCE, and SPECIAL PAPERS IN INTERNATIONAL ECONOMICS contain new work not published elsewhere. REPRINTS IN INTERNATIONAL FINANCE reproduce journal articles previously published by Princeton faculty members associated with the Section. The Section welcomes the submission of manuscripts for publication under the following guidelines:

ESSAYS are meant to disseminate new views about international financial matters and should be accessible to well-informed nonspecialists as well as to professional economists. Technical terms, tables, and charts should be used sparingly; mathematics should be avoided.

STUDIES are devoted to new research on international finance, with preference given to empirical work. They should be comparable in originality and technical proficiency to papers published in leading economic journals. They should be of medium length, longer than a journal article but shorter than a book.

SPECIAL PAPERS are surveys of research on particular topics and should be suitable for use in undergraduate courses. They may be concerned with international trade as well as international finance. They should also be of medium length.

Manuscripts should be submitted in triplicate, typed single sided and double spaced throughout on 8½ by 11 white bond paper. Publication can be expedited if manuscripts are computer keyboarded in WordPerfect 5.1 or a compatible program. Additional instructions and a style guide are available from the Section.

**How to Obtain Publications**

The Section's publications are distributed free of charge to college, university, and public libraries and to nongovernmental, nonprofit research institutions. Eligible institutions may ask to be placed on the Section's permanent mailing list.

Individuals and institutions not qualifying for free distribution may receive all publications for the calendar year for a subscription fee of \$35.00. Late subscribers will receive all back issues for the year during which they subscribe. Subscribers should notify the Section promptly of any change in address, giving the old address as well as the new.

Publications may be ordered individually, with payment made in advance. ESSAYS and REPRINTS cost \$8.00 each; STUDIES and SPECIAL PAPERS cost \$11.00. An additional \$1.25 should be sent for postage and handling within the United States, Canada, and Mexico; \$1.50 should be added for surface delivery outside the region.

All payments must be made in U.S. dollars. Subscription fees and charges for single issues will be waived for organizations and individuals in countries where foreign-exchange regulations prohibit dollar payments.

Please address all correspondence, submissions, and orders to:

International Finance Section  
Department of Economics, Fisher Hall  
Princeton University  
Princeton, New Jersey 08544-1021

## List of Recent Publications

A complete list of publications may be obtained from the International Finance Section.

### ESSAYS IN INTERNATIONAL FINANCE

158. Charles E. Dumas, *The Effects of Government Deficits: A Comparative Analysis of Crowding Out*. (October 1985)
159. Jeffrey A. Frankel, *Six Possible Meanings of "Overvaluation": The 1981-85 Dollar*. (December 1985)
160. Stanley W. Black, *Learning from Adversity: Policy Responses to Two Oil Shocks*. (December 1985)
161. Alexis Rieffel, *The Role of the Paris Club in Managing Debt Problems*. (December 1985)
162. Stephen E. Haynes, Michael M. Hutchison, and Raymond F. Mikesell, *Japanese Financial Policies and the U.S. Trade Deficit*. (April 1986)
163. Arminio Fraga, *German Reparations and Brazilian Debt: A Comparative Study*. (July 1986)
164. Jack M. Guttentag and Richard J. Herring, *Disaster Myopia in International Banking*. (September 1986)
165. Rudiger Dornbusch, *Inflation, Exchange Rates, and Stabilization*. (October 1986)
166. John Spraos, *IMF Conditionality: Ineffectual, Inefficient, Mistargeted*. (December 1986)
167. Rainer Stefano Masera, *An Increasing Role for the ECU: A Character in Search of a Script*. (June 1987)
168. Paul Mosley, *Conditionality as Bargaining Process: Structural-Adjustment Lending, 1980-86*. (October 1987)
169. Paul A. Volcker, Ralph C. Bryant, Leonhard Gleske, Gottfried Haberler, Alexandre Lamfalussy, Shijuro Ogata, Jesús Silva-Herzog, Ross M. Starr, James Tobin, and Robert Triffin, *International Monetary Cooperation: Essays in Honor of Henry C. Wallich*. (December 1987)
170. Shafiqul Islam, *The Dollar and the Policy-Performance-Confidence Mix*. (July 1988)
171. James M. Boughton, *The Monetary Approach to Exchange Rates: What Now Remains?* (October 1988)
172. Jack M. Guttentag and Richard M. Herring, *Accounting for Losses On Sovereign Debt: Implications for New Lending*. (May 1989)
173. Benjamin J. Cohen, *Developing-Country Debt: A Middle Way*. (May 1989)
174. Jeffrey D. Sachs, *New Approaches to the Latin American Debt Crisis*. (July 1989)
175. C. David Finch, *The IMF: The Record and the Prospect*. (September 1989)
176. Graham Bird, *Loan-loss Provisions and Third-World Debt*. (November 1989)
177. Ronald Findlay, *The "Triangular Trade" and the Atlantic Economy of the Eighteenth Century: A Simple General-Equilibrium Model*. (March 1990)
178. Alberto Giovannini, *The Transition to European Monetary Union*. (November 1990)
179. Michael L. Mussa, *Exchange Rates in Theory and in Reality*. (December 1990)
180. Warren L. Coats, Jr., Reinhard W. Furstenberg, and Peter Isard, *The SDR*

