INTERNATIONAL MONETARY REFORM:

CONTENT AND PERSPECTIVE

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PREFACE

In this Research Paper, Dr Deane surveys both the achievements and the failures of the recent exercises in international monetary co-operation which have been pursued under the auspices of the International Monetary Fund, and which have culminated in the preparation of the second Amendment of the Fund's Articles of Agreement. In particular, he covers the background of the events leading up to the formation of the Committee of Twenty, and its successor, the Interim Committee. The Research Paper then goes on to describe and analyse the various facets of the so-called reform, including reference to the adjustment process, convertibility, the role of reserve assets (gold, special drawing rights and currencies), and a range of other aspects covered by the amended Articles. In addition, there is some discussion of recent changes to the IMF's lending or "drawing" facilities, changes which formed an integral part of the package of measures finally agreed upon by the Interim Committee at their Jamaica meeting in January, 1976. These changes, including those envisaged by the amended Articles, have important consequences for the international community and, as time goes by, they will have both direct and indirect implications for New Zealand. Accordingly, it seemed useful to make available to a wider audience within New Zealand the sort of information provided by this Paper.

Dr Deane writes with the knowledge of an "insider" and discusses in some detail the stances that have been adopted by different groups with respect to the range of issues involved in international monetary reform. He also touches on the sensitive question of relationships between the Fund and national monetary authorities.

Finally, the Paper surveys some of the issues which remain unresolved. Dr Deane concludes that floating exchange rates have modified attitudes towards such questions as convertibility and the adjustment process, and have eased but not removed the problems relating to speculative capital flows that seemed to be widespread during the period of par values and pegged exchange rates. The Paper refers to the Fund's accommodation of the changes in international monetary relationships, albeit slowly and perhaps even reluctantly. This is illustrated by the final legalisation of the floating regime, long after events had rendered parts of the old Articles obsolete; and by the changes with respect to gold and SDRs which, although they move in the general direction of enhancing the SDR and diminishing the role of gold, appear to have less substance in fact than in spirit.

Nevertheless, we should now have more flexibility both in the system itself, and in the legal framework provided by the IMF's Articles, and this is to be commended. As to the Fund's surveillance over members' exchange rate policies, and its role in encouraging appropriate adjustment policies, it must remain to be seen whether the new Articles will in practice strengthen the Fund's hand in these areas. Whatever happens in this respect, the monetary system still remains completely dependent on close international monetary co-operation, and the IMF must continue to be a vital element in promoting such co-operation.

A. B. Sturm.

INTERNATIONAL MONETARY REFORM: CONTENT AND PERSPECTIVE

R. S. DEANE[1]

1. INTRODUCTION

Recent agreements reached by the Interim Committee on a range of international monetary matters have been variously claimed in the news media to represent either the completion of the so-called monetary reform exercise or, less extravagantly, a major step in an evolutionary process towards such reform. The publicity has no doubt been provoked partly by the optimistic claims of the leading finance ministers comprising the membership of the Interim Committee, some of whom clearly had a particular interest in ensuring a successful outcome to the extended negotiations on monetary reform; and partly by the news media's own wish or need to believe that some positive results must eventually emerge from such a protracted series of high level meetings. Following the January 1976 meeting of the Committee in Jamaica, where final agreement on many issues was indeed achieved, many press reports reflected something of the widespread sense of relief that, at last, perhaps some progress had been made in the discussions.

In the aftermath of this publicity, it may be useful to review briefly the circumstances leading up to the latest accord, the major elements of the agreement, and the significance of some of the topics which ended up being omitted from the final compromise. Moreover, during the course of the discussion, it may not be inappropriate to attempt some assessment of where matters now stand with respect to the various issues underlying monetary reform.

An appendix sets out some of the more direct implications of the partial reform for New Zealand.

2. BACKGROUND[2]

The Bretton Woods Conference of 1944 led to the establishment of the International Monetary Fund (IMF) and an international monetary system based on three major features:

(a) A par value system, under which exchange rates were adjustable only in circumstances of "fundamental disequilibrium" in a country's balance of payments. The system also reflected the desire to avoid "competitive depreciation" of currencies, which had been a problem of the inter-war years. In recognition of the need for international co-operation a change in a par value required the prior concurrence of the IMF.

(b) Exchange rates were to be maintained within narrow margins, implying the need for market intervention by the authorities to maintain their rates. The United States dollar was the major intervention currency and the United States itself avoided currency intervention by opting instead to use gold where necessary for ultimate settlement of its international transactions.

(c) Under the system, members were obliged to make their currencies convertible wherever possible and to avoid resort to payments restrictions (although there were no associated obligations to avoid capital controls).

For perhaps twenty years following the Second World War the system could be claimed to have worked reasonably well. Certainly, for much of this period, there was little enough discussion in official circles of alternative arrangements. But by the mid-1960s the system's rigidity, and hence its potential vulnerability, was becoming more apparent. Countries were too often reluctant to undertake, or even contemplate, changes in exchange rates despite growing evidence of incompatibility between nations' domestic policies and their exchange rate policies. Furthermore, the system was unable to cope adequately with certain major changes which occurred in the international economic and financial environment.

Several specific difficulties can be cited. First, there was the unwillingness of both deficit and surplus countries generally to vary their exchange rates. This problem became particularly acute in the case of the United States, which faced a gradual diminuation of its competitive position and a growing reluctance by its trading partners to live with ever-increasing dollar balances. The United States position was aggravated by its role as the major reserve centre and by its commitment to convert dollars for gold on request at the official price.

Secondly, a rising volume of world trade required corresponding increases in international reserves, a need which was met primarily through the United States incurring continuing balance of payments deficits while other countries acquired further dollars. This process persisted unabated, despite the concern of many countries and despite also the creation of special drawing rights (SDRs) in 1969, the allocation of which had been partly based on the erroneous assumption that the earlier process of reserve creation in the form of reserve currencies was likely to subside.

Thirdly, the need to adjust imbalances was heightened not only by differences in real growth rates between countries but also by growing wider differentials with respect to rates of inflation. A further major problem, and one which attracted substantial publicity, was that associated with massive capital flows, and especially those of a speculative nature. This was a problem which had been accentuated both by the greatly increased freedom

[1] At the time this Research Paper was prepared, Dr Deane was Alternate Executive Director of the International Monetary Fund. In November 1976 he took up the position of Chief Economist of the Reserve Bank of New Zealand. However, the views in this Paper are his own and do not purport to represent those of either institution.

[2] More comprehensive background information is available from a range of sources, including for example Gold [3], *Journal of International Economics* [10], Meier [12] and Yeager [15].

for capital movements to take place in the years since Bretton Woods, and by the vastly increased magnitude of the flows in monetary terms.

These difficulties led to diminished confidence in the ability of countries to maintain their par values and hence the par value system itself began to fall into some disrepute. The pressures on the United States dollar, and the reductions in the United States gold reserves, finally resulted in a withdrawal of intervention in the private gold market in March 1968 and the suspension of convertibility of officially-held dollar balances on 15 August 1971. Subsequent to this, most of the world's major currencies began to float in one form or another. Inevitably, as a consequence of the successive currency crises, a substantial realignment of the principal currencies emerged in December 1971, in the form of the so-called Smithsonian Agreement. The essence of this agreement was a widening of the official margins within which exchange rates were to be maintained, an increase in the official price of gold and, as a corollary, a devaluation of the United States dollar.

Despite President Nixon's extravagant claim that this agreement represented "the most significant monetary achievement in the history of the world", the fact was that the dollar remained officially inconvertible and the real factors underlying the potential instability of the par value system were little changed. The commitment to fixed rates was confirmed, for instance, by the April 1972 agreement of the EEC to hold their intra-EEC rates within half the range permitted by the Smithsonian Agreement—the "snake" within the "tunnel".

On the other hand, the IMF was not unaware of the need to study, and hopefully resolve, the problems. The Executive Directors of the Fund, in response to a request originating from the 1971 IMF Annual Meeting, published a report on *Reform of the International Monetary System* in 1972.[3] The issues dealt with in this study foreshadowed most of the those which were to be the subject of later reform discussions, both by the Committee of Twenty (the C.20) and its successor, the Interim Committee. The C.20, established in 1972 and disbanded in 1974, produced an *Outline of Reform*[4] which yielded no immediate reform as such, but at least laid some basis for subsequent Interim Committee deliberations (begun in 1974) and amendment of the IMF's Articles of Agreement. However, some of the matters to which the C.20 devoted much time have fallen by the wayside, such as the developing countries' proposal for a SDR/development aid "link" and the United States suggestion for use of "objective indicators" in assessing the need for balance of payments adjustment. In other areas —amendment of the Articles, valuation of the SDR on the basis of a basket of currencies,[5] introduction of guidelines for floating,[6] arrangements for gold, establishment of an extended fund facility, and more satisfactory arrangements generally for financing developing countries' deficits—some progress has been made. The nature of this progress will, hopefully, become clearer from the remaining discussion in this Paper.

3. ELEMENTS OF THE REFORM[7]

The major elements of the "reform" (itself an ambitious description of what has turned out to be very much a partial reform) fall conveniently under several headings: the adjustment process, including of course exchange rate arrangements and the question of convertibility; the role of reserve assets, including gold, SDRs and reserve currencies; and other issues relating to the IMF, such as increased quotas, improved financing or "drawing" facilities, and various administrative changes. The special interests of the developing countries are discussed in a subsequent section of the Paper.

