IMF REFORM: THE DEVELOPING WORLD'S PERSPECTIVE

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Introduction

This paper deals with the issues of the reform of the International Monetary Fund (IMF) under five major headings: (1) creation of international liquidity; (2) extension of payments finance and conditions attached thereto; (3) relationship with the commercial banks; (4) relationship with regional monetary groupings; and (5) participation in decision making by member countries. In the process of dealing with each of these issues, we have taken note of changes not only in the exchange rate regimes but also in the evolving balance-of-payments situation in general and of the developing countries in particular.

I. Creation of International Liquidity

The IMF was assigned an apex position under the international monetary system agreed upon at Bretton Woods in 1944. Its principal role was to oversee the arrangement under which each member country maintained the par value or exchange rate of its currency in terms of gold or the US dollar. Changes in exchange rate of up to only one percent on either side were allowed. Beyond that a member could change its exchange rate only in consultation with the Fund when its balances of payments was in fundamental disequilibrium, a situation that was never clearly defined.

The major sanction behind the Fund's supervisory role with respect to the exchange rates of member countries derived from the access each member country had to the resources of the Fund to finance its balance-of-payments deficit. The Bretton Woods system provided explicitly for the creation of a pool of currencies in the hands of the Fund. The pool was made up of the subscriptions - one-fourth in gold and three-fourths in the national currency - member countries made on the basis of their respective quotas fixed on the basis, principally, of economic size. It is out of this pool, it was evidently envisaged, that the Fund would, when necessary, sell the currencies of the

countries in payments surplus against the currencies of the countries in deficit. A deficit country's eligibility, however, to purchase currencies of surplus countries from the Fund was tied to its quota. Also such purchases were subject to conditions which varied directly with the ratio of these purchases to a deficit country's quota.

Whatever else one may say about the Bretton Woods arrangements, particularly now with the benefit of hindsight gained from the experience with these arrangements, one can safely say that in its conception the arrangements provided the Fund, at any one time, with liquid resources consisting not of the whole pool of currencies and gold placed by the member countries at the Fund's disposal but only of the gold plus the currencies of the surplus countries. Since, to begin with, the USA was the only major surplus country the resources at the Fund's disposal did not amount to more than 7 per cent of the aggregate imports of its member countries. As against that, the quotas taken together were 16 per cent of aggregate imports.[1/]

Although the provisions of the Fund's charter allowed it to generate liquidity, both directly as well as indirectly, the latter by borrowing from governments and the market, these provisions were invoked - and that too rather hesitatingly - after a lapse of some twenty-five years when the Bretton Woods system was on its last legs. Thus the access of the Fund to lendable resources was a limited one. Naturally, therefore, it constrained the Fund's ability to become a major source of finance to cover the payments deficits of the member countries.

Immediately after World War II, when the USA enjoyed large payments surpluses, it cycled back the surpluses which were not needed for enlarging its investments abroad to deficit countries. Major recipients of these recycled surpluses were the war crippled economies of Western Europe and Japan. Subsequently, when these economies emerged with payments surpluses, they used these surpluses largely to build up their exchange reserves by accumulating dollars and only marginally to encash them in gold. Thus it was again left largely to the USA both to cover its own payments deficits[2/] and to recycle them to other deficit countries in various forms.

When the US external position weakened somewhat as its reserves declined [3/] collective arrangements were agreed upon between the major industrial countries to extend help to each other in the event of excessive pressures. The General Arrangements to Borrow (GAB) was one such arrangement which was arrived at in 1962 between ten

industrialised member countries of the Fund.[4/] Under this arrangement, the Fund was to set up a special facility for which it could borrow the currencies of these countries up to specified amounts for extending low-conditionality, low-cost finance to any of the countries in need of payments support. No non-participant was eligible for drawing out of this facility.

Thus, from the very outset resources placed at the Fund's disposal were so limited that it could not have been expected to extend any large-scale credit to deficit member countries. Was it because of the belief that under a regime of fixed exchange rates there would be little need for providing large-scale cover to member countries? Or was it that, for the generation of liquidity needed to cover the payments imbalances arising between member countries, it was intended to rely on one or two national currencies?

Those who were principally responsible for hammering out the agreement, namely the Americans and the British, who, as the Brandt Commission put it, had "for unique historical reasons" an unusually large influence in establishing the system and subsequently controlling it, should have known better from the experience of the inter-war years.[5/] In the absence of satisfactory multilateral arrangements for the generation of liquidity the world was driven to relying on a country to meet the demands in liquidity by the creation of its national IOUs for use internationally. For this purpose, the country providing international liquidity has to either incur deficits on current account or make net investments abroad or, of course, do both in some combination. During the inter-war years this role was performed largely by the pound sterling. After World War II, the new system worked out at Bretton Woods surrendered this role to the dollar by making no arrangements for the Fund to create its own IOUs. When De Gaulle complained in the 1960s of the "exorbitant privilege" the system conferred on the United States of financing its deficits through the creation of more and still more dollars to be held abroad, he was not saying something new, he was only highlighting that an international monetary system relying on one or a few dominant national currencies to meet the requirements of international liquidity conferred enormous benefits on the countries issuing such currencies.

Such a monetary system, as Robert Triffin has been at pains to point out in his writings, is basically wrong because not only does it make the working of international monetary arrangements critically dependent on the decisions

of one or a few individual countries which can be highly erratic and unpredictable but also it entails a severely regressive distribution of resource transfer in favour of a handful of economically dominant countries. 6/ Not only are the developing countries altogether excluded from the benefit of such transfer but they also have to effect transfers in favour of the reserve-creating countries in the process of accumulating foreign exchange reserves. Thus, between 1944 and 1967, of the increase in non-gold reserves of the order of $ 20 billion, the benefit accruing to the developing countries (including the oil-exporting countries) can be placed at only $ 3.3 billion (i.e. 16.5 per cent)representing as it did the internationally created credit in the form of Reserve Positions in the Fund and SDRs allocations in their favour. Between 1967 and 1978, against the non-gold reserve additionality of $250 billion the corresponding benefit to the developing countries works out to $ 6 billion (i.e. 2.4 per cent). 7/ Even the above does not quite tell the whole story, because the developing countries have held an increasingly larger proportion of the world foreign exchange reserves. Between 1953 and 1978, foreign exchange reserves held by the developing countries increased by $ 112 billion. 8/ Thus nearly half of the resource transfer entailed in the generation of these reserves was from the developing countries to the developed countries, predominantely the USA.

