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The Horowitz Plan and Developing Countries

by Professor Dr Marion Mushkat, Tel-Aviv

Upon initiation of the International Monetary Fund in 1945, the parties involved undertook to fix the value of their currencies in gold and to maintain a fixed rate of exchange. Since then the dollar and the pound sterling have become increasingly acceptable together with gold as payment and reserve currencies.

The international currency system became progressively disjointed as the USA's expenses abroad increased for development and defence purposes as well as for investments, while its balance-of-payments reserves began to drop in 1967¹ and the value of the dollar was consequently endangered. The disturbances in the system were emphasised by the devaluation of the pound sterling in November 1967, and culminated with France's acute financial crisis in May-June 1968, March 1969 and after De Gaulle's resignation in April 1969.

Hence the proliferation of steps and proposals for amendment or even replacement of this system. The need for change was made even more urgent by virtue of the system's very nature: it has no independent objectives, but rather constitutes a means of spurring on the economy and apportioning international labour and trade. When this instrument functions improperly, the entire network of international economic relations is liable to be endangered.

Introduction of Special Drawing Rights

In view of the September 1967 International Monetary Fund decisions in Rio, together with the credit granted to Britain through the Bank of International Settlements by the Basel agreement of September 1968 among seven Western European countries, the USA, Japan and Canada (the Group of Ten), and the decisions of these countries in Stockholm in March 1968 and in Bonn in November 1968, it is clear that the West has firmly decided to maintain the present international financial system (although with several alterations)². The main alteration that has been

¹ Financial Times, 15. VIII. 1968. However, the USA succeeded in finishing 1968 with a balance which indicated a surplus of between \$ 200 and \$ 1,600 mn - depending on the method of calculation.

decided upon to improve the present international financial system is the introduction of Special Drawing Rights to improve world liquidity.

This improvement refers back to Keynes' proposals, as presented in the April 1943 British White Paper, in which the British economist introduced the idea of an international currency (Bancor) governed by the actual current requirements of world commerce, which could dispel the dangers of both deflation and inflation while promoting uninterrupted economic development. Keynes' idea was related to the creation of an International Clearing House Currency which would enable countries to keep their payment balances near the quotas assigned to them (interest rate penalties would be paid for excesses or insufficiencies with regard to these quotas) and which could create additional Bancor without introducing it into circulation. The currency's role was defined as constituting a unit of accounting and a reserve instrument rather than an international circulation currency. Keynes' plan was of course presented prior to creation of the International Monetary Fund. It was followed in 1959 by the Triffin Plan, which recommended replacing gold and other currency obligations with Bancor as a reserve unit, and increasing Bancor sums annually by 3-5 p.c., or slightly less than the current world trade rate of growth. This could be accomplished by ensuring credits and selling securities in Bancor—a method suitable also for the establishment of national deposit accounts in this unit in a way similar to the practice of federal reserve banks with regard to their member banks.

Raise of Gold-Price Rejected

The proposal made by some experts to raise the price of gold in order to improve international liquidity was not accepted in the various conferences of the last two years and cannot be adopted for four reasons. First, the industrial users would object. Secondly, the majority of countries, which have not converted their re-

² Karl Schiller, Die Internationale Währungsfrage nach der Bonner Konferenz der Zehnergruppe, Europa-Archiv No. 1/1969, p. 1.

serves to gold, would not agree to be penalised while the accumulators of gold receive a prize. Thirdly, this prize would be bestowed primarily on the USSR and South Africa. And fourthly, every country could not be expected to change its gold price equally and instantaneously — an inviolable precondition for the prevention of total confusion in world and money markets.

But the supporters of an international currency are realistic enough to consider the system of Special Drawing Rights to be at best a partial solution, and in the long run an unstable one. Not only would an extended interval be required for the implementation of this system but even after implementation there would remain the danger of a money scarcity and continued balance of payments difficulties for Britain and the USA.