3.1 The adjustment process

At the international level, the process of balance of payments adjustment can be facilitated both by (a) the existence of an appropriate exchange rate regime, and (b) the presence of sufficient incentive for individual countries to pursue policies conducive to such adjustment.

The essence of the exchange rate arrangements set out in the new Articles of the Fund is that individual countries should be free to adopt arrangements suitable to their own needs and preferences. Of course, this simply reflects (and will consequently legalise) the situation as it has existed for some time, under which there has been a multitude of different arrangements incorporating both floating and pegged rates, each in various forms. Such a simple yet flexible legal approach is not only sensible but probably also inevitable in the context of the present relatively fluid situation which does not lend itself well to very specific or measurable obligations. Regardless of what preferences individual countries might have as to the desired exchange rate regime for the Fund membership generally, the fact is that as far as can presently be seen no basic change in the current arrangements is likely in the immediate to near future. On the other hand, it would be possible under the amended Articles for the Fund to adopt alternative general arrangements, including even a refurbished par value system, subject to the need for a high (85 percent) majority decision and the preservation of the right of members to opt out of such general arrangements.

The cynical view of this might be that it represents little progress since it simply confirms the status quo as it has existed for several years. The Fund has belatedly recognized reality.

Yet the final compromise could be claimed at least to be less embarrassing than some possible alternatives. It basically acknowledges that the par value system is extinct, though conceding to the French and some other countries, especially developing ones, the chance that it may only be dormant and could perhaps one day be restored, albeit in modified form. It is also clearly more realistic than the C.20 view that "the exchange rate mechanism will remain based on stable but adjustable par values" with floating only in "particular situations, subject to Fund authorization, surveillance and review". On the other hand, the new provisions do not go as far

[3] Published by the IMF, Washington. They had also earlier produced a report on *The Role of Exchange Rates in the Adjustment of International Payments,* IMF (Washington, D.C., 1970), which had held firmly to the par value system.

[4] See *International Monetary Reform: Documents of the Committee of Twenty,* IMF (Washington, D.C., 1974) and also IMF *Survey* [7]. An interesting assessment of the issues as they stood at about that time is contained in Fleming [2].

[5] The technique used is set out in Polak [13].

[6] See IMF *Survey,* IMF (Washington, D.C., 17 June 1974).

[7] Full details of the content of the reform as represented by the Second Amendment of the IMF's Articles of Agreement are contained in *Proposed Second Amendment to the Articles of Agreement, Report by the Executive Directors to the Board of Governors* [6] and IMF *Survey* [9]. The results of the important Jamaica meeting of the Interim Committee are set out in IMF *Survey* [8].

as the Americans and some others wished, in that the revised Article is not the brief, relatively permissive and highly generalized provision that the United States advocated before finally reaching an agreed compromise with the French at the Rambouillet summit meeting in late 1975. For instance, the original American proposals made no specific provision for a return to a par value system.

Of course, early in the course of the protracted negotiations over the new set of exchange rate arrangements it became apparent that there existed substantially divergent views, both philosophical and economic, spread over such a wide spectrum as to prohibit any solution other than one which essentially accommodated many shades of opinion and practice. Accordingly, most countries welcomed the French/American compromise, not as a major breakthrough in international monetary accord, but rather with a sense of relief that finally the discussions could be brought to a not unreasonable close. This relief was reflected in a widespread and virtually immediate acceptance of the French/American draft, despite its unfortunate inelegance and vagueness. Not surprisingly, the latter was in fact claimed by some to be a sufficient justification for its acceptance.

The new Articles have been described as providing for "freedom of choice of exchange arrangements but not freedom of behaviour".(8) This is because they give rise to various obligations for members, both with respect to their own economic policies and to the need to collaborate with the Fund and other members. In particular, members would be expected to adopt policies consistent with promoting "orderly economic growth with reasonable price stability" and avoiding exchange rate policies which might either inhibit balance of payments adjustment or gain an "unfair competitive advantage over other members". Recognition is given to the view that while stability is desirable, it can only be achieved by "fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions."

Collaboration is obviously required to promote the stable system of exchange rates which the Articles assume to be desirable, an objective which it need hardly be mentioned is different from a system of stable exchange rates. With this in mind, provision is made for the Fund to oversee the international monetary system in a general way, and to exercise specific "firm surveillance" over the exchange rate policies of individual members. Just how this will be implemented remains to be seen, especially given the past sensitivities which have been apparent in this area. Nevertheless, the Fund is empowered to adopt principles for the guidance of members, to seek information necessary to its surveillance duties and, as has always been the case, to consult with member countries. Domestic sovereignty is preserved by requirements that, first, the Fund shall pay due regard to the circumstances of members—which, it is fair to say, it always has done in the past and must clearly continue to do if it is to remain an effective institution—and, secondly, any principles adopted must respect the domestic social and political policies of members.

Guidelines for the management of floating exchange rates have indeed been in existence since June 1974, although these relate primarily to intervention policies and in practice their influence has probably been only slight. The essence of the present voluntary guidelines is that a country may intervene to moderate short-term fluctuations in its exchange rate, consistent with avoiding "aggressive" action, but should not encourage movements away from what might be judged to be the medium-term norm. Countries are encouraged to yield to market pressures that tend to move the rate in the direction of the norm and to resist tendencies that cause the rate to diverge unduly from this equilibrium position. Furthermore, undue reserve accumulation or reduction is meant to be discouraged. The conceptual basis of the guidelines is to promote appropriate adjustment of exchange rates, to prevent competitive depreciation or appreciation, and to encourage the avoidance of inappropriate policies, such as balance of payments restrictions. If a member wishes to intervene in ways other than those suggested in the guidelines, it is meant to consult with the Fund on the matter.

More recently, under the agreement reached at Rambouillet and subsequently endorsed by the Group of Ten (G.10), consultation procedures between the major countries have been intensified with respect to exchange rate movements, with a particular underlying desire being to counter erratic fluctuations in rates. As announced, there were to be three tiers for these collaboration procedures: (a) daily consultation among central banks, which was extended from the countries participating at that time in the "snake" arrangements, to include also the United States, Japan and Canada; (b) regular contacts, perhaps monthly, among Deputy Ministers of Finance; and (c) ministerial level meetings, including active participation by the Managing Director of the IMF.

However, despite these moves, and notwithstanding the promise of closer Fund involvement under the new guidelines,(9) one could be excused a degree of scepticism about the type of role the Fund may play in exercising "firm surveillance" over members' exchange rate policies. This has always been an area of great sensitivity. For obvious reasons, IMF staff papers make no more than oblique references, if any, to the appropriateness of individual countries' policies in this area, although it is common enough practice for staff missions to have discussions on exchange rate matters with the monetary authorities of member countries, particularly at the time the country consultations take place.

The traditional sensitivity of many policymakers on exchange rates is pitched at several levels: the fear of the IMF "meddling" in a country's domestic affairs, despite the Fund's responsibilities at least in the area of exchange rates; the unbending commitment of some policymakers to stable or pegged exchange rates, despite the problems which such a commitment may give rise to, not only domestically but also in terms of international relationships and balance of payments adjustment generally; and the legitimate practical concerns about the impact on exchange rate markets of any publicity, accidental or otherwise, which might result from IMF involvement.

Beyond this, there is the problem of defining adequately the Fund's role, and the manner in which any guidelines or principles should be administered to ensure effective and equitable treatment for all members, whether they be in surplus or in deficit positions.

(8) By the IMF's Managing Director, as quoted in IMF *Survey* (Washington, D.C., 19 April 1976).

(9) At the time of writing, the guidelines under the new Articles had not been formulated. These will cover all members, whereas the present guidelines cover only those members with floating exchange rates.

The coverage would also need to cope with those members whose currencies are widely held as reserves (reserve centres), of which easily the most important is the United States. In developing a set of principles, the amended Articles may be of limited assistance. They speak of the need for "the orderly underlying conditions that are necessary for financial and economic stability" and a system that does not "tend to produce erratic disruptions"; and the avoidance of both exchange rate "manipulations" and "unfair competitive advantage"; phrases which are hardly models of clarity.

Furthermore, some of the more fundamental problems remain. In particular, while it is clear that various pressures can usually be brought to bear on deficit countries to encourage them to adjust to their balance of payments difficulties—especially if they borrow from the IMF, at which stage they would in many cases be required to undertake a well specified policy "program" —it is less apparent how the Fund can persuade surplus members to undertake adjustment measures. The same applies to reserve centres. The relevant question is one of how to provide sufficient incentives to promote appropriate adjustment, and what sanctions, if any, should be invoked if adjustment is not pursued.

It was for this reason that the C.20 discussed extensively the idea of using one or more "objective indicators" to provide the criteria which might indicate the need either for the Fund to examine a member's balance of payments policy or, more specifically, for the member to adjust its exchange rate. Not surprisingly, the suggested scheme fell by the wayside. Most members were simply not prepared to accept that some simple statistical norm (or set of norms) could provide even a presumption in favour of an examination of its policies by the Fund (which, it is worth noting, takes place regularly anyway), much less a presumption in favour of some pre-specified line of action. There was also the problem of defining and measuring objective indicators (or reserve indicators). The idea of any sense of automaticity in a country's policies, and the consequent threat to the scope of discretionary action carried little appeal, especially once the discussion moved from the realm of an academic debate to that of a political possibility. Generalized floating amongst the larger countries also complicated matters and presumably reduced the justification for an indicator system. A range of sanctions or "pressures" was also mooted, but for obvious reasons these attracted limited enthusiasm. The idea underlying this discussion had been that various pressures or penalties could be applied to those countries which failed to respond adequately under the objective indicator scheme.

