# THE EVOLUTION OF THE INTERNATIONAL MONETARY FUND TOWARD A WORLD CENTRAL BANK

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## I. Introduction

Sooner or later one country after another developed or created a national central bank to preside over its national monetary system. As the world becomes more interdependent are we likely to see a similar evolution at the global level? Should we encourage it? This paper will try to address the parallelism between central banking at the national level and at the global level, and also the differences, focusing on the International Monetary Fund. It will suggest the incipient characteristics of a world central bank in the IMF as it is currently constituted, and it will suggest how these characteristics might be developed to transform the IMF into a full-fledged central bank.

The next section of the paper sketches the principal characteristics and objectives of national central banks. That is followed by a discussion of the IMF as it is currently constituted. Section IV then draws a number of parallels between the present IMF and central banks. Section V considers the possible evolution of the IMF into a full-fledged central bank along several different dimensions.

## II. National Central Banks

The notion of a central bank has evolved over time, and it is still not completely well defined. Some central banks emerged from leading commercial banks, like the Bank of England. Others, such as the Federal Reserve System, were brought into existence by statute with a central banking role in mind. But even in the latter case the actual functioning of the central banks has evolved extensively with the passage of time.

We must look at the structure, objectives, instruments, and governance of national central banks. The structure of most central banks is like a commercial bank, from which many evolved. Like a bank, but unlike a business enterprise, the activities of central banks revolve around their balance sheets. On the asset side are its financial investments - typically of very short

maturity - allocated among domestic assets, claims on government, and claims on foreign countries (its international reserves). The liabilities of a central bank are typically deposits of commercial banks and the government, plus the notes issued to the public. The core of central banking is the manipulation of these assets and liabilities. Central banks have other functions as well, however, notably regulation of commercial banks to assure their soundness.

The instruments used by a typical bank include buying and selling securities against its own liabilities, in the process of which it creates money. This can be done at the initiative of the central bank, as in open market operations, or at the initiative of the seller of the securities under rules and conditions laid down by the central bank, as in rediscount operations. The central bank may change the conditions, and especially the interest rate, under which it rediscounts. It may also commit itself to a regular pattern of purchases or sales of securities. It implicitly does this when it adopts a fixed exchange rate between its currency and that of some other country, implying that it will buy or sell foreign exchange against its liabilities to limit movements in the exchange rates. Or it may engage in steady predetermined purchases of some assets to provide for a steady growth in the domestic money supply.

Under the laws of many countries the central bank can also instruct commercial banks or other regulated financial institutions on their portfolios, for example, as regards their foreign exchange holdings (as under exchange control regulations) or credits to private business.

It took about two centuries for the Bank of England to evolve from a commercial bank with special responsibility for financing the government to the exclusive issuer of notes to the public (except for the Scottish clearing banks), holder of the nation's gold reserves, and lender of last resort to the banking system. The last function involves a willingness to buy high quality assets from commercial banks against its own deposits - at a penalty interest rate. John Maynard Keynes complained in the 1920s of the limited role of the Bank of England, and urged it to manipulate its balance sheet so as to stabilise the price level rather than focusing exclusively on the exchange rate.1/

The Federal Reserve System came into existence in 1913 as a consequence of the banking panics of the 1890s

and of 1907. It was designed to provide an efficient clearing system, to regulate the commercial banks, and to provide a lender of last resort. The note issue in the United States had in practice already been taken over from commercial banks by the U.S.Treasury, but the Federal Reserve System was given that function for large denominations as well. As early as the 1920s the Federal Reserve System adopted practices different from those that had guided the Bank of England: it "sterilised" the impact on the domestic money supply of the inflow of gold from abroad to prevent excessive monetary growth from raising prices and destabilising the economy. Thus it began the process of economic stabilisation.