Any major reform of the world monetary system must, first and foremost, attend to the question of generating reserves multilaterally. The attempts made so far in this context have been, as we shall note presently, not only half-hearted and peripheral but also extremely conservative and narrowly focussed with an almost pathological reluctance to break new paths. Attempts at multilateralisation of liquidity generation have taken the form of (a) enhancement in the quotas of Fund members and (b) allocation of SDRs. In addition, the Fund has engaged from time to time in (c) borrowing from some countries in order to increase its ability to extend credits; but it has refrained so far from (d) raising funds directly from the capital market although the capital market has engaged increasingly, in recent years, in financing of payments deficits on the strength largely of the funds it could attract from the surplus countries. The Fund also has (e) a stock of gold, a legacy from the old days when part of the quota subscription had to be paid in gold. This stock of gold has remained virtually sterile. In the rest of this section, an attempt has been made to indicate in the above order, the lines on which IMF reform could accelerate the pace of multilateralisation of liquidity generation from the point of view of the developing countries.

(a) Quotas

Fund quotas have not remained unchanged. They added up to only $ 9 billion at the start, at present they add up to $ 66.7 billion and are stated to rise to $ 99 billion by the end of 1983. However, as a proportion of the value of world imports, Fund quotas have been on the decline. To quote the Brandt Commission, "the ratio of IMF quotas to world imports, which averaged about 10 percent in the period 1960-65, is now down to little more than 4 per cent, though the sixth review of quotas has raised the level of quotas to SDR 39 billion and the proposed seventh review will increase them even further to SDR 58.6 billion".9/

The increase in quotas has the effect, no doubt, of raising the size of the pool of national currencies at the disposal of the Fund and thereby of improving its ability to extend payments support to its member countries in deficit. So it certainly can be said to multilateralise extension of international credit. But it cannot be said to multilateralise the generation of international liquidity. The generation of international liquidity remains the responsibility of individual countries. Fritz Machlup has aptly described the role of the Fund in disposing of the national currencies placed at its disposal as one of cloak-room. 10/

Still, quotas remain the principal source of the Fund's access to resources and if the view that this should continue to be the case prevails, expansion of Fund quotas will have to be pursued with vigour. Furthermore, if the choice were only between the generation of international liquidity by individual countries according to their own whims and fancies and its generation through the expansion of Fund quotas, there can be no doubt that the choice would have to be made in favour of the latter because then one can hope for the extension of credit to be (a) based on considerations less weighted down by national factors and bilateral relations and (b) less inequitous.

While it is true that the expansion in Fund quotas has occurred much more frequently in recent years than was the case in the past, the fact remains that in relation not

only to the expansion in world trade but also to the escalation in payments imbalances quotas have expanded rather tardily. According to an UNCTAD study, 11/ from an average of 84 per cent in the period 1966-70, the ratio of the quotas of the Fund members to the sum of their current imbalances fell 39 per cent in the years 1971-75 and to 27 per cent in the five years thereafter. Also, the Fund quotas have not kept pace with the expansion in international reserves and commercial bank lending. From 1970 to the third quarter of 1981, international reserves and commercial bank lending increased some seven times whereas the Fund quotas barely more than doubled. Naturally therefore the Fund's capacity to cope with payments imbalances has suffered a severe decline relative to other sources of payments finance.

As a first step to restore the Fund's role, urgent action will have to be taken to change radically the procedure currently followed for expanding Fund quotas. The present procedures whereby each expansion in quotas has to go through a process of reviews by the Fund management followed by approval at the levels of the Executive Board and the Board of Governors and has ultimately to be ratified by each and every government - the majority required is 85 per cent - make each expansion an independent, major decision subject to considerable non-economic pulls and pressures. As a result, not only is the time taken to complete every quota review long but also its outcome is extremely uncertain. It is necessary to provide, instead,for the regular expansion of quotas on the basis of agreed objective criteria, such as expansion in the value of world imports and the size of payments imbalances.

At the same time, the broader question about the role of quotas in determining the size of Fund resources cannot be overlooked in any discussion of IMF reform. The dominant view so far, that quota subscriptions should be "the primary source of the Fund's financial resources" is open to objection on several grounds. Experience has shown that, by being tied down to quotas, the Fund's resources failed to expand not only in relation to world trade but also sufficiently to cope with the demands arising from the switch over from the fixed to floating exchange rates in the early 70s. What should be a cause of serious rethinking, even though in retrospect, is that, while all fears with respect to the inflationary consequences of an uncontrolled expansion in international liquidity had been concentrated on the Fund, hardly any step was taken to restrain and regulate the expansion of international liquidity through national currencies and commercial bank credit. This way of managing world finance needs radically to be altered; to achieve this it will be absolutely

necessary that the Fund, if it is intended to perform a pivotal role in world finance, should be made the real fountain-head of international liquidity. In this context, quota subscriptions to the Fund will have to be treated more like the equity capital of a commercial bank and the Fund given wide powers both to create its liabilities or IOUs and thereby to generate international liquidity and also to regulate and restrain the generation of such liquidity in other quarters.

b.(i) Issue of SDRs

When the decision for the first issue of Special Drawing Rights (SDRs) was taken in 1968, it was heralded as a major step in the direction of multilateralising international liquidity and reducing the dependence for that purpose on national currencies. The Fund management itself had hoped at the time that when the allocation of the SDRs to the tune of 9.5 billion, then agreed upon, was completed, they would represent some 16 to 17 percent of the world monetary reserves and that as a consequence it would prevent the dependence of the world monetary system on the creation of currency reserves. Actually, by the time the allocation of SDRs was completed in 1972 the world foreign exchange reserves alone had increased to $ 104 billion. As a proportion of world non-gold monetary reserves, the SDRs stood at a mere 6 per cent in 1972. Inclusive of gold reserves, valued at market prices, only 4 per cent of world monetary reserves were accounted for by SDRs.12/

The second issue of SDRs to the tune of 12 billion, over a three-year period, 1979-81, could be agreed upon after a lapse of ten years, while the world financial system was flooded with liquidity generated by the national currency authorities and even more by the commercial banks. At the end of 1981, only 2.5 percent of the aggregate monetary reserves (including gold reserves) comprised SDRs in spite of the second issue. Thus not only were the hopes set initially on the SDRs falsified by the events but also the belief then entertained that the dominant view had at long last conceded the need for a substantial generation of international liquidity multilaterally proved to have a rather weak basis in reality.