The essence of the matter then is that little progress has been made on the question of providing incentives to promote adjustment, and whether the Fund will in practice be able to exercise meaningful and helpful "firm surveillance" over the exchange rate policies of its members, especially the larger ones, must remain in some doubt.

3.2 Convertibility

Allied to the problem of inducing appropriate adjustment is the question of convertibility, the most worrying aspect of which, at least in the past, has been the accumulation of dollar balances (the dollar "overhang").

The provision in the old Articles which ensured convertibility, and one which has been retained in the new Articles, provides that all holders of currency balances recently acquired as a result of current transactions must be allowed to transfer those balances through the exchange markets. The effect of this provision is achieved by prohibiting the imposition of restrictions on payments and transfers for current international transactions,[10] unless specific permission to the contrary has been granted by the Fund.[11] But although this provision encourages the avoidance of restrictions on current payments there are two qualifications which should be remembered. First, the obligations of convertibility under the Articles do not extend to capital transfers and members are free to impose controls on these if they judge this to be desirable. Secondly, the legal provision is confined to the financial aspect of current transactions, which means that nothing is said about physical trade transactions. However, comparable prohibitions on interference with trade transactions are among the obligations of the Contracting Parties to GATT.

Some of the problems which gave rise to increasing concern about the general question of convertibility are not so acute today as they were a few years ago. Circumstances have changed, partly as a result of the resort to widespread floating and partly as a consequence of changed economic circumstances including, for instance, the substantial changes brought about by the large oil price increases since 1973. These developments, together with recent inflation, have to some extent reduced the so-called dollar overhang and there is currently less concern about the need seen by the C.20 to achieve a more symmetrical treatment of reserve centres and other countries. Furthermore, the difficulties which were created under a par value system by disruptive speculative capital flows are eased under a system of floating rates, although the fact that such rates are managed rather than fully market-determined suggests that the problem is still rather more significant than it might be under a more freely floating system. The nature of the risks to which official holders of reserves are subject has changed also as a result of the elimination of the old narrow margins which existed across the broad spectrum of members under the par value arrangements,[12] and because exchange rate changes no longer take place on such an infrequent (even rare) basis as in the past.

Another form of convertibility that was important for many years was the ability of holders of dollars to convert their dollars into gold, but in 1971 the United States ceased to accept this responsibility, and it was following this decision that concern about accumulations of dollar balances became even more widespread. Nevertheless, in the event the problem itself eased, quite apart from

[10] This basic convertibility provision of the Articles is contained in Article VIII, Section 2 (a). It is supplemented by an anachronistic additional provision (Article VIII, Section 4) which was incorporated in the original Articles but for which no need has ever arisen since the monetary system subsequent to 1944 developed in directions other than those assumed possible by the original drafters of the legislation. The provision is retained intact in the new Articles not because it has any operational significance but rather because it proved impossible to reach agreement on any alternative convertibility arrangements.

[11] Alternatively a member may opt to avail itself of the "transitional arrangements" of Article XIV, under which payments restrictions are permitted. However, members are expected to withdraw these "as soon as conditions permit".

[12] Although in some cases alternative similar margins arrangements are in existence, such as the "snake" agreement amongst major European currencies.

which it proved impossible to reach any agreement on a satisfactory solution despite the extensive deliberations of the C.20. In a sense this was a fortunate coincidence, although a potential difficulty still obviously exists for the future and the question of satisfactory treatment of reserve centres vis-à-vis other countries must remain as one of the unresolved issues of the reform exercise.

One method which was suggested as a possible substitute for convertibility was asset settlement, a subject into which the C.20 delved in some depth. At the risk of over-simplification, two broad approaches emerged from the discussions although in neither case has any progress been made since the C.20 brought down their final report. One technique envisaged that the major countries would agree to prevent their balances of reserve currencies from rising by converting increases in these balances into primary reserve assets. In addition, it was suggested that these countries could prevent their holdings of reserve currencies from falling by selling primary assets to the issuers of the currencies. The second approach was of a collective type, under which reserve centres would regularly settle changes in their outstanding reserve liabilities by exchanging SDRs and their currencies with other countries designated by the Fund, or with the Fund itself. It was this second collective approach which led to the idea of a substitution account through which the Fund would exchange currencies and SDRs with central banks. This is discussed in a later section.

The concept underlying assets settlement of course was to ensure that reserve centres and other countries were treated in a uniform manner. Such a scheme would imply that reserve centres would need to behave like other countries in terms of settling their deficits and surpluses through the transfer of reserve assets, although this would not prevent them from negotiating loans to finance their external position in the same way as other countries. Two important advantages of the asset settlement procedures, especially if the technique adopted included exchanging currences for SDRs, were that such a procedure would assist in regulating the volume of international reserves and also promote the SDR as a more important component of those reserves. Whether more pressing circumstances will arise in the future which might stimulate further consideration of the asset settlement system remains to be seen, and a particularly important consideration in this respect will be the nature of the arrangements which evolve for floating exchange rates.

3.3 Reserve assets

Turning to the question of reserve assets, it is perhaps useful first to discuss the changes which will take place with respect to two important forms of international reserves—gold and special drawing rights—and, secondly, to touch on one or two of the more general issues with respect to reserves, such as the role of currencies, and suggestions for a substitution account. A further relevant consideration, but one which has not yet really been tackled, is the question of whether or not (and how) the overall volume of international reserves should be regulated or controlled in order to ensure that these grow at a pace which is sufficient to sustain economic growth but not so excessive as to contribute to inflationary pressures. Although this issue was debated by the C.20, no progress has been made since the publication of their report (which itself agreed that Fund surveillance and overall management of the aggregate volume of official currency holdings was indeed desirable, but failed to agree on a set of arrangements to give effect to this principle).

(i) *Gold*[13]

Gold has traditionally performed several major functions within the international monetary system. On the one hand it has always constituted a major reserve asset, currently representing about 18 percent of total international reserves. However, given that these gold holdings are valued at the official price of SDR 35 per ounce, gold's relative importance as a reserve is probably underestimated by data such as those shown in table 1 on international reserves. On the other hand, within the context of the IMF, under the old Articles gold served as the unit of account, or the standard in terms of which par values were expressed. Furthermore, for many years gold was used regularly in Fund transactions with its members, most notably as an important element in initial quota subscriptions and subsequent payments of quota increases. As a result the Fund's holdings of gold are now substantial at SDR 5.4 billion, representing 153.4 million ounces valued at the official price.[14] By way of comparison, this figure represents about 15 percent of the total official stock of gold held by individual countries.

The official price of gold was for many years sustained by United States intervention in the gold market. However, after official convertibility of the dollar ceased, the market price of gold increased to the stage where it is now currently about three times the official price. Given the historical perspective, and bearing in mind also the substantial current holdings of gold by both the IMF and its member countries, it is easy to comprehend why the gold question formed an integral part of the amendment package.

It is obviously in the interests of some countries, especially the large gold holders which are not also major reserve centres, to maintain a central role for gold in the international monetary system. Until recently these countries have argued that the advantages associated with gold include its traditional and universal use, limited production and the physical characteristics of gold itself. Moreover gold is the only international asset held by monetary authorities which is not a liability of another monetary institution and, in one sense, it is an instrument of reserves that is subject to direct national control. But perhaps the most compelling argument in favour of the acceptance of gold as a major reserve asset, at least for the foreseeable future, is the simple fact of its contemporary existence as a highly important component of some countries' international reserves. This may be unpalatable to countries which hold no gold including, for example, most of the developing nations. But if the facts of the situation are to be accepted, then there may be some presumption in favour of the view that gold should be treated in a manner similar to other reserve assets and not be subject to particular ad hoc restrictions on its use.

[13] Some interesting alternative views on the outcome of the discussions on gold are contained in *Hearing on the IMF Gold Agreement* [14].

[14] Figures are as at May 1976, prior to the commencement of the IMF gold auctions.

TABLE 1
INTERNATIONAL RESERVES, BY TYPE
(In SDR billions, end of February 1976)

Country groups	*Foreign Exchange*	*Gold*	*Reserve Position in IMF*	*SDRs*	*Total*	*Percentage of Total*
Major industrial countries	61.3	29.7	8.1	7.0	106.1	53.6
Other developed countries	12.3	2.7	0.2	0.4	15.6	7.9
Major oil exporters	43.1	1.2	5.3	0.3	50.0	25.3
Other developing countries	22.7	1.8	0.5	1.1	26.1	13.2
Total	139.4	35.5	14.1	8.8	197.7	100.0
Percentage of total	70.5	18.0	7.1	4.4	100.0	

Note: Totals may not add due to rounding. Gold holdings are valued at SDR 35 per ounce.
Source: *International Financial Statistics,* IMF (May 1976).

Conversely, although those who support a reduction in the role of gold have varying motives, they generally argue that gold is unsuitable as an official reserve asset since private demand for it is relatively large and highly speculative. In the light of developments of recent years, gold as a standard of value is clearly an anachronism. The developing countries are not unnaturally concerned that the granting of complete freedom for monetary authorities to engage in transactions in gold—as they will now have under the amended Articles of the Fund—will lead to substantial changes in the distribution of liquidity in favour of the wealthy nations and to the disadvantage of the developing countries. By way of contrast the United States, despite its role as a major gold holder, has also strongly supported the view that the role of gold should be reduced. However, in this case the importance of the United States as a reserve centre and the extensiveness of official holdings of dollars, which represent United States liabilities, form additional considerations underlying the point of view adopted by the United States.