By the mid-1960s modern central banking seemed to have settled down into a pattern. The main instrument of policy was open market operations, although central banks had other instruments as well. Part of the art of central banking has been to maintain an aura of mystery around its objectives and how it pursues them. Most central banks have succeeded in creating a certain ambiguity about their objectives and the weights they attach to them. Nonetheless, based on testimony before the Radcliffe Committee, Richard Sayers could describe the objectives for the open market operations of the Bank of England in the following way: 2/ (1) the Bank seeks to protect the discount market and the banks from violent oscillation between stringency and glut of cash; (2) the Bank seeks a certain level of treasury bill rates, primarily in the interest of influencing international short-term capital movement so as to maintain the gold and foreign reserves at an adequate level; (3) the Bank seeks to influence the liquidity of the commercial banks; (4) the Bank has to manage the national debt in the sense that it has to arrange for issue and redemption of government securities and maturity distribution of the debt in such a way as to insure that the government can always meet its obligations, and to do this in such a way as to avoid an unnecessarily high burden of interest rate; (5) the Bank encourages an upward or downward movement in long-term interest rates according to which direction it considers appropriate to the underlying investment/saving propensities in the economy, although this is still probably a subordinate aim.

Notice that the focus here is on stability of interest rates, both short- and long-term, an objective that in recent years has yielded to much more focus on steadiness of growth in some variant of the money supply. The third objective stated by Sayers is ambiguous as regards the focus on long-term secular growth of bank liquidity as opposed to relatively short-run variation in liquidity to

counter business cycle tendencies in the private economy. The emphasis on managing the public debt is also noteworthy, the traditional function of the Bank of England, but one that is not shared by the Federal Reserve System.

The objectives of the Federal Reserve System are basically similar except regarding management of the government debt, for which it has accepted no responsibility since 1951, beyond the maintenance of orderly financial markets which make possible Treasury management of the public debt.

The Federal Reserve System is of special interest in the current context, because its creation entailed much controversy over the role of the Federal government in banking in the United States. The resulting structure of the Federal Reserve System reflects a compromise: it is composed of twelve regional reserve banks, whose stockholders are the commercial banks subject to regulation. In the early years of the Federal Reserve System these regional banks even maintained separate rediscount policies and rates. A seven-member Board sits in Washington, appointed by the President for fourteen-year terms, but responsible only to the Congress. Key monetary decisions are made by an Open Market Committee, which consists of the Board augmented by five of the twelve presidents of the regional reserve banks on a rotating basis. The Open Market Committee meets every three weeks. Regulations governing the commercial banks are promulgated by the Board, but executed by the regional banks. Unlike in some other countries, foreign exchange operations are under the control of the U.S. Treasury, but the Treasury has no decision-making powers with respect to monetary policy (except insofar as it can influence new legislation).

In contrast, the Bank of England is formally responsible to the British Treasury, although by tradition it has much autonomy. Central banks around the world run the spectrum in independence from the sitting government. In many cases central banks are merely the agent of the Minister of Finance. At the other extreme, the German Bundesbank is fully independent of the government in power, both as regards monetary policy and as regards foreign exchange rate operations, although of course it is sometimes in consultation with the government.

## III. The International Monetary Fund

Although the IMF has sometimes been called a central bank for central banks, and it does perform that function to a limited extent, its role both in conception and today

is much more limited than is the role of a national central bank. It is worth stating in full the formal objectives of the International Monetary Fund as stated in Article 1 of its Articles of Agreement:

> The purposes of the International Monetary Fund are:
>
> (i) to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
>
> (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economy policy.
>
> (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
>
> (iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
>
> (v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
>
> (vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

Four features of the operation of the International Monetary Fund are noteworthy:

(1) Member countries, which now number 146, including virtually all countries apart from the Soviet Union and some of its satellites, Switzerland, and Taiwan, deposit their currencies in the IMF in an amount defined by _quota_, which also defines each countries' voting rights. By recent agreement, the total quotas will be increased to 90 billion SDRs, just short of 100 billion U.S. dollars.*

(2) Member countries can draw on the currencies of other countries when they have a balance-of-payments problem. Allowable drawings are linked to quotas, with a current limit of 150 percent of a country's quota per year, and a maximum normal drawing of 450 per cent of quota. For extensive drawings, a country must work out a balance-of-payments adjustment program acceptable to the IMF.