It is important to note in our context that agreement on the issue of SDRs by the Fund was part of the package which stipulated at the same time how the SDRs would be allocated among the Fund's member countries. The SDRs were to be allocated to the member countries in the same proportion as their quotas. This meant not only that

almost 70 percent of the SDRs would be allocated to the industrial countries but also that the bulk, close to 60 percent, would go to countries with either payments surpluses or the privilege of financing deficits by issuing their own IOUs. By deciding thus, the Fund was clearly being denied the right to treat the SDRs as a source to be tapped for providing payments cover to member countries in deficit. On the other hand, it was being left to member countries to decide when and where to use the deposits thus created in each country's favour. Naturally, as Machlup has pointed out, it meant that while part of the newly created deposits going to deficit countries would "have a quick first round of spending", the part of these deposits going to the member countries in payments surplus or those who could issue their own IOUs would "never be used in even a first round of spending."[13] Thus, while of the quota subscriptions, subscriptions made in reserve currencies constitute the primary source of finance for the Fund's operations, in the case of SDRs the part allocated to the reserve currency countries is likely to remain altogether unused.

The SDRs can become an effective centre-piece of the international monetary system, if, as the Brandt Commission rightly urged, (a) "it becomes the principal means of increasing global liquidity" and (b) "it is itself used to improve the adjustment mechanism."[14] To achieve the first, it will be necessary to agree on the objective criteria on the basis of which SDRs can be created regularly and in sufficient quantities in accordance with what the Brandt Commission refers to as "non-inflationary demand for world liquidity". At the same time, further creation of national reserve currencies as well as new commercial bank lending will have to be severely curtailed.

b.(ii) Substitution arrangement

As for the problem posed by the massive overhang of national reserve currencies, in particular US dollars which account for close to 80 percent of the world foreign exchange reserves, the solution no doubt lies in pursuing the idea of a possible substitution arrangement. The idea of substituting SDRs for the reserve currency balances of the various monetary authorities is not new. Triffin, who has for long lamented over the system that permitted one national currency, namely the US dollar, to perform the role of reserve currency and forecast the emergence of a situation in which the dollar would continuously be faced with crisis of confidence is on record for having proposed large-scale replacement of dollar balances of the monetary authorities with appropriate internationally

created assets as part of a programme of international monetary reform.[15] Later, during the 1972-74 discussions within the Fund's Committee of Twenty, it was also recognised that suitable arrangements would have to be made for the substitution of excess holdings of dollars in the hands of various monetary authorities by SDRs as part of the reform effort in general and particularly in the context of an asset settlement arrangement, under which imbalances in payments of any country would not in future be settled by using its own currency. Unfortunately, none of the substitution account proposals has made much headway so far because of the inability to agree upon the asset settlement obligations of the countries now providing currency reserves. In particular, the US has shown no inclination to accept a reduction in the future reserve currency role of the dollar. During the 1972-74 reform discussion, the US was prepared to consider only such substitution arrangements as would offer to fund such of the dollar holdings of the other countries as are voluntarily surrendered and that too without accepting any limitation on its future method of payments financing. In more recent discussions when the substitution account idea was revived largely out of concern of countries like Germany and Japan which are reluctant to let their currencies play a major reserve currency role alongside dollars, the proposal had to be dropped once again because of the continued US rejection of any constraint on the privilege it enjoys of creating dollar liabilities abroad.

Whether the reserve currency countries, particularly the US, will be more or less receptive in the future to the demand for asset settlement obligation as part of a substitution arrangement is difficult to say. Going by the experience of the past ten years or so, the US position on the question seems to have hardened over the years. At least, there is no indication that it has softened. The substitution arrangement discussed in 1979-80 was far less demanding of the US than the arrangement which the Europeans mooted during 1972-74 reform discussions even though the overhang of dollars has become far more formidable in recent years than ever before notwithstanding the phenomenally large expansion of Eurodollar credit, by the US-dominated commercial banks no doubt, in the intervening years. It might be therefore quite unrealistic to assume that much progress can be made towards a substitution arrangement that requires the reserve currency countries, in particular the US to agree to any sort of asset settlement obligation.

In the circumstances, would it be worthwhile to pursue the substitution arrangement idea? In this context, it is important to bear in mind that, really and truly,

a substitution arrangement involves the creation of international credit with a view to funding the external obligations of the reserve currency countries. It is basically no different from that of rescheduling the external debt of a country. The difference is that the reserve currency countries have come to realise that the size of their external obligations is of less concern to them than to those who hold these obligations as their reserve. So, why should the reserve currency countries agree to limit the creation of their obligations in the future? It is the reserve accumulating countries which will first have to agree not to accumulate further reserves in the form of national currencies. This they will be more willing to do, the more they are attracted to the alternative offered to them in the form of SDRs or SDR-denominated claims. The Fund can do a lot in this regard by making the holding of SDRs and SDR-denominated claims sufficiently attractive to hold in terms of both yield and usability. It is not in the interests of the developing countries to keep the yield on SDRs low or to restrict the usability of SDRs.[16/]

From the point of view of promoting multilateral generation of international liquidity, it is important that any substitution arrangement must provide for adequate safeguards that the national reserve currencies do not expand at the same time and add to international liquidity. In other words, an effective and comprehensive asset settlement must be agreed upon before a substitution arrangement comes into effect. [17/]

b.(iii) SDR allocation

Not only have the issues of SDRs been small in amounts and far between but, as noted earlier, the allocation of SDRs on the basis of quotas is both inequitable and contrary to what any need-based criteria would suggest. The question of further issues of SDRs cannot therefore be divorced from the allocation formula. If quotas remain the basis for allocation, not only will every SDR issue aggravate the inequality in the distribution of multilaterally created liquidity but also every such issue will have to be far larger to meet a given estimated need for international liquidity than if allocation is need-based.