After lengthy debate, it was agreed that the Articles should state that the role of gold in the international monetary system should be gradually reduced although the specific new provisions with respect to gold by no means guarantee that such a result will emerge from the reform exercise.

A variety of changes are incorporated in the amended Articles of the Fund. The official price of gold will be abolished which implies that monetary authorities, which may sell gold at present but only buy at the official price,[15] will after amendment be able to purchase gold at market prices. This suggests that gold will indeed again become a usable reserve asset, although there will undoubtedly be some not inconsiderable problems for gold-holding central banks in terms of deciding on appropriate pricing policies for their transactions in gold. Gold is also removed from its old central place in the IMF Articles, both as the common denominator of the now extinct par value system and as the unit of value for the SDR. It will be recalled that the SDR is now in fact valued on the basis of a basket of major currencies. As a consequence of this approach, all obligations to use gold in transactions with the Fund are eliminated and if any future transactions in gold take place between the Fund and members they will be based on the market price. Furthermore, decisions to this effect will require a high voting majority. The cessation of any obligations to use gold in transactions with the Fund confirms, for example, the practice of recent years that no portion of quota increases need be paid in gold.

In accordance with the agreement reached by the Interim Committee, the new Articles require the Fund to complete the disposal of 50 million ounces of its gold holdings, with half of this to be restituted to members and the other half to be sold for the benefit of developing countries. Restitution will be in proportion to quotas and members will pay for the gold in their own currencies at the old official price. The profits realized on the sale of gold for the benefit of developing countries will be largely used to finance the Trust Fund, a subject which is referred to again later in this Paper.

The Articles include several enabling provisions with respect to gold which will empower the IMF to dispose of the remainder of its gold holdings, subject again to any such decision being taken by at least an 85 percent majority. For example, further restitution of gold would be possible. Alternatively, if the gold was sold, an amount equivalent to the present official price would be credited to the Fund's general resources and any excess (the "profit" on gold sales) could be used either

(a) to finance the regular operations of the Fund, or

(b) to provide balance of payments assistance on concessional terms to developing members of the Fund.

In the latter case the level of per capita incomes would be an important determinant of eligibility for such assistance.

There is a general undertaking by members (Article VIII, Section 7) to collaborate with the Fund and with other members to ensure that their policies with respect to reserve assets (including gold, as well as SDRs and reserve currencies) are consistent with "promoting better international surveillance of international liquidity", and making the SDR the "principal reserve asset" in the international monetary system.

Although these changes modernize the provisions with respect to gold, and allow for considerable flexibility in the future insofar as the remainder of the Fund's own gold holdings are concerned, they will not and cannot guarantee that the underlying objective—a reduction in

[15] The official price, at SDR 35 per ounce, is so far below the market price as to rule out any possibility of monetary authorities acquiring gold at the official price (other than by, say, restitution from the IMF).

the role of gold—will necessarily be achieved. Nevertheless, they can be said to represent a sensible step in the right direction. But many major industrial countries continue to hold large amounts of gold as part of their foreign reserves, and the future role of gold will no doubt be primarily dependent upon the actions of these countries.

In the light of this situation, and bearing in mind the possible effects of these changes on international liquidity, both in total and in terms of its distribution, the Group of Ten agreed in August 1975 that there should be no action to peg the price of gold and that the total stock of gold held by monetary authorities and the IMF should not be increased. These arrangements, which are outside the jurisdiction of the Fund, will be reviewed after an initial two-year period, and during this time each party to the arrangements will report semi-annually to the Fund and to the Bank for International Settlements the total amount of gold that has been bought or sold. At least in the short term, this agreement is as important as the changes in the Fund's Articles since it means not only that total official holdings of gold will not increase, i.e., that monetary authorities in the aggregate will not engage in net purchases of gold from the private market, but also that these countries presumably will not collude on price. In effect then, the agreement will inhibit the complete freeing-up of transactions in gold until late 1977, at which time the voluntary agreement will be reviewed.

(ii) *Special Drawing Rights*

Following increased concern during the 1960s about the process of reserve creation which involved persistent balance of payments deficits for the United States, Special Drawing Rights (SDRs) were created in 1969. At that time, it was hoped that this would lead to a more rational and efficient mechanism for adapting the world's supply of international reserves to long-term global needs and that it might eventually lead to a more satisfactory centralized regulation of the volume of international liquidity, especially if a way could be found in which SDRs could be substituted for other reserve assets. Initial allocations of SDRs took place in the period 1971-72 with the result that participants in the scheme now hold Special Drawing Rights totalling SDR 8.8 billion, representing about 4.5 percent of total reserves. However, there have been no further allocations of SDRs since 1972, primarily because international liquidity has expanded strongly during the 1970s of its own accord. The possibility of further allocations has been regarded as not only unnecessary but probably also harmful in the light of the worldwide inflation of recent years.

Although there has been much discussion about giving the SDR a more prominent role in the international monetary system—a principle which has now been enshrined in the new Articles by the requirement that members should co-operate with the Fund in order to make the SDR "the principal reserve asset of the international monetary system"—it proved impossible during the course of the reform discussions to make very much positive progress in this direction. Conceptually, the most satisfactory way to enhance the status of the SDR would be to allow it to be freely held and freely usable. This would mean that the general attractiveness of the SDR, including its yield, would have to be such as to make it fully competitive with alternative reserve assets. Only in this way would the SDR be held voluntarily (which is hardly the case at present given the nature of those provisions which determine the characteristics of the SDR).

As part of a move in this general direction it was agreed that the requirement that a user of SDRs should have a balance of payments need would be abolished with respect to voluntary transactions between members, although in all other cases the requirement of need is retained. The other constraints on the operation of the SDR remain, including the acceptance obligation, the acceptance limit and the reconstitution provisions. While the rate of interest on the SDR remains significantly below the returns which are obtainable on some other reserve assets, especially currencies, it could be argued that these constraints strengthen the SDR in the sense that the acceptance obligation constitutes a basic safeguard of the usability of the SDR by making acceptance of SDRs compulsory in certain circumstances and up to certain limits. On the other hand, the reconstitution procedure ensures that all participants record certain minimum holdings of SDRs on average over a specified time period.

Accordingly, if the SDR was to become genuinely the central reserve asset in the international monetary system, it would probably be necessary to adopt a package of changes including the abolition of both the acceptance and reconstitution obligations together with a more attractive market-competitive interest rate. Unfortunately the inability of the Fund membership generally to agree on such a package means that in the meantime at least the SDR must be relegated to a subsidiary role in the system.

Some other minor changes were also included in the Articles with respect to SDRs, such as the inclusion of the power for the Fund to authorize new operations between participants in the SDR scheme and to broaden the categories of holders other than members of the Fund, although such holders will still be restricted to official entities.

(iii) *Further considerations*

In the latter stages of the reform discussions, and especially during that phase in which the amended Articles were being prepared, the third major form of reserve assets, namely currencies, received scant attention. The exchange of views which had been generated earlier on the subject of reserve currencies as a consequence of the dollar overhang problem had waned considerably by the mid-1970s, most notably because the overhang itself had been more or less eliminated through the devaluation of the United States dollar and other economic changes which took place during this time. Nevertheless, in the course of the discussions on the new Articles, some members wanted to speak of a reduced role for reserve currencies, a position which was not unnaturally resisted by the major reserve centre, the United States. The debate was most vigorous in the context of the amended provisions on gold where it was finally agreed that the Fund must be guided in its policies with respect to gold by the objectives of:

(a) promoting improved international surveillance of international liquidity,

(b) making the SDR the principal reserve asset in the international monetary system, and

(c) avoiding the management of the price, or the establishment of a fixed price, in the gold market.

Under a much debated collaboration provision (Article VIII, Section 7), each member undertakes to collaborate with the Fund and with other members to ensure that its policies with respect to reserve assets shall be consistent with at least the first two of these objectives.[16]

The implication of the thought that the SDR should become the principal reserve assets is that the role of gold and, presumably, the role of reserve currencies, will gradually diminish over time. But just how this is to come about is by no means clear. The facts of the matter are that the United States dollar remains easily the most important reserve asset. Moreover it is officially inconvertible, in the sense that the United States no longer stands ready to convert dollars for gold. There can be no doubt that many countries will continue to view reserve currency holdings as an important part of their international reserves and this situation seems unlikely to alter significantly in the absence of any substitution facility whereby, for example, currencies could be exchanged for SDRs or some other form of international money.

Such a substitution account has been considered at various times and in various forms, but as with a number of related innovative ideas, it has proved impossible to reach any consensus. When the C.20 discussed the question of possible new arrangements for asset settlement it was envisaged that such arrangements could be complemented by a substitution account for currencies. The idea was that this would be an account in the Fund that could exchange currencies and SDRs with central banks. It was felt that this would have several advantages, including enabling countries to alter the composition of their reserves, ensuring that reserve centres would be able to acquire reserves as a result of any surpluses they may run, and paving the way for a monetary system in which the SDR would be genuinely the principal means of settlement. But the pressure for a substitution facility of this type eased as the dollar overhang problem faded. Furthermore a currency substitution account would presumably be pointless unless accompanied by the establishment of an asset settlement system and this too now seems to be an unlikely possibility.