(3) The IMF has general responsibility for "surveillance" over the rules and functioning of the international monetary system. The rules involve, _inter alia_, convertibility of currencies for current account transactions. Originally the rules also required that exchange rates be relatively fixed, but now they require only that national exchange rate policy is consonent with smooth functioning of the international monetary system. More generally, in accordance with its charter, the IMF is concerned with assuring relatively smooth balance-of-payments ajdustments to avoid persistent disequilibria in international payments.

(4) Since 1969 the IMF has been empowered to create a new international money for transactions among official monetary institutions, the SDR, and has actually created SDRs on two occasions, 1970 to 1972 and 1979 to 1981, to the total extent of about 24 billion U.S.dollars.

The governance of the IMF is unique among international organisations, along with its sister institution The World Bank, in having a representative form of government. Day-to-day management of the Fund is in the hands of a managing director, who reports to a board of 21 executive directors that meet thrice weekly. The 21 executive directors represent all the 146 members of the IMF. The Managing Director is formally responsible to a full Board of Governors, which meets once a year and whose votes in the ultimate decisions governing management of the Fund are weighted according to a formula (embodied in each country's quota) which is designed roughly to reflect both the importance of each country in the world economy and the importance of world trade for each economy.

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* The Board of Governors of the Fund reached agreement in early 1983 to increase quotas by 47.5 per cent, from SDR 61 billion to SDR 90 billion by end-1983, subject to ratification by members holding 85 per cent of votes. Ed.

## IV. Parallels Between the IMF and a National Central Bank

One can see in the structure of the IMF faint glimmerings of a world central bank, but on close examination it falls far short of the role played by central banks in national economies. Like a national central bank, the IMF can effectively create international money in two ways: (1) through its lending operations, at the initiative of a borrowing country, because the Fund's use of currencies creates a "reserve position in the Fund" for the country whose currency has been drawn, and this reserve position in turn can be freely drawn upon by that country when it needs to; (2) through the allocation of SDRs, at its own initiative (i.e. following a vote of its members). In this sense the IMF is already a bank of issue. But in the case of the first channel of money creation, roughly analogous to the rediscount facility in a national central bank, the IMF's medium is national currencies. It issues its own liabilities, not to the borrowing country, but to the country whose currency has been borrowed. Polak has argued that the IMF could function with considerably greater simplicity, both of mechanism and of language to describe what is happening, by consolidating its General Account, which is available for normal drawings, and the SDR Account, which deals with creation of SDRs[3]. This would avoid the intermediating use of national currencies in Fund operations. We will return to this possibility below.

The IMF can even perform the lender-of-last-resort function as that term has been used historically. In particular, it can lend large amounts to a particular country that is in balance-of-payments trouble. True, normal borrowing is limited by each country's quota. But in extreme circumstances these limits can be waived by a vote by the Executive Board. Then the limit is simply total available IMF resources (that is, its usable currencies) for these purposes.

The SDR-creation mechanism cannot be used for such emergency lending, because the decision-making process for creating SDRs is a complicated and prolonged one. And SDRs must be allocated to all member countries, not selectively. But we should recall that while the Bank of England and other central banks historically could issue their own liabilities as lender of last resort, they could not do so without limit. In some cases there were legal limits on the creation of their liabilities; but even when there were no such limits, they feared the loss of gold, or other reserves, which were held in limited supply. Thus the IMF

in this regard stands at a certain point of the historical evolution of national central banks, but it has not reached the present state of national central banks where there is in principle no limit to the support that they can give to their banking systems. We will return to this point below, to clarify certain misunderstandings about the lender-of-last-resort function.