Insufficient Consideration of Developing Countries

Although the SDR system may imply a certain bias in favour of the developing countries due to the commitment of the industrial countries to increase development finance, nevertheless throughout all these deliberations, considerations and commitments primarily Western interests were actually taken into account. The decision-makers paid insufficient attention to the interests of the developing countries. This attitude possibly stems from the fact that these countries' financial structure does not yet play an important role, and relatively little banking activity (by Western standards) takes place in them³. It is therefore fitting that the experts on the financial problems of developing countries, who anticipate the continued existence—with only slight adjustments—of the international monetary system, place great emphasis on the necessity for including in these adjustments special provisions for the benefit of developing countries.

Hence the continued display of interest in the proposal to include among the means of payment a kind of "commodities currency" and to ensure a suitable regulation of the volume of currency by limiting the sale of commodities involved through the creation of stores and the preservation of currency holdings. Such a plan would ensure better correlation between international liquid assets and general economic needs. Of course only selected goods, non-perishable and easily storable and exported primarily by developing countries, would be exploited for this purpose. A storing plan of this nature would afford the possibility of making payments not only in gold, dollars or pounds sterling, but also in bills representing the value of stored commodities, obtainable from an international institution to be created for this purpose.

³ Cf. Dr G. U. Papi, "Monetary Aid and Real Problems of Developing Countries", Rehovot Conference on Fiscal and Monetary Problems in Developing States, Israel 1965, p. 1-2.

Moreover, the credits created in this way, which would not affect liquid assets, would be available to developing countries only. The prices of the raw materials and commodities accepted for storing would be more easily stabilised, and goods could be marketed in accordance with the arrangements and timing fixed by the international institution for storing and credit rather than under the pressures operating on a cash transaction framework⁴.

The Horowitz Proposal

However, it appears that the financing plan for the expansion of international trade and development proposed by the Governor of the Bank of Israel at the UNCTAD Conference on April 6, 1964, and known as the "Horowitz Proposal"⁵, which is also related to the international monetary system and which includes a detailed programme for development financing, is far more substantial than the plan already discussed. The author of the Horowitz Proposal has carefully investigated the many dangers and difficulties involved in financing development. He has analysed the nature of the gap between the developed world and the developing countries—which threatens to continue widening unless appropriate measures are taken⁶, and has also taken into account the need to adjust the international monetary system to his proposals. Therefore his proposal has not lost its actuality, and discussion concerning its practical application will continue⁷.

The starting point of the Horowitz Proposal is the feasibility of mobilising large sums—not through governments but rather on world currency markets—by an international institution on a purely commercial basis, and at suitable interest rates. Thus, for example, at a given time the total cost could be fixed at 5.5 p.c. per annum, including cost administration; however, it must be noted that this rate will of necessity fluctuate according to changing interest rates. Nevertheless, such a programme need not involve serious difficulties. If the World Bank were chosen to implement the Proposal, it would have to lend funds at a cut price to the International Development Agency, which in turn would re-lend them at only 1 p.c. interest. The difference could be covered by a relatively modest budgetary allowance to an Interest Equalisation Fund by the developed countries. For example, the Interest Equalisation Fund for \$ 3 billion would be \$ 135 mn, or one pro mille of the developed countries' gross national product,

⁴ Cf. P. Mendes France, "International Monetary Reform and the Developing States", Rehovot Conference on Fiscal and Monetary Problems in Developing States, Israel 1965, p. 2-3.

⁵ UNCTAD, E/Conf. 46/C.3/2, 6 April 1964.

⁶ D. Horowitz, *Hemispheres North and South, Economic Disparity Among Nations*, J. Hopkins Press, Baltimore 1966.

⁷ See *The External Financing of Economic Development: International Flow of long-term-capital and official donations, 1962-1966*, Report of the Secretary General, United Nations, among others in "The Horowitz Proposal", 5th rev. ed., Aug. 1968, p. 140.

which could even be deducted from the bilateral grants-in-aid currently extended by them to the developing countries.