The case of the developing countries for linking the issue of SDRs to development finance and allocating therefore the SDRs newly issued by the Fund to the developing countries is primarily actuated by the objective of making SDR allocation need-based. The Brandt Commission fully conceded this case when it suggested that new SDRs should

be allocated to "countries which are most likely to experience balance-of-payments deficits and high domestic costs of adjustment and least likely to be able to finance them from alternative sources". Since "many developing countries fit into these categories", the Commission felt that there was "therefore a strong case based on efficiency as well as equity for a larger share of new unconditional reserves to be distributed to the developing countries than is achieved through allocations proportional to the IMF quota system". 18/

Still, it has to be faced that a possible major factor coming in the way of more regular and larger issues of SDRs is the strong, persistent demand for linking the SDR issue to development. To the extent this is valid, the developing countries may have to show some flexibility in this regard. This is a concession they will be making to the reality of world politics. That SDR allocation must be need-based cannot and ought not to be given up. But whether a need-based allocation must necessarily be in favour of countries regardless of their immediate balance of payments need, or in favour of an institution like the Fund itself, which can then dispose of the resources thus placed at its command according to objective criteria,with minimum relationship of member's access to quotas, is something that the developing countries should be prepared to treat as an open question.

(c) Borrowing from member countries

Although the Fund has, as indicated above, relied principally on quota subscriptions for the resources it requires to finance its type of payments support, it has, from time to time, entered into agreements with the member (and even non-member) countries to borrow temporarily both for special purposes as well as for supplementing its general resources. 19/ The earliest such arrangement, entered into in 1962, was, as stated earlier,the GAB specially devised for exclusive use by a small group of industrial countries (G-10) with a view to extending help to each other on soft terms and conditions but under the Fund's auspices. The Fund borrows from the participating countries in certain specified proportions as and when it needs to extend assistance to any of these very countries. Most recently, it has been decided to enlarge the GAB from $ 7.1 billion to $ 19 billion and to make its GAB resources available for conditional assistance even to non-participant countries.

In 1974 and 1975, the Fund entered into borrowing agreements with 17 lender countries, including Switzerland (which, though a non-member, also contributed to GAB) with a view to raising an amount of $ 7.6 billion for the Oil Facility which was set up temporarily to finance special low-conditionality Fund credits to countries with payments difficulties in consequence of the oil price rise.

In 1979, the Supplementary Financing Facility was established, funded by borrowing to the tune of $ 8.6 billion from 14 lenders including Switzerland. This was in response to the second round of oil price increases but the Fund credits to be financed out of this facility had to carry high conditonality.

As the resources raised for the Supplementary Financing Facility came to be committed, the Fund negotiated another set of borrowing agreements. The principal lender this time was Saudi Arabia which undertook to lend the Fund up to $ 5 billion annually for three years starting with 1981. Another set of 18 countries also undertook to lend the Fund a total amount of $1.5 billion over a two-year period. The resources thus raised by the Fund were again supposed to finance high-conditionality assistance to member countries under its policy on enlarged access.

The outstanding borrowing of the Fund on April 30, 1982 added up to $ 7.5 billion - 11 percent of the total value of Fund quotas. However, when the unused credit lines amounting to $16.5 billion are added to outstanding borrowing, the total was equal to 34 per cent of quotas. Since under the present guidelines for Fund borrowing the outstanding borrowing plus unused credit lines must not exceed the range of 50 to 60 per cent of quotas, the maximum amount the Fund might borrow additionally as from May 1, 1982 could not exceed $ 11.6 billion. [20] That, more or less, equals the amount by which the credit line to GAB has been raised. Of course, one has to make note of the provision that under the guidelines referred to above "in respect of the GAB either outstanding borrowing by the Fund under the GAB or one-half of the total credit lines under the GAB, whichever is the greater, has to be taken into account." [21] Therefore, of the enhancement of GAB by about $ 12 billion, only half will count towards determining whether the ceiling has been reached or not, so long as less than half GAB credit line has actually been used by the Fund. Also, with the enhancement in quotas to $ 99 billion likely to come into effect towards the end of 1983, the ceiling on Fund borrowing should rise by $ 18 billion. So the scope for Fund borrowing is not so bad, judging by the level of Fund quotas or even by the level of outstanding

Fund borrowing. However, if one goes by the pace at which the total drawings of the member countries have been rising - from around $ 3.5 billion in 1974 they have gone up to $ 7.7 billion in 1982 22/ - or by the escalation in the payments deficits of the non-oil developing countries - the group that alone has, in recent years, resorted to the Fund - the increased borrowing that the Fund can rely upon, to augment its resources within the framework of its existing guidelines, will appear to be very modest indeed.

There are, in addition, two basic questions with regard to Fund borrowing. One concerns the linking of Fund borrowing to its quotas. If, as has been argued above, Fund quotas ought to be treated more like the equity of a banking company than as a yardstick to Fund borrowing, as at present, this practice cannot but be considered as extremely restrictive. The less the Fund depends on quotas to provide it with its major resources, and that is how it should be regardless of whether or not the proposition put forth later in this paper with regard to the re-distribution of quotas, the more it will be necessary to relax the limits on Fund borrowing. As a first step, the minimum immediately necessary action called for is to raise the ceiling on Fund borrowing to 150 percent of quotas to come into effect by the end of 1983. However, as a measure of basic reform, it would be advisable to delink Fund borrowing altogether from quotas and instead relate it to factors such as anticipated payments imbalances, the likely demand for Fund support and the Fund's access to other resources.

(d) Borrowings from private market

The second question concerns the sources the Fund should be allowed to tap for the purpose of its borrowing. The Fund has so far been restricted to borrowing from governments/monetary authorities, and, more or less, precluded from resort to the private market. Although lately it has been conceded that the possibility of the Fund resorting to the private market cannot altogether be ruled out, the dominant view has prevented this from coming about. At the same time, phenomenal expansion has been allowed to take place, virtually unchecked, in the size of the private market. The aggregate of bond issues plus net bank credit expanded from some $ 60 billion in 1970 to $ 85 billion in 1972; thereafter it expanded to over 1,000 billion by the end of 1982, with both the national monetary authorities as well as the Fund acting as virtual spectators. While the question of instituting some system of international surveillance over this market and the

Fund's role in exercising such surveillance is dealt with later in this paper, it ought to be said, right at this stage, that by denying the Fund access to the private market not only has the international community foresworn the use of a major, proved instrument of central banking control, namely open market operations, at the international plane but also it has left untapped a major source of finance for the Fund's operations. Indeed, if the Fund had a relatively greater access to the private market it could possibly have responded much more effectively to the situation that emerged after the first and second rounds of oil price increases as a result of immense payments surpluses on the one hand and equally large deficits on the other. Also, the Fund's access to the market would have reduced its dependence on governments, for, direct or indirect, budget support is not always easy to extend because of domestic budgetary consideration for even the most well meaning political leadership at the national level.