- System and the Issue of Resource Transfers*. (December 1990)
181. George S. Tavlas, *On the International Use of Currencies: The Case of the Deutsche Mark*. (March 1991)
  182. Tommaso Padoa-Schioppa, ed., with Michael Emerson, Kumiharu Shigehara, and Richard Portes, *Europe After 1992: Three Essays*. (May 1991)
  183. Michael Bruno, *High Inflation and the Nominal Anchors of an Open Economy*. (June 1991)
  184. Jacques J. Polak, *The Changing Nature of IMF Conditionality*. (September 1991)
  185. Ethan B. Kapstein, *Supervising International Banks: Origins and Implications of the Basle Accord*. (December 1991)
  186. Alessandro Giustiniani, Francesco Papadia, and Daniela Porciani, *Growth and Catch-Up in Central and Eastern Europe: Macroeconomic Effects on Western Countries*. (April 1992)
  187. Michele Fratianni, Jürgen von Hagen, and Christopher Waller, *The Maastricht Way to EMU*. (June 1992)
  188. Pierre-Richard Agénor, *Parallel Currency Markets in Developing Countries: Theory, Evidence, and Policy Implications*. (November 1992)
  189. Beatriz Armendariz de Aghion and John Williamson, *The G-7's Joint-and-Several Blunder*. (April 1993)
  190. Paul Krugman, *What Do We Need to Know About the International Monetary System?*. (July 1993)
  191. Peter M. Garber and Michael G. Spencer, *The Dissolution of the Austro-Hungarian Empire: Lessons for Currency Reform*. (February 1994)
  192. Raymond F. Mikesell, *The Bretton Woods Debates: A Memoir*. (March 1994)
  193. Graham Bird, *Economic Assistance to Low-Income Countries: Should the Link be Resurrected?*. (July 1994)

PRINCETON STUDIES IN INTERNATIONAL FINANCE

56. Paul De Grauwe, Marc Janssens and Hilde Leliaert, *Real-Exchange-Rate Variability from 1920 to 1926 and 1973 to 1982*. (September 1985)
57. Stephen S. Golub, *The Current-Account Balance and the Dollar: 1977-78 and 1983-84*. (October 1986)
58. John T. Cuddington, *Capital Flight: Estimates, Issues, and Explanations*. (December 1986)
59. Vincent P. Crawford, *International Lending, Long-Term Credit Relationships, and Dynamic Contract Theory*. (March 1987)
60. Thorvaldur Gylfason, *Credit Policy and Economic Activity in Developing Countries with IMF Stabilization Programs*. (August 1987)
61. Stephen A. Schuker, *American "Reparations" to Germany, 1919-33: Implications for the Third-World Debt Crisis*. (July 1988)
62. Steven B. Kamin, *Devaluation, External Balance, and Macroeconomic Performance: A Look at the Numbers*. (August 1988)
63. Jacob A. Frenkel and Assaf Razin, *Spending, Taxes, and Deficits: International-Intertemporal Approach*. (December 1988)
64. Jeffrey A. Frankel, *Obstacles to International Macroeconomic Policy Coordination*. (December 1988)
65. Peter Hooper and Catherine L. Mann, *The Emergence and Persistence of the U.S. External Imbalance, 1980-87*. (October 1989)

66. Helmut Reisen, *Public Debt, External Competitiveness, and Fiscal Discipline in Developing Countries*. (November 1989)
67. Victor Argy, Warwick McKibbin, and Eric Siegfloff, *Exchange-Rate Regimes for a Small Economy in a Multi-Country World*. (December 1989)
68. Mark Gersovitz and Christina H. Paxson, *The Economies of Africa and the Prices of Their Exports*. (October 1990)
69. Felipe Larraín and Andrés Velasco, *Can Swaps Solve the Debt Crisis? Lessons from the Chilean Experience*. (November 1990)
70. Kaushik Basu, *The International Debt Problem, Credit Rationing and Loan Pushing: Theory and Experience*. (October 1991)
71. Daniel Gros and Alfred Steinherr, *Economic Reform in the Soviet Union: Pas de Deux between Disintegration and Macroeconomic Destabilization*. (November 1991)
72. George M. von Furstenberg and Joseph P. Daniels, *Economic Summit Declarations, 1975-1989: Examining the Written Record of International Cooperation*. (February 1992)
73. Ishac Diwan and Dani Rodrik, *External Debt, Adjustment, and Burden Sharing: A Unified Framework*. (November 1992)
74. Barry Eichengreen, *Should the Maastricht Treaty Be Saved?*. (December 1992)
75. Adam Klug, *The German Buybacks, 1932-1939: A Cure for Overhang?*. (November 1993)

#### SPECIAL PAPERS IN INTERNATIONAL ECONOMICS

15. Gene M. Grossman and J. David Richardson, *Strategic Trade Policy: A Survey of Issues and Early Analysis*. (April 1985)
16. Elhanan Helpman, *Monopolistic Competition in Trade Theory*. (June 1990)
17. Richard Pomfret, *International Trade Policy with Imperfect Competition*. (August 1992)
18. Hali J. Edison, *The Effectiveness of Central-Bank Intervention: A Survey of the Literature After 1982*. (July 1993)

#### REPRINTS IN INTERNATIONAL FINANCE

25. Jorge Braga de Macedo, *Trade and Financial Interdependence under Flexible Exchange Rates: The Pacific Area*; reprinted from *Pacific Growth and Financial Interdependence*, 1986. (June 1986)
26. Peter B. Kenen, *The Use of IMF Credit*; reprinted from *Pulling Together: The International Monetary Fund in a Multipolar World*, 1989. (December 1989)
27. Peter B. Kenen, *Transitional Arrangements for Trade and Payments Among the CMEA Countries*; reprinted from *International Monetary Fund Staff Papers* 38 (2), 1991. (July 1991)

The work of the International Finance Section is supported in part by the income of the Walker Foundation, established in memory of James Theodore Walker, Class of 1927. The offices of the Section, in Fisher Hall, were provided by a generous grant from Merrill Lynch & Company.

ISBN 0-88165-100-1

Recycled Paper