On the regulatory side the IMF also performs the function of a rudimentary central bank, but here its authority is even more limited than it is as a bank of issue. Its members are sovereign states, bound in principle by the Articles of Agreement, but with no enforcing authority. The IMF can enforce to a limited degree by making its loans conditional on specified changes in behaviour by the borrowing countries. This practice, known as conditionality, is resented around the world, but it follows closely, *mutatis mutandis*, the behaviour of national central banks. National central banks universally set down the ground rules on which they will lend to commercial banks. Often they designate certain high quality paper as "rediscountable" without question - the analogue to low-conditionality lending by the IMF, although without the collateral that the rediscountable paper offers - but even those designations can be altered. Beyond that a central bank will examine the portfolio of a commercial bank that desires to borrow, and perhaps will require alterations in it. In addition, central banks have the authority to direct portfolio changes by commercial banks even when they do not come to the central bank to borrow - by changing reserve requirements (in the United States), by requiring special deposits, by placing ceilings on certain kinds of credit, and so on. The legal set up within nations requires compliance by the banks if they want to continue to operate. The IMF has no analogous authority at the international level. Its Articles do however decree certain general norms of behaviour that members are expected to follow, and it does have the authority to designate national currencies for its own use in its lending operations.

There has been a debate from the beginning over the balance to be struck in the IMF over the degree of IMF guidance on economic policies appropriate for member states. The original (1943) American plan for what later became the IMF, proposed by Harry Dexter White, the chief American delegate, gave the proposed new institution wide supervisory powers over domestic economic policy, even the power to alter exchange rates. Writing in January 1944, J.M.Keynes described the then U.S. views: "In their eyes (the new Institution) should have wide discretionary and policing

powers and should exercise something of the same measure of grandmotherly influence and control over the central banks of the member countries, that these central banks in turn are accustomed to exercise over the other banks within their own countries."4/ Keynes' reference to "grandmotherly" was no doubt a gentle allusion to the role that the Bank of England, the "old lady of Threadneedle Street", played with respect to the British banks; and on occasion "grandmother" was more like a stern father. What actually emerged in the IMF involved a good deal less discretion and power than White had originally proposed - on reflection Americans could not accept the wide powers involved in his plan either - but a good deal more than Keynes would then have preferred, and than he thought he had negotiated. Some form of conditionality, that is, tightening down on the economic policies of countries that borrowed from the IMF, was necessary because the IMF resources were much more limited than Keynes had proposed. Moreover, even Keynes was prepared to see quite strong IMF discretionary powers with respect to borrowing countries once they had drawn more than 50 percent of their very large quotas under his plan.5/

## V. Possible Evolution of the IMF Toward a World Central Bank

In speculating on how the IMF might evolve further toward a world central bank, it is necessary to specify the institutional setting in which this is to take place and the motivations for economic behaviour that can possibly be influence by an XIMF - an expanded IMF.

The relevant time horizon is taken to be roughly the next 20 years. In this period the world will continue to be made up of sovereign nation states with autonomous national monetary policies. Exchange rates among currencies will in principle float against one another, but there will be increased perception of economic interdependence and the need to coordinate various aspects of economic policy. This perception will lead *inter alia* to heavy management of exchange rates and acceptance of the implied restraints on the exercise of full monetary autonomy.

The key behavioural assumption is that world reserves can influence world economic activity, at least for a time. The mechanism operates through national government policy, rather than directly on private transactions, although if the SDR's use is broadened to include private holding there might also be some influence directly on commercial bank lending and hence on private economic activity.6/ More will be said on this point below. A more

generous level of world reserves will result in less restrictive economic policy by member countries, and vice versa. The process is limited in time, however, because of the presence of "reserve sinks", that is, large countries that determine their policies more or less independently of reserve levels, and who if necessary are willing to accumulate reserves without relaxing their economic policies.7/ Most countries, however, are assumed to be constrained by foreign exchange, so that an augmentation of reserves will permit relaxation of trade controls and/ or macroeconomic restraints. By the same token, a reserve contraction will have the opposite effect, where "contraction" need not mean a literal decline in world reserves, but only reserve growth less than the normal growth in demand for reserves.

So long as the IMF does not have a monoply on international liquidity, however, its influence will be heavily conditioned by what is happening in private financial markets as well, since most countries can add national currencies - mainly the U.S. dollar, but also other currencies such as the German mark, the British pound, the Japanese yen, the Swiss franc - to their reserves by borrowing or by earning them from other countries that have borrowed them. This possibility raises the interesting question of whether there is an asymmetry in influence. Perhaps the IMF can stimulate world demand, but cannot restrain it when private markets are ebullient. This would reverse the British economist Dennis Robertson's dictum concerning national monetary policy that "you cannot push on a string". He thought monetary policy could restrain demand but could not stimulate it.