More recently, attention has turned to the possibility of introducing a gold substitution account, although strenuous efforts by some member countries failed to achieve sufficient agreement to provide for the inclusion of a suitable enabling clause in the amended Articles. This does not augur well for future discussions on such an account. The proponents of a gold substitution account suggest that it could be used by the IMF to exchange SDRs for gold held by members. The aim would be to reduce the role of gold and promote the SDR, although it has been by no means agreed that such an account would in fact achieve this purpose.

Various inter-related objectives emerged from the discussion. It was thought that one of the attractions of such an account would be that it could be used on a once-for-all basis to convert part or all of members' gold holdings into more usable and stable interest-earning SDRs. In turn, the Fund would gradually dispose of the gold in the open market. It was also felt that this procedure would yield the IMF more effective surveillance over international reserves and might at some stage facilitate special distribution arrangements for SDR allocations to members with negligible gold holdings. This latter suggestion arose from a desire to offset the uneven distributional effects on international liquidity arising from increases in gold prices.

A scheme of this type, if it was to operate in a manner genuinely consistent with the desire to reduce the role of gold in the system, would also need to provide answers to a range of fundamental questions, including such matters as what might happen to the Fund's own remaining gold holdings; the problem of establishing an appropriate price for the transactions; and the liquidity implications of exchanging the relatively more usable SDR for gold, the official holdings of which can still be regarded as somewhat illiquid in present circumstances. A variety of proposals has been put forward, but none of these has attracted sufficient support to enable the Fund to pursue the matter in great depth. Whether the discussion will proceed further has not been clearly decided. It is uncertain whether much progress could be made in the absence of an appropriate legal enabling provision.

The amended Articles assert that the IMF should be concerned with promoting better international surveillance of world liquidity, but are not very helpful in suggesting how the Fund might go about this. Certainly, the Fund already regulates new allocations of SDRs and will theoretically be able to exercise surveillance over members' exchange rate policies, including laying down guidelines on these matters. In addition, the Fund can exert some influence through the provision of its own credit. But in other crucial areas, most notably with respect to gold and currency holdings, no solution has been found to the question of what would be an appropriate and acceptable method by which the Fund could ensure that international liquidity is in adequate but not excessive supply.

In recent years, other considerations have emerged in the form of the now extensive Eurodollar market and the regime of managed floating. Obviously, reserves remain an essential ingredient in the monetary system so long as floating is managed rather than clean (or where exchange rates are wholly market-determined), and given also that many countries continue to maintain adjustable pegged rates of one form or another. Despite floating, the questions of asset settlement and world reserve management are still important ones since, apart from anything else, the managed floating arrangements imply the possibility of serious disequilibria again emerging between reserve centres and other countries. So long as countries can freely buy and sell whatever currencies they choose, there can be cumulative expansions and contractions of reserves. At present, these changes would be largely beyond international control.

Furthermore, as the developing countries continue to remind the world, the problem is one not only of a satisfactory volume of liquidity but also of an acceptable distribution of reserves. For example, as table 2 shows, over the past few years the aggregate reserves of the industrial nations have been relatively stable, largely as a consequence of the floating rates situation, while the total reserves of the major oil exporters have expanded by enormous amounts. The other developing countries, many of which have suffered substantial deficits during the 1974-75 recession, have experienced virtually no increase in reserves since 1973. Bearing in mind their rather urgent needs, it is not surprising to find them feeling gravely dissatisfied with the situation. Their only consolation, if it could be described as that, has been extensions to various IMF financing facilities.

[16] As for the third objective, the avoidance of a pegged price for gold, it will be recalled that the G.10 have committed themselves to this aim for a two-year period.

But additional credit gives rise to future liabilities, and the developing nations feel that such measures are only of a stop-gap type, failing to cope with the more basic problems. Nevertheless, these are issues of equity and distribution, and for various reasons must probably be answered (if at all) independently of solutions with respect to regulating liquidity in a global sense.

3.4 Other amendments

Apart from the major amendments relating to such matters as exchange rate arrangements and gold, which are likely to be important not only for the IMF as such but also for the international monetary community at large, the amended Articles also contain a wide range of new provisions on matters which are more specifically relevant to Fund operations. In particular, many of these amendments are intended to simplify and, in some cases, extend the financial operations and transactions of the Fund.[17] As one would expect, a number of new provisions are essentially designed to incorporate policies and practices which past experience has shown to be sufficiently useful to warrant inclusion in the Articles.

TABLE 2

INTERNATIONAL RESERVES, 1972 TO 1975
(In SDR billions, end of periods)

	1972	1973	1974	1975
Developed countries	116.8	115.7	115.2	119.4
Major oil exporters	10.3	12.4	39.2	49.6
Other developing countries ...	19.4	24.3	25.9	25.5
Total	146.5	152.3	180.3	194.5

Source: *International Financial Statistics,* IMF (May 1976). (Amounts might not sum to totals due to rounding.)

An important illustration of this procedure is the new repayment or "repurchase" provisions which have been substantially amended to permit greater flexibility and to eliminate the complexities which existed in the old Articles. Of course, repurchase will still be required commensurate with an improvement in the member's balance of payments and reserves position, and it is specifically mentioned that use of the Fund's general resources will not normally extend beyond three to five years. Nevertheless, there are specific exceptions to this arrangement under some of the special facilities, such as the oil facility and the extended fund arrangements.

Another major new provision will ensure that the Fund's holdings of all its members' currencies will be usable, providing the members' balance of payments positions are sufficiently strong to justify them being Fund creditors. In the past, most countries with balance of payments surpluses voluntarily agreed to make their currencies usable, i.e., to become Fund creditors, so that these currencies could in turn be made available as foreign exchange to help assist financing the balance of payments deficits of other members. However, there was no specific legal obligation for a country to make its currency usable and indeed some countries with large surpluses, such as some of the major oil exporting nations, have previously been reluctant to become Fund creditors. This reluctance was partly associated with the fact that the return or the "rate of remuneration" on creditor positions in the Fund is less than that which can be obtained by investing reserves in alternative forms, such as other countries' government securities. But this implied some inequities as between potential creditor nations, and the new agreement that all member countries' currencies should be usable in appropriate circumstances (i.e., when their balance of payments positions are strong enough), will not only result in a more equitable arrangement but will also generally enhance the financial position of the Fund.

The new Articles include an enabling provision which if implemented at some stage in the future could allow the Fund to carry out investment operations. These would be limited to an amount equal to its reserves. Again, the power to invest could potentially strengthen the Fund's financial position, since the return on investment in, say, government securities would usually be higher than the rate of interest obtained on Fund lending to members. Funds for investment may originate either from the profits on the sale of the Fund's gold or from currencies held by the Fund. Although this provision provides a sensible degree of flexibility for the future management of the Fund, some members were doubtful about the appropriateness of the Fund engaging in investment activities, probably primarily because they felt that all available funds should be used solely to finance members' balance of payments deficits. While these members were agreeable to the Fund using their currencies in its regular lending operations, they were not unnaturally hesitant to provide the Fund with relatively cheap currencies which could in turn be invested at market interest rates simply to yield the Fund additional current income.

From a political point of view, the new system of voting majorities incorporated in the amended Articles assumes some importance. There are basically three categories: a simple majority, for day-to-day administrative decisions; a majority of 70 percent of the total voting power for more important operational decisions; and an 85 percent majority for decisions on major matters involving political or structural considerations. In the final analysis, virtually all the major policy decisions which will be taken in the future will require the 85 percent qualified majority. This gives various groups of countries, such as the EEC or the developing countries in general, and the United States alone, a veto power with respect to these decisions. Whether such an apparently inhibiting procedure will detract from the effectiveness of the Fund remains to be seen.

[17] Two of the more significant examples can be cited. First, since in the future it will be possible for the Fund to decide that increases in quotas may be paid entirely—or at least in proportions beyond the old 75 percent figure—in domestic currencies rather than by way of primary reserves, it is likely that the old gold tranche (now to be the reserve tranche) will gradually diminish in size relative to its present 25 percent of quota. For this reason, and to simplify the Fund's accounting procedures, the basic "norm" for determining remuneration for Fund creditors will gradually move towards 100 percent. For all other purposes, the 100 percent figure will apply immediately upon the amendments becoming effective. Secondly, in the use of its general resources, the Fund will have more extensive authority to permit members to engage in transactions under special policies, such as the buffer stock financing facility, without at the same time foregoing their reserve tranche positions. In other words, a member will be able to borrow under such specified special facilities while maintaining its reserve tranche (the old gold tranche) intact. In some cases in the past it had been necessary to draw the gold tranche before making a purchase under a special facility.

Although several major countries, including the United Kingdom, the United States and France, felt that a Council of Ministers should be established immediately when the amendments become effective, many other Fund members felt it would be wise to accumulate more experience through the continuation of the Interim Committee in order to gain a better understanding of the potential role of a Council before creating a permanent body. Accordingly, it was decided that the Articles should provide for a Council to come into being only when a decision to that effect is taken by the Board of Governors. It is geenrally agreed that, except for a few powers of a political or structural character that should be reserved to the Board of Governors, all powers of the Board of Governors should be delegable in principle to the Council, or to the Executive Directors.

As a consequence of the introduction of these new Articles, many of the rules and regulations which guide the Fund's day-to-day operations will need to be modified. It is intended that work in the Executive Board will proceed on these matters with the object being to facilitate the introduction of appropriate new rules and regulations simultaneously with the application of the new Articles, probably some time in 1977.