(e) Activation of gold stock

The gold holdings of the Fund are now worth about $ 45 billion. Various suggestions are afloat with regard to the disposition of these holdings. They fall into broadly two groups: (1) suggestions for the sale of gold and using the proceeds or profits only for development finance and (2) suggestions for "restitution" to the member countries. While gold has formally been demonetised, in the sense that not even reserve currencies are obliged to maintain a gold value, the fact remains that the monetary authorities still hold on firmly to their monetary gold stocks. Restitution would only mean transfer of gold from the Fund to national monetary authorities. The suggestions for sale seem to be unacceptable, although that seems to be the right course to adopt, regardless of how it is decided to make use of the sale proceeds. If the proceeds cannot be used for development finance, they could go to augment the pool of resources the Fund can use for extending payments support to member countries. In the event that even this is not acceptable, the Fund should then be able to use its gold holdings as collateral to borrow from the market. Of course, the question of using gold as collateral arises only if it is decided not to let the Fund borrow on the basis of its need, as proposed above.

II. Extension of Payments Finance and Conditionality

Right from the start, a major issue to sort out in the negotiations leading to the Bretton Woods arrangements was about the symmetry of adjustment action by the

countries in payments surplus as well as deficit. In the actual working of the old arrangements however, not only did the burden of adjustment fall more and more on the countries in deficit but alsc among the countries in deficit a great divide emerged. This was the divide between the reserve creating deficit countries (principally the US) and the non-reserve creating deficit countries. While the former could finance almost any amount of payments deficit by the creation of its external IOUs, the latter had to look around for necessary finance. Naturally, therefore, the burden of adjustment fell almost wholly on the latter. With the collapse of the Bretton Woods system, the former were released from whatever obligations they had undertaken to maintain the exchange value of their reserve currencies and there has, as a result, been a virtual flooding of the world with reserve currencies. The relative position of the non-reserve creating deficit countries, on the other hand, can be said to have suffered a set back except that those of this large group of countries which, for various reasons, enjoyed access to the emerging, fast expanding private capital market for their payments finance were, temporarily at least, in a position to cope satisfactorily with their payments deficits which started mounting in consequence of the drastic deterioration in terms of trade following the increases in oil prices.

Since a loan by its very nature, once taken, must be serviced, that is, repaid with interest, it goes without saying that a country incurring a loan must take suitable steps to make sure that it can service its debt according to schedule. The borrowing country has therefore to take appropriate measures to make sure that it will not default in the servicing of the debt it is incurring. Of course, it depends considerably on the terms and conditions at which a borrowing country can raise external finance how much latitude it really has in the choice of measures to be taken in order to generate the required debt servicing capability. But there is absolutely no question that a country cannot go on incurring payments deficits, unless, of course, it is a reserve currency country whose IOUs are acceptable as reserve by the reserve accumulating countries.

Also, as the Secretariat document prepared for UNCTAD VI [23/] points out, much depends on the causes behind a country's payments deficit. Is it a deficit that is expected to reverse itself in the short-to-medium term? That would be the case when a temporary downturn takes place in commodity prices because of recession in the importing countries or when because of crop variations the import bill goes up or when interest payments go up on

debt contracted at variable interest rates. Or is it a deficit caused by an irreversible drop in a country's terms of trade? Or is it a consequence of the country's own domestic inflation? When a payments deficit is the result of domestic demand expansion, a policy of disinflation, combined where necessary with exchange rate adjustments designed to offset the rise in domestic prices, can generate the necessary correction in the country's payments position. When a deficit is the outcome of temporary, reversible causes, the appropriate response is to finance such a deficit rather than incur the costs associated with changing the level of demand and output which would have to be reversed at a later date. This indeed is the rationale behind the Compensatory Financing Facility (CFF) which the Fund has already had in operation for several years now. However, when a deficit is caused by an irreversible factor, it creates a structural imbalance calling for an adjustment in the structure of supply. Such a structural adjustment can be both costly and time-consuming. In order for a country to apply the right remedies, it is necessary first to have a correct diagnosis made of the nature of its deficit and then to ensure that the diagnosis is backed by finance in adequate quantities and on appropriate terms and conditions.

The recent escalation in the payments deficits of the developing countries has been the consequence of a sharp drop in both their terms of trade and finance. As the IMF Annual Report 1982 notes, more than two-thirds of the deterioration in the payments position of the non-oil developing countries from 1978 to 1981 was due to adverse movements in terms of trade and the rising cost of debt servicing accounted for the major part of the remaining third. The latter was a clearly temporary phenomenon. Also, some part of the deterioration in terms of trade caused by the cyclical downturn could be considered temporary. Both call for adjustment action on the part of the developed countries in the form of reflation of their economies and lowering of interest rates whereas the enduring component represented by permanent changes in terms of trade calls for structural, supply-adjustment measures in the developing countries. Thus the present situation clearly calls for a substantial availability of bringing finance to the developing countries on conditions which do not force them to take measures that may impose unnecessary sacrifices on them in the name of adjustment action. In fact the IMF itself advised countries with payments problems arising in the wake of the first round of oil price rises not to resort to adjustment action such as "deflationary demand policies, import restrictions and general resort to exchange rate depreciations" because

"it would serve only to shift the payments problem from one oil-importing country to another and to damage world trade and economic activity".[24] It is only after the second round of oil price rises that the IMF has made the major change in its stance and has stridently been calling for strong policies of aggregate demand restraint and realistic exchange rate adjustment on the ground that since the payments deficits are structural rather than transitory they are not amenable to correction over a short period of time.[25] But the argument offered altogether overlooks that the structural cause of the recent payments deficits has little to do with demand expansion and that adjustment action, if any, has to concentrate on the supply side.