The exact role of the SDR is crucial in assessing potential IMF influence on world monetary conditions. At present it is only a minor supplement to international reserves, amounting to less than 5 per cent of world reserves even if gold is valued at (artifically low) official prices - and considerably less if monetary gold is valued at (artifically high) market price. Nor is it used extensively except in transactions with the IMF itself. Indeed, by late 1981 a quarter of total SDRs created were in the Fund's own general account. There is no general disposition at present to increase vastly the role of the SDR.

Professor Kenen has correctly pointed out that the SDR is not likely to be wanted extensively by central banks until it is integrated into the actual method by which international settlements take place, that is, through intervention in foreign exchange markets. Kenen would have the IMF encourage more extensive private use of SDRs.

To this end he proposes setting up a new Clearing House to which central banks could transfer SDRs in exchange for deposits of national currencies by their commercial banks with the central bank.8/ In this way commercial banks would effectively have access to SDRs and could begin to deal in them. Once private use of SDRs was widespread, central banks could intervene in foreign exchange markets through the medium of SDRs, and demand for SDRs as reserves would rise relative to the desire to hold national currencies as reserves. Kenen's proposal is ingeniously designed to avoid an amendment to the Articles of Agreement, which now limits holdings of SDRs proper to official institutions, of which the Clearing House would be one. If the commercial banks began to trade extensively in SDR-dominated claims, based on their SDR claims on the Clearing House, that would represent the beginnings of fractional reserve-based deposit banking on a world scale, and IMF issuance of new SDRs(or transfers into the Clearing House by other official holders) could then influence bank credit, and hence economic activity, directly rather than only indirectly through alterations in government policies.

As noted above, Polak has sketched a revised IMF that integrates the general account and the SDR account, basing both on SDRs, and shows that this could simplify the IMF considerably without changing fundamentally its mode of operation. SDRs would replace the current reliance on national currencies. This change would however require an amendment to the Articles of Agreement, and if that were done the amendment could be extended to allow private holders, in particular commercial banks, to hold SDRs directly in the IMF, rendering Kenen's Clearing House unnecessary as a device to avoid amendment. The implied division of labour between the Fund, dealing with official institutions, and the Clearing House, which would deal with commercial banks and other private financial institutions, might still be desirable even if the Articles of Amendment could be altered to permit private holdings of SDRs.

Polak's scheme does entail one important substantive change: the IMF would no longer depend on contributions of national currencies to support increases in quotas. It could simply, under the amended Articles, create SDRs in order to meet calls on it by would-be borrowers. In this respect it would represent a strong move closer to a true central bank. However, its ability to create SDRs in this way would (under Polak's scheme) still be limited by the quotas of the member countries, which would be added to their acceptance limits under the current provisions for SDR creation.

We turn now to five central bank functions and ask how the IMF might evolve during the next 10-20 years toward a world central bank with respect to each of them. Some have already been covered implicity in the discussion above; others involve new elements.

## Lender of Last Resort

As noted above, in important ways the IMF already performs the function of lender of last resort. It cannot, however, create its own liabilities without limit under emergency circumstances, as a national central bank can. The scheme outlined by Polak would effectively permit it to do this, although full freedom to do so would also require elimination of acceptance limits on SDRs. But a word should be said about this central bank function, for it has been used too loosely in much recent discussion. The phrase arose, and is still used, in the context of meeting a liquidity crisis in a commercial bank, whose liabilities are more liquid than its assets and may be called faster than the bank can mobilise its assets to meet the calls. The central bank then steps in and "liquifies" the bank's assets by making a market for them, perhaps at a penalty interest rate. The function is not designed to bail out an insolvent bank, where liabilities exceed assets in value. Different remedies are necessary for that. In macroeconomic terms, applying the lender-of-last-resort function to the entire banking system, it is designed to accomodate a shift by the public in its demand for money, typically toward money issued by the central bank (e.g. currency). It is not designed to finance a run from all financial assets, including money, into goods.