3.5 Use of IMF resources

During the course of the reform discussions a number of other matters, especially those relating to the use of Fund resources, became intertwined with the issues underlying the amendment of the IMF Articles. The pressures for improvements and extensions to the range of financing facilities offered by the Fund were a consequence not only of the need to take an overall view of the international monetary system as a result of the reform efforts, but also reflected major economic events which occurred during the course of the discussions such as the steep increase in oil prices, widespread inflation and the international recession which led to acute declines in the terms of trade for many member countries. This gave rise to special difficulties for developing nations, and more generally for countries dependent on exports of primary commodities. Moreover, the developing countries had been pressing for a meaningful increase in the transfer of real resources from the rich to the poor, first by way of advocacy of a SDR/aid "link", and more recently by arguing for easier and wider access to Fund credit. These latter pressures intensified after it became clear that the link procedure was a lost cause.

By way of background information, it should be recalled that each member of the Fund has a quota which forms the basis for both its capital subscription to the Fund (such subscriptions are the major form of the IMF's resources) and an individual member's borrowing or "drawing" rights. To the extent that a member has contributed gold to the Fund[18] and its currency has been used by other members, it can utilize the corresponding claim to obtain foreign exchange promptly and without any particular conditions being attached. With respect to borrowing or "purchasing" under its gold (or reserve) tranche which has been in the past equivalent to 25 percent of quota, a member has to represent to the Fund that it has a balance of payments need for the foreign exchange, although such a representation is not subject to challenge by the Fund. When a member requests a transaction beyond this stage, it is essentially proposing to use Fund credit. Such requests are made on the basis of its quota, which for this purpose is divided into four equal credit tranches, i.e., each tranche is normally 25 percent of quota.

Although a policy program is always drawn up as the basis for any transactions in the first credit tranche, the degree of conditionality is significantly less than that which is required for drawings in the following three credit tranches. In other words, for purchases beyond the first credit tranche the Fund requires a more "substantial justification" with respect to the economic policies the member is pursuing to ensure that its balance of payments problems are of a temporary nature and that some appropriate adjustment is undertaken. In these upper credit tranches, Fund programs include phasing and performance clauses. The temporary nature of the regular credit facilities is emphasized by the fact that funds are normally available for a period of three to five years.

TABLE 3
TOTAL USE OF IMF CREDIT
(In SDR millions, end of period)

	Developed Countries	*Developing Countries*	*Total*
1960	43	377	420
1961	753	684	1,437
1962	225	778	1,003
1963	172	916	1,088
1964	602	834	1,436
1965	2,044	980	3,024
1966	1,994	1,027	3,021
1967	1,331	1,151	2,482
1968	2,445	1,243	3,688
1969	2,843	1,167	4,011
1970	2,514	718	3,232
1971	626	714	1,340
1972	84	999	1,082
1973	69	958	1,028
1974	1,701	2,039	3,740
1975	3,938	3,497	7,435

Source: *International Financial Statistics,* IMF (May 1976).

As a result of an agreement reached in 1975 by the Interim Committee, the total quotas of members will be increased by just over one third, from SDR 29.2 billion to SDR 39 billion. Furthermore, a significant realignment of relative voting positions within the Fund will take place when this quota increase becomes effective (which will occur simultaneously with sufficient parliamentary approval of the amended Articles, probably some time in 1977). In particular, the voting strength of the developing world will be increased as a consequence of the decisions (a) to double the share of the major oil exporters, from effectively 5 percent to 10 percent of total quotas, and (b) not to reduce the share

[18] Strictly speaking this is to the extent of a member's gold tranche. Although most of the gold tranche subscriptions have been paid in gold, some portion has been met in foreign exchange. In the past, the gold tranche has always been equivalent to 25 percent of quota. However, under the new Articles, this proportion may fall since it will be possible for quota increases to be paid in a member's own currency, if the Fund so decides.

of the 87 non-oil developing countries below their present proportion of 20.85 percent of total quotas. The result of this essentially political decision is that the voting power of the remaining 28 developed nations will decline, in some cases by significant margins. It was also agreed that the next quota review will take place within three years whereas the normal time span between quota increases had previously been five years. The reduction in the period represented in a sense a concession to those countries, especially the developing ones, which had favoured a higher overall percentage increase in quotas than the one third finally agreed upon.

In addition, as an interim measure pending the increase in quotas and as a response to the widespread balance of payments deficits, it was decided in January 1976 to increase access to the ordinary credit tranches by 45 percent. This implies that individual credit tranches will equal 36.25 percent of quota instead of the traditional 25 percent until the overall increase in quotas becomes effective. Such an approach also substantially preserves the structure of the Fund's conditionality arrangements.

Those who favoured a broadening of access in this way based their case on the large financing needs which have been projected over the next year or two, especially for the developing and primary producing countries, many of which have already borrowed heavily in the market and may not be able to continue to have recourse to market financing to the same extent as in recent years. Many of these countries have drawn down their reserves, which in any case have suffered a substantial decline in real terms. It has also been argued that the level of unused Fund credit in relation to imports has declined substantially, due to the shrinkage of quotas in relation to trade flows. Furthermore, there was a widely felt need that some expansion of the Fund's regular credit facilities was necessary in view of the termination of the oil facility arrangements early in 1976. However, there was a good deal of controversy about the extent to which this access should have been liberalized, if at all. This point of view was supported by evidence that there currently exists a large amount of unused access to the existing credit tranches and that any extension of these would in a sense jeopardize the Fund's role in the adjustment process since broadening of access implied some reduction in conditionality.[19] The final outcome was a compromise which resulted from protracted political bargaining and should really be considered within the context of the overall package of changes, including the whole range of amendments to the Articles, decided upon in Jamaica in early 1976.

Apart from the ordinary credit tranches, the Fund also has available a number of other financing channels. In line with the C.20 recommendation, and following the sharp rise in the price of oil in late 1973, the IMF established an oil facility in 1974, which was continued through 1975. The purpose of this facility was to finance a reasonable portion of members' balance of payments deficits which were attributable to the effect of higher oil prices. During 1974 and 1975 a total of 55 countries drew SDR 6.9 billion under the facility (see table 4), which was financed by the Fund obtaining borrowed funds from the major oil exporters and, to a lesser extent, from some of the industrial nations. In order to ease the transition process, access to the facility in 1974 was relatively straightforward involving rather light conditionality arrangements. However, in 1975 members borrowing under the oil facility not only had to have a sufficient balance of payments need but also had to undertake a financial program similar to that which would have been applicable under a first credit tranche drawing. The declared objective of this was to promote balance of payments adjustment over the medium term, with loans being for a maximum period of seven years. Given that the funds were borrowed specifically for the purpose of this facility at rates comparable with those prevailing in the open market, charges on a member's outstanding drawings were rather higher than under normal credit tranche arrangements (see table 6).

In order to reduce the effective interest rate burden on the poorest developing countries borrowing under the oil facility—the 43 countries classified by the United Nations as MSA or "most seriously affected"—an interest subsidy account was established by the Fund. By May 1976, 23 countries had promised contributions of SDR 160 million to this account, which is likely to reduce the average interest cost to those countries benefiting from the subsidy account by perhaps 5.5 percentage points.[20]

When it became apparent that it would not be possible to establish a SDR/aid link, the developing countries proposed the establishment of an extended fund facility within the IMF. This approach was supported by the C.20. The facility was set up in 1974 to provide medium-term financial assistance to those members, especially

[19] Although the use of a common factor (45 percent) for the increase in each credit tranche maintains intact the overall conditionality structure, some reduction in conditionality could be said to be implied by the fact that a member can now draw 36.25 percent of quota under the more liberal first credit tranche arrangements compared with 25 percent of quota formerly.

[20] This assumes all the promised contributions are collected. Total drawings under the oil facility by the MSA countries amounted to SDR 550 million.

TABLE 4
IMF LENDING UNDER THE OIL FACILITY

	1974			1975		
	No. of countries	*SDR millions*	*% of total amount*	*No. of countries*	*SDR millions*	*% of total amount*
Major industrial countries	1	675	26.1	2	1,780	41.2
Other developed countries	6	795	30.8	8	1,114	25.8
Developing countries	33	1,113	43.1	35	1,426	33.0
Total	40	2,583	100.0	45	4,320	100.0

developing countries, suffering serious balance of payments difficulties. The decision on this matter mentions specifically economies suffering from "structural maladjustments in production and trade and where price and cost distortions have been widespread" or where the economy has been characterized by slow economic growth and an inherently weak balance of payments position which inhibits pursuit of an active development policy. Extended arrangements can be made for periods up to three years providing they are based on an adequate medium-term policy program. Total purchases under this facility can be up to 140 percent of a member's quota with repayment of the loans due over a four to eight-year period. Despite the pressures underlying the introduction of the facility, by May 1976 only two countries (Kenya and the Philippines) had drawn under it, although there are several other cases in various stages of preparation.

Another facility, and one which is currently subject to intensive use, is that relating to the compensatory financing of export fluctuations. This arrangement was first introduced in 1963 and was the subject of a major review in 1975, when it became apparent that the formula used to calculate export shortfalls did not take adequate account of the high rates of inflation experienced in recent years. The facility is designed to assist with the short-term financing of balance of payments difficulties resulting from fluctuations in export earnings, especially those related to primary commodities. These fluctuations are often to a large extent beyond the individual member's control. Ideally, the member country should be able to draw on the facility when its export earnings are abnormally low and to repay the loan when earnings rise above the medium-term trend. With this in mind, an export shortfall is computed as the difference between a five-year moving average of export earnings centred on the shortfall year, and earnings in the shortfall year itself. The level of conditionality attached to the facility is relatively light on the grounds that the loan represents compensation for a temporary export shortfall which should hopefully remedy itself within a relatively short space of time.