The Extended Fund Facility(EFF) is meant to enable the Fund to offer support for a multi-year programme to deal with the structural disequilibria requiring extensive changes in the member countries' economies, including changes in the pattern of production. In practice, however, as has been pointed out by Ariel Buria, most of the so-called structural adjustment programmes designed by the Fund for borrowing member countries availing themselves of this facility, "remain essentially a chain of conventional demand management programmes built around the usual ceilings on credit expansion, fiscal deficit etc. to which ad hoc measures of trade liberalisation and production incentives have been added to stimulate a supply response". [26] Though the number of Fund-supported multi-year programmes has increased relative to one-year programmes, it ought also to be noted that the difficulties of member countries in meeting the Fund's performance criteria have led to a large number of the programmes, particularly multi-year programmes, being discontinued. In 1981 alone, the value of cancellations of Fund programmes added up to $ 2.7 billion, which was more than thrice the total value of the cancellations in the preceding three-year period. It would not be unfair therefore to raise doubts even at the practical level about the appropriateness of the conditionality the Fund is currently intent on imposing on the borrowing member countries.

Two aspects of Fund conditionality need urgently to be attended to. First, the content of a Fund conditionality package has to be delinked from the size of a country's payments deficit. Instead, the conditionality package has to be designed on a case-by-case basis depending upon the factors leading to the deterioration in the payments position of a country. To the extent the deterioration is temporary and reversible, it should be financed in the manner in which temporary

shortfalls in commodity export earnings are sought to be offset through the Fund's CFF. In fact, there is an urgent need to liberalise this facility considerably in several respects. If drawings from this facility have to continue to be tied to quotas, then the present ceiling of 125 per cent on cumulative drawings will have to be raised substantially to accomodate much larger use of this facility in line, at least, with the increase in limits on credit tranche drawings from 150 per cent to 450 per cent. As the UNCTAD document refered to above notes, while drawings equal to 125 per cent of quota would have, in the years 1966-1970, financed an overall deficit of a "representative" member country for 21 months, they would have covered that deficit on average for only seven months in the years 1976-1981.[27] Since the quotas themselves are being increased by roughly 50 per cent by the end of 1983, in order to restore the relative position of the facility it will be necessary to raise its quota-related ceiling on drawings by members to 250 per cent. If the facility is also to support deterioration in payments for temporary or reversible causes other than shortfalls in commodity export earnings (and increases in the cost of cereal imports, a purpose that the facility has lately been allowed to accomodate) the ceiling would have to be fixed even higher.

Secondly, when it comes to dealing with the deterioration resulting from more enduring factors, a clear distinction must be drawn between demand and supply adjustment required for restoring the payments position to health. The Fund's bias in favour of demand adjustment action needs severely to be restrained. Also, to the extent adjustment action is required on the supply side, the Fund should be prepared to extend support for programmes designed to meet the situation in sufficient amount and for a period long enough to show results. For this purpose again, the Fund must not be restrained, as at present, by a ceiling on Fund support tied to quotas. In any case, the present ceilings on annual and cumulative drawings of 150 per cent and 450 per cent of even revised quotas, coming into effect at the end of 1983, may be insufficient to accommodate the genuine need for Fund support from member countries when they face irreversible deterioration in their payments position.

The higher ceilings on drawings, as recommended, should not be difficult to accomodate, once it is agreed to allow the Fund to supplement its resources both by the regular issue of SDRs for financing its own operations rather than for allocation to member countries and by resort to the private capital market, in addition to

borrowings from governments or their monetary authorities, on the basis of need-based criteria.

III. Relationship with Commercial Banks

Reference has been made above to the phenomenal role the international capital market has come to play in payments financing in recent years. As the IMF Annual Report 1982 puts it, "the rapid growth of private international lending has reflected not only an increase in flows between industrial countries but also growing use of these markets by developing countries". 28/ This started happening at a particularly rapid pace after the first round of oil price increases in 1973-1974. Indeed, the recycling of payments surpluses of the oil-exporting countries to the oil-importing deficit countries was done primarily through the intermediation of the commercial banks. The role of the IMF and other multilateral arrangements was only marginal in the financing of the payments deficits. Of the total net external borrowing of the non-oil developing countries to the tune of $ 76 billion during the three years 1974-1976, while as much as $ 36 billion (45 per cent) came from private sources, the Fund's contribution (by way of various types of support including that from the Oil Facility) added up to a mere $ 6.1 billion (8 per cent). During the three-year period 1979-1981, following the second round of oil price increases, while the net borrowing by the non-oil developing countries was as high as $ 190 billion and the contribution of the private sources was also higher at 60 per cent, the Fund's relative support was lower at 4 per cent. 29/ Taking the whole decade of 1970-1979, private flows, other than direct foreign investment, rose from less than 20 per cent to more than 40 per cent of the payments finance drawn upon by the non-oil developing countries; in the same period,the proportion of such finance covered by bilateral and multilateral official development assistance fell from 60 per cent to 40 per cent.30/ There can be no doubt, therefore, of the increasing dependence of the developing countries on the private capital market for payments support.

The new pattern of financial flows, as the UNCTAD document referred to above points out, has had important implications for the distribution of available foreign funds among developing countries and for their burden of interest costs. Borrowing from the international capital market has been not only large but also highly concentrated, the main recipients being a limited number of countries with relatively high levels of per capita income. 31/ Thus practically the whole of Euro-currency financing raised by

non-oil developing countries in 1978 and 1979 was accounted for by countries with per capita income above $ 500. Indeed, in early 1980 lower-income developing countries actually had deposits in the Euro-currency market of a value larger than loans they received from the market.

At the same time, the countries which came to depend heavily on borrowing from private capital markets not only accumulated large amounts of debt from this source but also became increasingly vulnerable, as a consequence, to the high and fluctuating costs of debt servicing. The market rate on Euro-currency lending, the principal source of commercial bank finance, has been subject to wild fluctuations since the mid-1970s; it has also manifested a marked upward trend in recent years. 32/

The rapid build-up of the external indebtedness of the developing countries to commercial banks has now reached a stage 33/ where fears have been expressed more and more about the increasing exposure of the banks to developing country borrowers. This has coincided with the particularly difficult liquidity, as well as payments, position which the major borrowing countries (along with all the other developing countries) currently face in consequence of the sharp deterioration in their terms of trade and finance. In the circumstances, it is of great interest to the developing countries in general, and particularly those indebted heavily to the private banks, what role the IMF plays in not only sorting out the payments problems immediately arising on account of the debt servicing liabilities falling due, but also establishing a long-term, stable relationship between the commercial banks and the developing country borrowers which is at the same time less volatile and fluctuating than it has proved to be so far, particularly in recent months.