The distinction between liquidity and solvency does not apply cleanly to countries. A country can find itself illiquid in the sense that it is short of ready-at-hand cash to meet its pressing obligations. But how is a country involvent? The natural extension of this concept, which is not without its problems, is that the country has borrowed abroad more than it can service in the long run. That is, national solvency involves maintaining some maximum relationship of external debt to GNP, properly measured; in terms of growth, debt should not grow more rapidly than the capacity of the borrowing country to service it.

By analogy with national central banking, the lender-of-last-resort function of the IMF should be to meet liquidity needs that arise in some context other than external borrowing in excess of what a country can service in the long run. The IMF is not designed to finance an excessive demand for foreign goods over the long period. In playing

its role of lender-of-last resort today, the IMF does not make this distinction explicitly,but presumably it is reflected in the adjustment programme worked out with each particular borrowing country. The main limitation on the IMF's ability to function today as a lender of last resort is its limited resources; it is simply not large enough to handle the United States as a borrower, or several medium-sized countries that need to borrow at the same time. The General Arrangements to Borrow had to be created in the 1960s to deal with the possibility of a U.S. borrowing; and in some of its recent programmes the IMF has made going ahead conditonal on substantial additional lending also by commercial banks.

A final remark is desirable to clear up a misunderstanding: the term "lender of last resort" has never meant "only lender of last resort." Central banks have often lent funds, directly or through the market, to the commercial banking system before it encountered a liquidity crisis. Similarly, the IMF can and should be able to lend well before a country reaches a liquidity crisis. The term simply conveys the notion that if a country has a liquidity crisis, an institution is available to lend what is necessary to see the country through a difficult period.

## Secular Growth in International Liquidity

With a mechanism in place for creating the SDR, the IMF is able to add to international liquidity on a secular basis. Indeed, that was the rationale for the creation of SDRs in the first place, to supplement and ultimately perhaps to substitute for gold and national currencies in the growth of international reserves. Being able to influence international liquidity, however, is not the same as being able to control it. Control is impossible so long as countries are free to add national currencies to their reserves, as they are likely to be able to do for a long time. Within the 10-20 year time horizon of this paper, a prohibition on increments to foreign currency reserves is highly improbable. A more likely development is that countries whose currencies are used as foreign exchange reserves will come increasingly to appreciate the cost of this role for their currencies, especially in terms of their own loss of national monetary autonomy. They may even take steps to discourage expanded use of their currency abroad. But return to a one-reserve world, even if an extensive private use of SDRs is encouraged, is unlikely in the remainder of this century. The IMF can thus contribute to the growth of international reserves, and because it generates a claim that is no country's liability

it can control the growth of net reserves. But it will not in this period be able to control the growth of gross reserves without major and probably undesirable changes in the ways nations interact with financial markets.

Stabilising the World Economy

As noted above, the role of central banks in stabilising economic activity, as opposed to financial markets, came relatively late in their evolution. And even today it is not fully accepted as a legitimate function. Indeed, monetarists contend that central bank efforts to "fine tune" their actions in the interests of economic stabilisation are more likely to be a destabilising influence than a stabilising one, because of lags and uncertainties in the economy's response to a given monetary action. Be that as it may, the IMF could play a modest role in global economic stabilisation within the framework described earlier, of nation states constrained by external payments. In particular, three mechanisms for helping to stabilise the world economy are possible with only modest extensions of the present IMF.

First, the IMF could consciously vary the conditions on which it lends according to the state of the world economy. In times of world economic boom, the IMF could somewhat tigthen its conditions to all borrowers on the two-fold grounds of helping to cool the world boom and encouraging the borrowing country to adopt a stabilisation programme that does not rely for its effectiveness on a continuing world boom. By the same token, in periods of world economic slack the IMF would ease up on the conditions it imposes on all borrowers, compared with what otherwise would be imposed, thus helping to cushion or reverse the world recession. Such adaptation of IMF conditionality to world economic conditions might also include the interest rate charged on loans, although that would be less important than the stabilisation targets agreed with the borrowing countries. This kind of adaptation to world economic conditions would be analogous to a central bank's altering the conditions for rediscounting in response to the business cycle. Those adjustments have historically focused on the rediscount rate of interest, but other conditions, particularly as regards the quality of rediscountable paper, have also been altered as well.