In late 1975 the facility was liberalized in two major ways. First, the maximum amount which could be drawn was increased from 50 percent to 75 percent of quota (50 percent in the first year and 25 percent subsequent to this). Secondly, the formula for calculating the export shortfall to determine a member's eligibility under the facility was modified in such a way as to take more appropriate account of the generally sharply rising values of world trade, which has been a predominant characteristic of the last few years.[21]

Table 5

COMPENSATORY FINANCING FACILITY DRAWINGS

(In SDR millions)

	Drawings[1]		*Outstanding Drawings*
	Yearly	*Cumulative*	
		(from start of facility)	*(on April 30 each year)*
1969	13	390[2]	218
1970	3	393	151
1971	69	462	111
1972	299	762	224
1973	113	875	378
1974	107	982	553
1975	239	1,221	528
1976	n.a.[3]	n.a.[3]	1,208[4]

[1] Under the 1963 and 1966 IMF Decisions. Figures on a calendar basis, rounded to nearest million.

[2] Cumulative drawings 1963 to 1969. Facility commenced in 1963.

[3] N.a., not yet available (table prepared in May 1976).

[4] Drawings under 1975 Decision commenced in 1976, so this figure for outstandings on 30 April 1976, includes drawings under the 1975 Decision to that date together with outstandings carried over from drawings under the 1966 Decision.

The IMF's seldom-used buffer stock facility[22] is also designed to assist with the problem of stabilization of prices of primary products. This has been in operation since 1969 to assist members with the financing of international buffer stocks of primary products, providing the member has a balance of payments need and the relevant commodity agreement meets appropriate criteria. So far, only tin and cocoa have qualified, although in the case of cocoa no use has yet been made of the facility. At the end of 1975, the Fund eliminated the combined ceiling on members' potential access to this facility and the compensatory facility (it had been 75 percent) so that buffer stock drawings can be up to 50 percent of quota independently of arrangements under the compensatory facility. At that time there was considerable pressure on the IMF to finance directly international buffer stocks but it was decided that it was preferable to maintain a direct relationship between the Fund and those members using its resources. For this reason the direct financing proposal was rejected, at least in the meantime.

Finally, as part of the understandings reached with respect to the disposition of the Fund's gold, a Trust Fund has been established by the IMF for the purpose of providing highly concessional balance of payments assistance to low income developing countries. The Trust Fund will be financed from both voluntary contributions (hopefully) and the profits or "surplus value" realized on the sale of one sixth (25 million ounces) of the IMF's gold. The gold sales will take place at regular public auctions to be held over the next four years. Eligible beneficiaries are those 61 member countries having a per capita annual income of less than SDR 300 in 1973. These countries will receive assistance on the basis of their balance of payments needs providing they under-

[21] The old formula, based on a 1966 Board decision, included a limiting factor which essentially assumed a very low rate of inflation. When inflation became more rapid in the 1970s this limiting factor operated in such a way as to inhibit severely use of the compensatory financing facility other than by those members with extremely serious export shortfalls. Because the scope of the facility thus became much narrower than originally intended, the 1975 review was undertaken to find a more appropriate formula. One procedure which was widely favoured by the primary producing nations, which are the major beneficiaries under the facility, was to carry out the measurements in real terms so that fluctuating rates of inflation would not of themselves affect the principles underlying eligibility to use the facility. However, this procedure was inappropriately likened to "indexation" by a number of the major industrial countries and was unfortunately rejected as a possible solution to the problem.

[22] Total purchases from 1969 to May 1976 have been about SDR 30 million.

take a satisfactory adjustment program, on the basis of conditionality similar to that prevailing in the first credit tranche. Trust Fund loans will be for periods of up to ten years at a nominal interest rate of 0.5 percent per annum. Since the finance is so obviously concessional, some countries felt the assistance should be in the form of outright grants rather than loans, especially bearing in mind the extremely low incomes of the beneficiary nations. However, others claimed that loans were more consistent with normal Fund policy, and that it was important for such loans to be granted on a conditional basis to ensure that adequate policies were undertaken to facilitate at least some degree of balance of payments adjustment.

A brief summary of the IMF's various credit facilities as they now stand is set out in table 6.[23]

4. THE DEVELOPING COUNTRIES

One of the more difficult and controversial aspects of the reform discussions was whether there should be some special treatment for the developing countries. The facts of the matter are that the rate of growth in these countries is still not sufficient to narrow the gap between them and the industrial nations, and their share in world trade has progressively declined while that of the developed countries has risen. While this regrettable situation has been attributable to basic economic factors, inadequate resource endowment and other domestic problems, it has been compounded by difficulties of access to markets, an inadequate flow of capital to developing areas, and problems of debt management. For these sorts of reasons, and given the enormous gap in relative affluence between the developing and developed nations, there was considerable pressure brought to bear by the developing countries during the negotiations on monetary reform for measures to take account of what were claimed to be their special interests and particular problems.

In varying degrees, the industrial countries recognized the severity of the difficulties facing the developing nations but on the whole were reluctant to associate monetary reform with measures geared solely to the needs of the developing world. It was pointed out that these needs could be met more satisfactorily through other appropriate channels already established for the purpose, such as the various specialized United Nations agencies, UNCTAD, the World Bank group, the Conference on International Economic Co-operation, and regional development organizations such as the Asian Development Bank. As far as the international monetary system was concerned, and with respect to the International Monetary Fund in particular, it was felt that the best interests of both the developed and developing countries would be served by preserving the traditional one-world approach.

The IMF has always endeavoured to maintain reasonable uniformity of treatment for all its 128 members, regardless of their various stages of development, social systems, or political attitudes. It has been maintained that the Fund is a monetary institution, not an aid agency or development organization. All members have equal rights and responsibilities. Fund credit is available to help finance temporary balance of payments problems on the basis that members accepting assistance endeavour to pursue internationally acceptable policies of payments adjustment. Fund credit is thus of a temporary and revolving character, available to any member which has a demonstrable need for it. The developed countries have argued that discriminatory policies favouring particular groups of members may weaken the strong political base of the IMF and reduce its leading role as the world's major monetary institution.

However the uniformity principle has not been interpreted so literally as to prohibit completely sympathetic consideration of the special difficulties in which many developing economies find themselves. Acceptance of the need to protect the interests of the developing countries was partly demonstrated during the course of the most recent quota review when the voting share of the major oil exporters, most of which are classified as developing countries, was doubled and the share of the other developing nations was maintained undiminished. The consequent reduction in voting share was borne by the developed members.

The most apparent break with the one-world tradition was the recent decision to establish a Trust Fund which will be financed by the profits from the sale of one sixth of the IMF's gold (except that the share of profits on the gold imputable to the developing countries will be returned to them directly, which simply means that the Trust Fund will be financed by the disposition of gold originally subscribed by developed members). As mentioned earlier, the Trust Fund will provide loans at nominal interest cost to the low income developing nations.

Another measure specifically geared to the interests of the "most seriously affected" developing countries is the oil facility subsidy account, which is designed to subsidize the interest cost of drawings under the oil facility by these low income members. The contributions to this account are primarily from the developed countries and the major oil exporters.

Although neither the extended fund facility nor the compensatory financing facility is specifically restricted to use by the developing countries, and nor was this the underlying intention at least with respect to the compensatory financing facility, it is true that the major beneficiaries in practice are likely to be developing countries. This was recognized in the decisions underlying the introduction of these facilities. For example, in the case of the extended fund facility, which was established after efforts to introduce a SDR/aid link had failed, the decision specifically notes that "the facility, in its formulation and administration, is likely to be beneficial for developing countries in particular". The sorts of problems which are necessary to justify a drawing under this facility are also most prevalent amongst the developing nations.

In a similar manner, the decision on the compensatory financing of export fluctuations mentions that this facility is most likely to assist "primary exporting member countries", enabling them "to pursue their programs of economic development with greater effectiveness". It is generally understood that the major industrial countries will refrain from using this facility and in fact the only developed countries which have drawn under the com-

[23] Further more detailed information is available in *Selected Decisions of the International Monetary Fund* (Washington, D.C.), Seventh Issue (1 January 1975).