In recent months, as the liquidity position of some of the major borrowers among the developing countries deteriorated sharply, the IMF has been called upon to intercede between the commercial banks on the one hand and the concerned borrowing countries on the other with a view primarily to rescheduling debts and debt servicing. Though the Fund's own access to resources is limited, it has succeeded in hammering out case-by-case arrangements whereby crises have been successfully overcome and the much feared collapse of the private capital market averted. But it has thrown doubt on the future role of the commercial banks in the financing of the payments of even those of the developing countries which enjoyed access to them so far.

As the Fund Managing Director observed recently, 34/ the degree of exposures of the commercial banks coupled with the emergence of debt servicing difficulties in several of the largest debtor countries almost simultaneously in the latter part of 1982 have sharpened bankers' perception of the risk in lending to the non-oil developing countries. They may therefore be much more restrained in their future lending to these countries. The Fund Managing Director felt that while over time this general reassessment by the commercial banks should strengthen the system, it will be important to see that in the immediate future an indiscriminate or abrupt retrenchment of bank lending is avoided. If that were to occur, it would, he felt, force adjustment on deficit countries on a scale and in a time frame that would be disruptive and harmful to creditors and debtors alike. His message therefore for the immediate future to the commercial banks was clear; it was in their own interests not to push the borrowing countries to the wall. Going by the Fund's experience in hammering out recent rescue arrangements for the countries in trouble, it is evident that the banks got the message right and have agreed not only to reschedule debts but also to lend afresh, although much of the new lending covers only the interest payments falling due. The banks committed these new amounts in parallel with the Fund.

The Fund's success in working out the rescue arrangements has encouraged it to claim that the present international financial system has shown both its resilience and its adaptability. The Fund Managing Director remarked that the Fund, the BIS, the central banks and the commercial banks, "have shown a capacity to handle crisis in full cooperation and in a quick, pragmatic, and effective way". 35/

Three sets of questions arise in the above context. First, even assuming that the Fund Managing Director has not spoken too soon, what is important from the point of view of the developing countries is not whether future crises faced by individual countries can effectively be met on the basis of the new ground broken in the relations between the various institutions mentioned above, but whether in future conditions can be created under which such crisis situations have little chance of recurring. Will the banks be as amenable to pressure and advice in non-crisis

situations as in crisis situations? Must these banks continue to be allowed to engage in international financing operations on the scale and in the manner of the recent past without effective, multilateral control? And if controls are necessary, what role will the IMF play in the exercise of such control? Additionally, if the objective is to expand international credit in line with the non-inflationary requirements of world trade, the role of the commercial banks will have to be kept within strict limits which are effectively enforced. This is as important as curbing the creation of national IOUs for use as international reserves. Finally, it is important that access to market finance is much less unevenly provided to the various countries in need of payments support than has been the case so far. To achieve these objectives, the Fund will need to be given an effective say, something that it now is completely denied, in the overseeing of the international operations of the commercial banks. Fund surveillance will therefore need to be made more comprehensive so as to cover not only the reserve creation by national governments but also the international operations of the commercial banks in so far as they result in the generation of international liquidity.

IV. Regional Monetary Unions

Any scheme of IMF reform will have to take note of the possibility that at regional and sub-regional levels member countries of the Fund may follow the lead of the European Monetary System (EMS) and establish institutions with a view not only to stabilising their mutual exchange rates but also to reducing the variability of their exchange rates with countries outside the regional or sub-regional arrangements. While this is no place to go into the pros and cons of regional and sub-regional arrangements between countries, particularly of countries the bulk of whose trade may be with countries outside the region or sub-region, the possibility of such arrangements emerging within the foreseable future cannot be ruled out, especially if effective steps are not taken at the global level to move towards a system of exchange rates whose variability can be kept within certain acceptable limits.

It will have to be recognised that whether or not the European Monetary System has, in the four years of its existence, fulfilled all the high hopes and expectations set on it when it was established, the system has, as a recent Fund study brings out, not only worked quite smoothly in an operational sense, which in itself is said

to be quite an achievement, but also avoided major exchange rate disruptions. At the beginning, it was feared that, under the system,the required exchange rate changes might not be undertaken in time or to the extent required. Actually, the system proved to be much less rigid than initially feared. It was still possible to bring down exchange rate variability. In fact, as the Fund study referred to above observes, "this stabilising influence has spread to the exchange rates of those European countries outside the EMS which have close economic and financial ties to EMS participants". 36/

Among the developing countries, the experiments with earlier payments unions have not been as rewarding as originally believed. So it can certainly be argued that these countries may not be attracted to the suggestions for monetary unions. While this argument cannot easily be brushed aside, it has, at the same time, to be recognised that since the payments strains on the developing countries are significantly greater than ever before they may be much more receptive to ideas on effective payments union arrangements than in the past. And if the idea of a payments union takes firmer root in the changed circumstances of today, there is every chance that the new payments union schemes will incorporate ideas on monetary cooperation as well, if for no other reason than to strengthen the ability of the arrangement to settle the payments between its member countries.

Of course, there is no question of the Fund not allowing member countries to form regional/group payments-cum-monetary unions. But can it not be much more positive in this regard? Should it not actually promote the formation of such unions so that the concerned countries are enabled thereby not only to make much better use of their national gold as well as foreign exchange reserves to finance their collective payments deficits,but also to expand mutual trade and economic cooperation?

V. Participation in Decision Making

The much expanded role for the IMF envisaged in the proposals made above is predicated on a radical re-thinking in regard to the sharing of decision making among the Fund member countries. The present arrangement is extremely one-sided: it gives to the industrial countries close to 70 per cent of the voting power and to one country, viz., the US - with over 20 per cent of the voting power - a virtual veto over practically all the major Fund policy decisions since they must be carried by 85 per cent majority. It is an arrangement that the non-industrial participants

cannot be happy about, even if the industrial countries had been less mindful of their own individual and group interests while participating in the Fund's decision making. Actually, the non-industrial countries have reason to complain that the decision making in the Fund has been directed principally to promoting the interests and meeting the concerns of the industrial countries. Benefits, if any, for the non-industrial countries have followed mainly as by-products.