Such behaviour by the IMF could not eliminate booms and recessions in world economic activity, for IMF lending would not be large enough in the foreseeable future to do that. But it could help to damp down fluctuations.

There are practical difficulties with this proposal. Countries would have to understand that, depending upon world economic conditions, they might be required to undertake stiffer actions than they did on some past borrowings, or than another otherwise comparable country did in the previous year. Acceptance of this variation would require exceptional understanding on the part of high turnover Ministers in the borrowing countries. Similarly, it is not easy to induce a bureaucracy of country desk officers to alter their criteria in a more or less uniform way according to general instructions from top management based on world economic conditions. But these are difficulties, not insuperable obstacles, and such variations in conditionality would be well worth introducing.

One feature of the present IMF does automatically alter lending conditions with world economic conditions: the compensatory financing facility. In a world slump, if export earnings fall below the projected level as defined by a five year moving average, countries can borrow under the compensatory financing facility with little or no conditionality. Recently this facility has been extended to cover increases in the prices of imported cereals. The facility has worked well, and over $11 billion had been borrowed under it by early 1983. But many countries exhausted their borrowing rights, which are limited in relation to quota, during the 1981-82 world depression. The compensatory financing facility should be enlarged to deal with such severe recessions. As the IMF is presently constituted, its resources ultimately pose a limit to the degree of liberality of the compensatory facility, along with other IMF lending. Adoption of the Polak scheme would deal with that. The IMF could lend SDRs through the compensatory financing facility as well as in its normal lending operations, and its total lending capacity would then be limited only by the willingness of member countries to accept SDRs in payment for their goods, a limit that is not likely to be binding during periods of world recession.

A number of proposals have been made for extending further the coverage of the compensatory financing facility. These include measuring export earnings, for purposes of drawing from the compensatory financing facility, in real rather than nominal terms.9/ Whatever the merits of this idea purely in terms of stabilisation, extension of the CFF in this direction would be imcompatible with the evolution of the IMF toward a world central bank. Banks of issue must deal in nominal, not real, values. Automatic unlimited financing of export shortfalls in real terms could lead to an acceleration of world inflation, with the IMF financing an ever increasing world price level in an attempt to compensate for a change in relative prices. This particular

reform is therefore undesirable in a setting in which evolution of the IMF toward a world central bank is considered desirable.

Third, the XIMF could issue SDRs on a countercyclical way, providing more in periods of slump and fewer or none in periods of world economic boom. If commercial deposits are developed in SDRs, along the lines discussed above, such variation in SDR issues could influence economic activity not only through its influence on government policies, but also by making the commercial banking system more or less liquid in terms of SDRs and thus by influencing private bank lending.

To move in this direction would require streamlining the procedures for SDR allocation to allow for year-to-year variations and to permit relatively quick decisions, instead of the prolonged process of bilateral consultation that now occurs for allocations that are to cover a period of 5 years.

Regulating National Economies

An important role for national central banks is regulating the behaviour of the commercial banks under their jurisdiction. The extent and visibility of this regulation varies greatly from country to country. The analogous role for the XIMF would be to regulate the economic, or at least the monetary, policies of its member states - in Keynes' words to exercise "a measure of grandmotherly influence and control over the central banks of member countries ". As discussed above, the degree of this control has been a source of controversy and disagreement from the inception of the IMF. Yet it is not conceivable to have a central bank that lends to its members, and creates money in the process, at the member's initiative, without some degree of control over the policy actions that influence the need for member borrowing and ability to repay. If this is granted, then the discussion must focus on the practical and detailed implementation of this general authority, and it is difficult to do so intelligently at a level of high generality. The particulars of the individual cases are decisively important. Given the strong resentment that exists, wrongly, in many parts of the world concerning IMF conditionality, however, it is difficult to imagine a consensus developing that would endow the IMF with more direct authority than it now has over national economic policies, which in their totality strongly influence world economic conditions. This means that the IMF's influence over world economic conditions is likely to remain relatively indirect, exercised along the lines already sketched above,

through alterations in conditonality and variations in SDR allocations. Direct coordination of national macroeconomic policy by the IMF, as Harry Dexter White once envisaged, does not seem likely in the forseeable future.