Advantages of the Plan

IDA guarantees to the Bank would be in the form of a mortgage on repayments of loans to the IDA and guarantees on the part of the developed countries—which are easier to obtain than budgetary allocations. The problem of extending the loans for thirty years could be solved by refunding of securities on the part of the Bank. The advantages of the Proposal involve both the relative ease of obtaining financing for an Interest Equalisation Fund and the fact that loans will be provided under conditions compatible with the requirements of developing countries, with an equitable distribution of the burden, and in a multilateral aid framework. Provision of such aid will be freed of the need for governmental and parliamentary deliberations with their relatively narrow scope of interest, and will not involve any pressure on balances of payments. Moreover, countries participating in the Equalisation Fund will not even be required to increase their current aid contributions.

It is worthy to note that the Horowitz Proposal was adopted and incorporated in its entirety in the "Algiers Charter", in Chapter C: "Development Financing", paragraphs (b), (c), and (d), at the Conference of 77 Developing Nations (although the identity of the Proposal's author and the country he represents were not mentioned). This is further proof not only of the Proposal's complete adaptability to the specific requirements of those involved, but also of its practical operability.

No Grounds for Technical Difficulties . . .

Moreover, a report on the plan prepared by the UNCTAD Secretariat concluded that the creation of an Interest Equalisation Fund with an appropriate system of guarantees need not involve any serious technical difficulties. On the basis of this report it appears reasonable to assume that large sums can be mobilised on capital markets and savings transferred into long-term investments for development needs without arousing opposition on the part of the developed countries which control these markets and which oppose the system of trade preferences.

Mr David Horowitz took pains to emphasise these factors in his address to the Third UNCTAD Conference in February 1968, and in order to eliminate any apprehension on the part of the developed countries due to the pressures on their balances of payments, he proposed to finalise an approach whereby the total of the loans authorised and spent by the recipient countries would be comprised of diverse cur-

rencies in accordance with their representation in the fund.

The purpose of this proposal is to coordinate the use of the proceeds from bond sales in various countries by purchasing from these same countries if balance of payments difficulties necessitate such a step. This system would avoid the dangers inherent in tied aid, since it would involve only timing and it would protect prices and terms of aid from the repercussions of tied aid.

In explaining the avoidance of negative influences on balances of payments, Horowitz noted that the interest subsidy would be paid to bond holders who are citizens of the country providing the subsidy, so that in fact only an internal shift of income would take place. Moreover, the Interest Equalisation Fund can be prepared from government grants, surplus profits from the World Bank and/or allocations from funds created by the IMF through the mechanism of Special Drawing Rights.

Thus in Horowitz's opinion, in view of these sources and of the fact that the total sum required is extremely modest—\$ 50-60 mn per annum per billion dollars worth of transfer of capital from the entire developed world—and that interest payments will not burden the balance of payments in the least, it is most unlikely that any difficulties will be encountered in arranging the fund⁸.

. . . or World Inflation

This investigation of the Horowitz Proposal also indicates that there are no grounds for the fear that its implementation will cause world inflation. On the contrary, the proposal can be tied up with the creation of increased liquidity assets recently decided upon as a consequence of the approval of Special Drawing Rights. Furthermore it not only brings aid to developing countries but also contributes to the enrichment of the developed countries.

Thus it was not surprising that at the 15th annual meeting of the Alliance for Progress, at Chestertown, Md., in April-May 1968, it was decided to initiate research—in cooperation with the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Development Agency and other institutions—on the feasibility of establishing a monetary system on a regional or international basis in accordance with the general framework of the "Horowitz Proposals"⁹. This decision, then, represents a positive evaluation of the Horowitz Proposal and a critical attitude towards supporters of the maintenance of international reserves in gold alone—among them J. Rueff, M. Allais

⁸ Statement of D. Horowitz, Second UN Conference on Trade and Development, New Delhi, February 1968, "The Horowitz Proposal", op. cit., p. 15.

⁹ See "The Horowitz Proposal", op. cit., par. 19.

and P. Samuelson¹⁰. It is also, of course, a first step, however regionally restricted it will undoubtedly be, towards actual realisation of the proposal.

Facilitation of Development Progress

The proposal's importance is also attested to by the similarity between its sources and the reasoning of the supporters of an international currency idea with reference to facilitated development progress in general and UN activities in particular.

