IMF's Issue of Fresh SDRs*

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The International Monetary Fund has announced a fresh issue of $650 billion Special Drawing Rights in August which would be distributed among member countries in proportion to their IMF quotas. This amount is less than what had been demanded by many, which was a trillion dollars, but it does represent a small temporary comfort for the heavily indebted third world countries.

Almost all of it will go into the pockets of the private financial institutions who are the creditors of the heavily indebted third world countries, but within the system as it exists it represents a relief for these countries. The paltriness of the relief however arises from the fact that the distribution of SDRs is in accordance with quotas, which means that the bulk of it goes to the advanced countries, and only a tiny amount to the third world. Of the 190 member countries of the IMF, 55 rich countries will get $375 billion while 135 relatively poorer countries will get only $275 billion. And of the latter, 29 "low income" countries will get only $27 billion, even though according to the IMF's own calculations, these countries require $450 billion of external resources over the next five years.

There have been suggestions that the rich countries should give their share of SDRs to the poorer countries. They do not require these resources and can borrow easily if necessary; besides, the strength of their currencies prevents them from getting into external debt-traps. The rich countries however insist that they should be paid an interest for doing so, even though the SDRs themselves, not being a loan but just an addition to foreign exchange reserves, do not carry any interest rates. The first absurdity of the SDR issue therefore arises from the very structure of the IMF: SDRs are distributed not according to need but according to the prevailing distribution of economic power (which underlies the quotas). Those who need it the most get the least, while those who need it the least get the most.

The second absurdity arises from the fact that the basic reason why third world countries get indebted at all is not tackled by the fresh issue of SDRs. The SDR issue is just to keep the system going; and therefore, within the system as it exists, it provides some breathing space to indebted countries, but does nothing to overcome their basic problem.

There are two essential requirements of the countries in debt. One, the most obvious one, is debt cancellation. Unless this is done, SDR issues will simply go into servicing existing debt, without providing any resources for spending by the poor countries on healthcare or education or other essential social services. And the problem with the fresh issue of SDRs is that while providing a degree of temporary relief it does away altogether with the need for discussing debt cancellation.

Even debt cancellation however, though an essential step, will not be enough to overcome the problem of third world debt. As with the Indian peasants in whose case one debt-waiver has been followed by another, there will be recurring debt build-ups unless the basic neo-liberal arrangement within which the indebted countries are trapped, is done away with.

The basic problem with the poor countries is that they have a recurring current account deficit on the balance of payments, quite independent of interest payments on already incurred debt, which has to be financed through external borrowing. Unless this current account deficit is closed, any particular episode of debt cancellation will simply lead to a further build-up of debt that would have to be met by another episode of debt-cancellation, and so on.

The reason why a current account deficit persists is because these countries are not allowed to protect themselves against low priority imports under a neo-liberal regime. In the absence of such protection, their attempt to improve their current account can only take the form of an exchange rate depreciation, which is a blanket measure with inflationary consequences. An example will make clear the difference between a protectionist regime and a neo-liberal regime that is constrained to rely only on exchange rate movements to improve the current account.

If tariff rates are raised on luxury imports which are not easily producible domestically, then that increases the domestic price of these goods which means a lower demand for them in the domestic market and hence lower imports. If of course such imports are simply quantitatively restricted, then the reduction follows directly. There is thus a saving of foreign exchange on such imports, while the rise in prices being confined to luxury goods, neither impinges on the standard of living of the working people, nor increases the prices of exports at the given exchange rate (which has not been tampered with). There is thus a reduction in current account deficit without any fall either in the level of employment or in the real wage rate.

By contrast if there is an exchange rate depreciation for closing the current account deficit then that raises the domestic prices of all imports, including of essential imports like oil that go as inputs into the production of almost all goods. An exchange rate depreciation therefore raises the general price level, which, for given money wages, lowers the real wage. In fact if the real wage is not lowered then an exchange rate depreciation for reducing a current account deficit will keep on raising the prices and keep on lowering the exchange rate ad infinitum. For instance a 10 per cent nominal exchange rate depreciation will raise domestic prices by 10 per cent if real wages and profit margin remain unchanged (the latter administered by the capitalists will necessarily remain unchanged), which means that there would have been no real effective exchange rate depreciation (the nominal depreciation having been counteracted by an equivalent rise in prices); and that in turn will mean a further nominal exchange rate depreciation to reduce the current account deficit, and a further equivalent rise in prices, and so on.

Thus an exchange rate depreciation works only through, and necessarily through, squeezing real wages. And the fall in real wages may have to be prohibitively large for bringing about a noticeable reduction in the current account deficit.

Having one base common exchange rate, and quantitative restrictions or tariff rates in addition that differ across commodities (a system that is referred to as "multiple exchange rates"), is thus superior to having simply one common exchange rate with scarcely much variation in tariff rates across commodities. But the latter is precisely what the Bretton Woods institutions insist on; "unifying" the exchange rate is one of the "conditionalities" they impose on third world countries, which is also one of the features of a neo-liberal regime.

One other way that a country can manage a current account deficit without getting into unsustainable debt, is by having a trading arrangement like what India used to have with the Soviet Union and the Eastern European socialist countries in the sixties and seventies. This arrangement meant that a country sold to its trading partner and bought goods from it, and the balance was not settled immediately in hard currency but remained in the books and was settled through subsequent purchases of each other's commodities. Even such bilateral trade agreements however are ruled out under the neo-liberal regime, which therefore appears tailor-made to catch third world countries in a debt-trap.

Since the trade between the metropolis and much of the third world (except some Asian countries to which there has been some relocation of activity from the metropolis in the recent years) is still of the form where the former sells manufactured goods and the latter sells primary commodities, whose relative prices always remain unfavourable to the latter, the two regions being knit together within a neo-liberal regime is a sure-fire prescription for the latter being caught in a debt-trap.

This is why the issuing of fresh SDRs by the IMF, while in one sense providing relief to the indebted third world countries, is really a means of keeping a fundamentally iniquitous system going. It used to be said of the Indian peasants in the old days that "debt supports the peasant like a hangman's rope supports the hanged". Much the same can be said of the third world countries under neo-liberalism.

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