There is one dimension of policy coordination in which the IMF could perhaps play a more active role: management of exchange rates. There is widespread dissatisfaction with the last 10 years of floating rates. Much of this dissatisfaction is misplaced, in that it attributes to floating exchange rates difficulties in the world economy that were quite different in their origin. A return to fixed (adjustable peg) exchange rates among all major currencies is neither feasible nor desirable in the near future. At the same time, there is little doubt that some international cooperation in the management of exchange rates is desirable, and indeed it has already occured among some countries on occasion. The IMF is charged with the responsibility of exercising firm surveillance over the exchange rate policies of its members, to assure that they are consistent with the purposes of the IMF, set out in Article 1 reproduced above. The IMF could move more aggressively than it has to identify inappropriate exchange rates and even to define target zones or reference rates for member currencies. These designations would have operational significance insofar as they guided exchange market intervention by member states and insofar as they influenced market perception of where exchange rates ought to lie. The IMF could identify publically exchange rates that were out of line, whether or not it had specified reference rates, with a view to influencing both government and market behaviour.

The focus on exchange rates is not so narrow as it at first may seem, since the level (in a market system) and sustainability of any particular exchange rate depend *inter alia* on the entire array of member country economic policies but especially monetary policies. Thus a surveillance mechanism which narrowed variations in exchange rates would do so by implicity coordinating national monetary policies.

## Stabilising Markets

A final function of national central banks has been to help maintain orderly markets. By analogy, in respect to member nation policies this issue has already been covered in the proceding section. But one might go further and ask whether the IMF should not invervene *directly* in currency and/or short-term financial markets when necessary to help maintain orderly markets. This activity would

require a major institutional overhaul of the existing IMF, which is not set up either for direct market intervention or to select and handle the financial assets that it would have to hold in its portfolio if it were to be a regular participant in financial markets. In a run longer than that under consideration here, such direct intervention might be something to keep in view as a future step in the evolutionary process toward a world central bank, but it goes even further in allowing the SDR to be held by private banks, and will not be considered further here.

Governance

If the IMF is to be moved toward becoming a world central bank, with greater authority and operational flexibility than it now exercises, who is the IMF to be responsible to for its actions? Under its present structure, it is responsible to its member governments as embodied in their Finance Ministers meeting annually. No doubt that could remain the basic arrangement for some time to come. But if the IMF is to be more actively involved in global economic management, judgments on the state of the world economy will have to be made more often than once a year, and Ministers are not likely to be willing (or politically able) to delegate responsibility for decisions on such weighty matters to the managing director or his board of executive directors. It will probably be necessary to institute some intermediating arrangement for making key economic decisions. Adaptation of the Interim Committee of governors, sitting on a representative basis, would be a natural way to accomplish this, although it is by no means the only possible way. The Interim Committee could extend its meeting times from two or three or even four times a year and sit as a kind of open market committee to guide the XIMF in its enlarged responsibilities.

## VI. Concluding Observations

The IMF has already evolved extensively, and in general toward an international central bank, during the first 35 years of its existence. Its creators would be surprised at the authority it has developed during this period, especially as regards conditionality and its ability, albeit limited, to create reserves through its lending operations and through the allocation of SDRs. (They would probably be astonished, however, given its general success, to discover how small its resources have become relative to the value of world trade and other international transactions).

By the mid-1970s it was beginning to take a global view of its lending activities, rather than simply viewing them as a series of individual country problems. And by 1982 the IMF was insisting successfully that commercial banks must increase their lending to particular countries in support of IMF lending and stabilisation programmes if they were to be effective. By the year 2003 the IMF could have advanced much beyond this in its authority, unless its evolution is stunted by sharp disagreements over the basic philosophy that is to guide IMF actions, and over how it is to be governed.