Backers of an international currency have established the conclusion that since trade is increasing out of all proportion to the volume of monetary means (during the past thirty years world trade has grown from \$ 24 billion per annum to \$ 240 billion in 1968—according to GATT statistics—and maintaining a current annual growth rate of 7 p.c., while gold reserves have only increased during this same period from \$ 26 to 40 billion), gold is not sufficient as backing for the turnover, and must be supplemented by the currencies accepted for this purpose—primarily the dollar and the pound sterling. For various reasons holders of these currencies tend to exchange them often for gold, and in so doing they cannot avoid causing occasional crises in the international currency market. Hence the desire on the part of the backers of an international currency, in contrast to the French and Soviet positions, to demonetise gold. They consider this step to be particularly important in light of the relatively meagre maximum annual gold production rate of \$ 1.5 billion, part of which is for industrial purposes and part is not deposited in reserve banks.

The Stamp Proposal

In consideration of the requirements of developing countries Maxwell Stamp has proposed complementing the Triffin Plan with a system of long-term (50 years) low interest loans to facilitate accelerated development and an increased share for these countries in world trade. These loans would be drawn from the increased reserves, and the minimal interest would be paid to the International Development Agency. This measure would not reduce world reserves, yet it would enlarge the development funds and even facilitate sales by developed countries to developing countries, since the formers' reserves would reabsorb the funds involved, when transactions with the latter were concluded.

Stamp has proposed that for this purpose the International Monetary Fund first create an annual reserve of approximately \$ 3 billion—a relatively small sum constituting 20 p.c. of the volume of world trade. Moreover, B. L. Johnson contends that in this way it would be possible

¹⁰ Cf. M. Vasey, "International Monetary Reform and the Reserve Currency Problem", *Lo Spettatore Internazionale* No. 4/1968, p. 422.

to finance all related activities of the UN and its special agencies. These activities do not currently require more than \$ 500 mn per annum, and such a system of financing them would give new impetus to the international assistance machinery¹¹.

The aforementioned plan is undoubtedly far better suited to the developing countries than the system of Special Drawing Rights, which fails to take into account either all their requirements or those of the entire UN family.

Realisation of Proposals

In accordance with Articles 57 and 63 of the UN Charter, the Economic and Social Council is authorised to initiate measures for the implementation of these programmes and to bring before the General Assembly pertinent conclusions—particularly those relating to agreements with specialised agencies, the foremost of which would be the International Monetary Fund. These programmes are important for four principal reasons: first, an international currency would be a stable unit for reserves, account settlements, and promotion of international trade, services and travel; secondly, it would be suitable for countering inflationary and deflationary currents; thirdly, it might serve as the exclusive currency for small countries; fourthly, and most important, it would facilitate increased UN-family aid and increased funds for the IDA and the UN Capital Development Fund¹².

However, we realise that the developed countries are not yet anxious to implement complete programmes of this nature¹³. In contrast there is no indication of opposition in principle to the "Horowitz Proposal", which under the circumstances appears to be the best suited to the requirements of developing countries and which, as previously noted, is already being practically adopted to the conditions of diverse regions. As long as fundamental changes in the international monetary system have not come about and do not even appear to be in the offing¹⁴, the Horowitz Proposal constitutes a landmark as an improvement in this system and as a step toward dealing with the developing countries' justified claims. These claims are of course highly variegated¹⁵, and the financial aspect may not be the dominant element in their make-up. Nevertheless without a solution which accounts for this element we cannot narrow the gap between the world's rich and poor, nor can we avoid the dangers inherent in its continued existence.

¹¹ Cf. B. L. Johnson, *Needed a World Currency*, WAR/PEACE Report, Nov. 1968, p. 16.

¹² Johnson, *op. cit.*, p. 16-17.

¹³ Cf. Fr. H. Rosentiel, *Währungsexperten vor neuen Aufgaben*, *Frankfurter Allg. Zeitung, Wirtschaftsblatt* No. 224, 26. IX. 1968; and Otmar Emminger, *Pfund, Dollar und das heutige Währungssystem*, *Europa-Archiv*, No. 3, 10. II. 1968, p. 87-88.

¹⁴ Cf. Mendes France, *op. cit.*, p. 4.

¹⁵ Papi, *op. cit. passim*.