As the Brandt Commission perceived it, "the new international monetary system should have a pluralistic basis, in which no single political entity or small group of entities plays a predominant role". The Commission called for a broad-based leadership to manage the international monetary system and suggested, for that purpose, "clear, fair and explicit rules for managing the system, rules which will protect the interests of all members of the system, including the weaker ones". Such rules, the Commission felt, "must ensure that the Fund is not wholly administered on the basis of shareholding". The Commission specifically asked that "the participation of the developing countries in the staffing, management and decision making of the IMF should be enlarged". 37/ It is worth noting in this context that under the EMS, while each country was obliged to contribute to the European Monetary Cooperative Fund (ECMF) 20 per cent of its gold and dollar reserves, so that their contributions varied considerably, exchange rate changes were to be a matter of common decision making requiring unanimity among EMS participants. No country, however large its contribution to ECMF, enjoyed a dominant position by virtue of its reserve contribution. As has been noted already in this paper, the smooth operation of EMS during the past four years of its existence has not suffered on this score.

In order to broaden the base of Fund decision making, it is necessary as a first step to re-allocate quotas among member countries so as to enhance the voting power of the developing countries. In this context, it is appropriate to refer to the latest communique issued after the February 1983 meeting of the Intergovernmental Group of 24 on International Monetary Affairs (G-24). The group emphasised "the urgency of a comprehensive re-examination of the economic criteria and the weights to be attached to them in quota formula so as to reflect the financing needs of members". More specifically, the group asked that "the quota share of the developing countries should go up to 45 per cent". The group asked also for "a special adjustment in quotas of small countries, including small island economies, having regard to their size,

openness and limited access to capital markets and their narrow productive and export base". [38]

Reallocation of quotas and therefore voting rights should, it is felt, be less difficult to agree upon, the less the Fund is dependent on quotas as the principal source of its resources. In this context, the reforms suggested earlier in the paper in regard to the regular creation of SDRs for the Fund's own use and the Fund's access to capital markets assume importance.

VI. Concluding Observations

Since the collapse of the Bretton Woods System in the early 1970s, it has not been possible to agree upon a comprehensive substitute system. What has been in place ever since is an *ad hoc* arrangement combining decisions taken on various issues as and when their consideration could not be deferred any longer. There is a widespread recognition now that this "adhocism" must give way to a properly thought out financial system for the sake of a smooth working of the world trading system. This recognition is not confined to the developing countries only, though they insist that any new arrangement must not overlook their interests.

Whatever new system is thought up, it may well be in everyone's interest if the system makes use of the existing institutional arrangement to the maximum extent possible instead of dismantling altogether the existing institutions and building everything from scratch. It is in this spirit that this paper has sought to offer ideas on IMF reform.

Notes and References

1. Author's own calculation. The figure for the period 1960-65 works out at 10 per cent, as per Brandt Commission's calculation; see North-South: A Programme for Survival, The Report of the Independent Commission on International Development Issues under the Chairmanship of Willy Brandt, Pan Books, 1980 (elsewhere referred to as Brandt Report), p. 213.

2. In four years, 1946 to 1949, the US surplus on current account excluding transfers was $32.8 billion; in the subsequent five years, 1950 to 1954, it was only $13.1 billion. Transfers in the former period added up to $17.1 billion as against $14.8 billion in the latter period, when the balance on current account including transfers had been converted from an earlier sizeable surplus into a deficit. See The Economic Report of the President 1982, Washington D.C.

3. Between 1952 and 1962, the decline was of the order of 30 per cent, from $24.7 billion to $17.2 billion. See The Economic Report of the President 1982, Washington D.C.

4. These ten industrialised countries comprise the Group of Ten.

5. See Brandt Report, p. 202.

6. See Robert Triffin, International Monetary System, Yesterday, Today and Tomorrow, Random House, 1968, p.87.

7. Author's own calculation based on the data published in the International Financial Statistics, a regular publication of the IMF. It is to be noted also that only a handful of the developing countries, mostly oil-exporting, have been able to have a Reserve Position in the Fund.

8. Author's own calculation.

9. See Brandt Report, p. 213.

10. See "The Cloakroom Rule of International Reserve Creation and Resource Transfer" in R.N. Cooper (Editor), International Finance, Penguin Modern Classics, 1969.

11. See UNCTAD VI Policy Paper on International Financial and Monetary Issues (Document No. TD/275 of 26 January 1983) p. 30.

12. Author's own calculations.

13. See "Cloakroom Rule.......", op cit.

14. See Brandt Report, p. 210.

15. See his Gold and the Dollar Crisis, Yale University Press, 1960.

16. See Robert Triffin, "'Europe and Money Muddle' Revisited", Banca Nazionale del Lavoro, Quarterly Review, Vol. 31, 1978.

17. See Brandt Report, p. 210.

18. Ibid, pp. 211-2.

19. See IMF, Annual Report, 1982, p. 84.

20. Ibid, p. 85.

21. Ibid, p. 162.

22. These exclude interest subsidy receipts of the member countries of $36 million in 1982, out of the special accounts administered by the Fund.

23. See UNCTAD, op cit, pp. 25-6.

24. See IMF, Annual Report, 1974, p. 26.

25. See IMF, Annual Report, 1980, p. 18.

26. See his "IMF Financial Programmes and Conditionality" cited in UNCTAD, op cit, p. 33. See also I.S. Gulati, IMF Conditionality and Low Income Countries, Kale Memorial Lecture, Pune, 1982.

27. See UNCTAD, op cit, p. 30.

28. See p. 70.

29. See IMF, World Economic Outlook, Occasional Paper 9, 1982, p. 167.

30. See UNCTAD, op cit, pp. 15-24.

31. See UNCTAD, op cit, p. 16.

32. The quarterly average for 6 months' LIBOR varied between 5 per cent and 15 per cent during 1974-79. At times, during 1980-81, it reached 17-18 per cent Lately, however, it has come down to just below 10 per cent. See UNCTAD, op cit, p. 49.

33. By the end of 1981, almost 60 per cent of the total outstanding long-term debt of the non-oil developing countries was owed to private creditors. See IMF, Annual Report, 1982, p. 36.

34. See J. de Larosiere, The IMF and the Developing Countries, Address at the University of Neuchatel, Switzerland, on March 3 1983.

35. Ibid.

36. See IMF, The European Monetary System. The Experience, 1979-82, Occasional Paper 19, 1983, p. 9.

37. See Brandt Report, p. 220.

38. See IMF Survey, February 21, 1983.