TABLE 6. SUMMARY OF

1. Facility	Reserve tranche (or gold tranche)	Ordinary credit tranches	Compensatory financing facility
2. Commenced	At outset of IMF operations.	At outset of IMF operations.	1963
3. Latest review	—	1976	1975
4. Nature of review	—	Each tranche increased by 45% pending sixth general review of quotas becoming effective.	Maximum access increased from 50% to 75% of quota and formula revised to take more adequate account of inflation.
5. Maximum drawing entitlement	Normally 25% of quota. (Under the amended Articles this percentage may gradually be reduced since the new Articles will provide that more than 75% of quota increases may be paid in domestic currency.)	Normally 100% of quota (4 tranches of 25% each). Temporarily 145% of quota.	75% of quota overall with up to 50% in any 12-month period and 25% thereafter.
6. Designed especially for	All members.	All members.	Primary product exporters experiencing export shortfalls.
7. Eligibility determined on basis of	Member's own representation of balance of payments need (which cannot be challenged).	General balance of payments need. (Note that funds can be made available either at time Board decision is taken (direct drawing) or on a stand-by basis, under which funds may be drawn up to 12 months after Board decision.)	Temporary export shortfall calculated as difference between 5-year moving average of exports centred on shortfall year and shortfall year itself, provided balance of payments need also exists. Separate formula is used initially to generate export forecast for two post-shortfall years, but this creates presumption only, and may be (and usually is) superseded by subsequent judgmental forecasts.
8. Conditionality	None.	Purchases in the credit tranches are in support programs to cope with balance of payments difficulties. Requests for purchases in the first credit tranche are granted provided that the member itself is making reasonable efforts to solve its problems; they can be made in the form of either a direct purchase or a stand-by arrangement. Purchases under such stand-by arrangements are not subject to phasing or performance clauses. Requests for purchases beyond the first credit tranche require substantial justification. These purchases are normally made under a stand-by arrangement which is subject to phasing and performance criteria.	Shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member. The member is expected to co-operate with the Fund in an effort to find appropriate solutions for its balance of payments problem. However a formal program, such as that applicable to the ordinary credit tranches, is not required. Requests for drawings going beyond 50% of quota are met only if the Fund is satisfied that the member has been co-operating with the Fund in an effort to find appropriate solutions for its balance of payments problem.
9. Normal maximum period for repurchase	3-5 years.	3-5 years.	3-5 years.
10. Interest charges (per annum)	No charge.	4 to 6 percent (depending on period; also 0.5 percent service charge payable once per transaction).	As for ordinary credit tranches.

IMF's DRAWING FACILITIES

Buffer stock facility	Extended fund facility	Trust fund	Oil facility
1969	1974	1976	1974
1975	1976	—	1976
Combined limit with compensatory finance eliminated (it was previously 75% of quota).	Combined maximum in terms of IMF's holdings of member's currency as result of drawings under this facility and ordinary tranche policy temporarily increased (see below).	—	Facility ended after being in operation for two years.
50% of quota.	Up to 140% of quota, over period up to 3 years (but purchases not to raise IMF's holdings of member's currency above 265% of quota normally, 276.25% temporarily in line with expanded credit tranches).	Depends on profits realized on sale of portion of IMF's gold over 4 years from 1976. Entitlement determined on basis of quota shares of list of eligible beneficiaries.	Varied according to "oil deficits" of member countries. Such deficits were calculated by a formula based on increases in members' oil import costs, with some minimum and maximum rules.
Primary product exporters participating in approved international buffer stock arrangements (only tin and cocoa have so far qualified).	Developing countries.	Low income developing countries (those with per capita income in 1973 less than SDR 300).	Members seriously affected by steep oil price increases.
Participation in approved buffer stock arrangement and individual balance of payments need. Extent of eligibility dependent on member's financial contribution to buffer stock arrangement, with maximum being 50% of quota.	Longer term balance of payments need, involving structural maladjustments, price and cost distortions, and slow economic growth.	General balance of payments need (but restricted to low income developing countries).	Sufficient "oil deficit" in balance of payments together with more general balance of payments need.
Member expected to co-operate with the Fund as in the case of compensatory financing.	Medium-term program for 2-3 years, designed to achieve solution to member's economic problems. Detailed statement of policies and measures for first and subsequent 12-month periods. Resources provided in the form of extended arrangements subject to phasing and performance criteria.	Conditionality equivalent to drawing under first credit tranche.	In 1974, undertaking to avoid restrictions on current international payments and transactions. Latter provision also applied in 1975, when conditionality was extended to be similar to that prevailing under first credit tranche.
3-5 years.	4-8 years.	6-10 years.	3-7 years.
As for ordinary credit tranches.	4 to 6.5 percent (depending on period; also 0.5 percent service charge payable once per transaction).	0.5 percent.	1974 facility: 6.875 to 7.125%. 1975 facility: 7.625 to 7.875% (depending on period; service charge of 0.5 percent in case of each transaction).

pensatory arrangements prior to May 1976 have been Iceland and New Zealand. It is clear that the type of export shortfall problem envisaged under this facility is most likely to be experienced by exporters of primary commodities, and most of these nations are indeed developing countries.

It is interesting to recall that on the occasion of the latest review of the facility in late 1975, the United States initially sought to restrict compensatory financing to developing members only when this approach failed the United States endeavoured to obtain specific voluntary undertakings from most developed members of the Fund to refrain from drawing under the facility. In the event, these efforts to reach a formal understanding were unsuccessful, although the longstanding but very informal voluntary "understanding" that the major industrial nations would not normally use the facility appears to remain effective. No doubt the willingness of the industrial countries to implement significant improvements in compensatory financing in 1975 reflected at least in part a desire to diffuse some of the pressures the developed countries were facing in other international fora such as UNCTAD. These pressures arose from the developing countries' wish to pursue the well-publicized integrated commodity package approach, which would require the consent of both producing and consuming nations.

A further interesting illustration of the desire for uniform treatment of all members was the final outcome of the debate on Article IV relating to members' obligations on exchange rates. The developing countries felt that in exercising surveillance over exchange rate policies the Fund should pay particular regard to the special problems of developing members, implying the possibility of some sort of exemption or escape clause, or at least a "softened" interpretation with respect to their obligations under this Article. However, this met with blanket opposition from the developed countries and the agreed draft clearly relates to all members. With respect to the principles which the Fund shall adopt for the guidance of members in the exchange rate area, the Articles read: "These principles shall respect the domestic, social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members."

There were two other matters specifically relating to developing countries which were discussed at some length by the Committee of Twenty. First, it was recommended that a ministerial level Development Committee be established as a counterpart of the Interim Committee. This was done, although there must be some doubts about the extent to which the Development Committee has been useful in promoting the study and transfer of additional real resources to developing countries, which was its prime objective. Not surprisingly, it has been largely overshadowed by the Interim Committee.

Secondly, the question of a SDR/aid link was extensively discussed by the C.20 but it proved impossible to reach a unanimous conclusion, due primarily to the unbending opposition of the United States and Germany. At least for the moment, the link seems to be a dead issue. The idea underlying the various proposals on this matter was that a "link" should be established between the allocation of special drawing rights and additional development finance by, for example, granting the developing countries a larger share in total SDR allocations than would correspond to their share in Fund quotas. Alternatively, again by way of illustration, it was suggested that a portion of any SDRs created could be made available directly or indirectly to development finance institutions which would then in turn on-lend the funds to developing countries.

The arguments in favour of a link included suggestions that it would provide further financial resources for developing countries (thus giving substance to the general agreement on the desirability of this aim), promote trade and economic development, and help rectify some of the inequities seen to exist in the world distribution of wealth and international reserves in particular. For instance, it was thought it might be equitable in the sense of constituting an offset to past reserve creations which had tended to imply resource transfers to gold producers and reserve centres.

Those who opposed the introduction of a link argued that it would undermine confidence in the SDR since it might not only potentially complicate the operation of the international monetary system but also induce additional pressures for further SDR allocations because of the link to development assistance. This could aggravate inflation especially since SDRs acquired through a link process would tend to be spent rather than held by recipients. Moreover, doubts were expressed as to whether the aggregate net flow of financial resources for development would indeed increase by anything close to the full amount of SDR allocations under a link, and it was suggested that such a link would be unlikely to contribute to the solution of problems of balance of payments adjustment among member countries. Although these arguments can be countered in various ways, the upshot of the debate was that there was insufficient agreement to enable a link to be created.

5. UNRESOLVED ISSUES

Having traversed the ground covered by the reform exercise, it may be useful to return to some of the unresolved issues in order to draw together the various strands of thought.[24]

As far as balance of payments adjustment is concerned, it could reasonably be claimed that during the last few years this has been substantially assisted by the partial regime of floating exchange rates and the increased willingness of those countries with pegged exchange rates to vary these more frequently. Nevertheless, the rather mixed system, if it could be called that, now in operation combining floating and pegged rates in various forms still implies the existence of balance of payments deficits and surpluses. Apart from the fact that the majority of the IMF's members in fact maintain pegged rates of one form or another, those countries (which happen to be the Fund's largest members) which engage in floating do so not on the basis of a free market system—a clean float—but rather on a managed basis. Furthermore, the international environment continues to be characterized by marked differences in rates of inflation between individual countries. Some of the problems which the present system gives rise to are illustrated by the so-called "snake" arrangements under which a number of the European countries have

[24] For alternative summaries and assessments of the reform exercise, see de Vries [1] and Kafka [11].

endeavoured to maintain a system of common margins. These arrangements, which are not unlike a par value system with limited membership, have proved too restrictive for some countries, which have had to desert the system.

Given that the monetary system is such that deficits and surpluses will continue to occur, it is clear that as in the past adjustment will in fact be forced upon some countries. For instance, a deficit member will suffer reserve losses or incur debts through borrowing either during the course of intervention activities to maintain its exchange rate above the level the market considers appropriate, at least in the short term, or alternatively up until that time it decides to depreciate or let the rate float down. The real problem for countries with floating exchange rates (and, in a comparable sense, also for countries with pegged rates) is to detect what is in fact the medium-term trend in the rate which would achieve equilibrium and, in the light of this, what constitutes a short-term departure from this trend which might justify temporary intervention.

The problem of disruptive large speculative movements in capital flows, which was given considerable attention during earlier stages of the reform discussions, has eased to some extent but has not been eliminated as a consequence of the floating arrangements. In addition, trade restrictions continue to pose some threat to the system and although the issue of restrictions on physical transactions was not really dealt with during the course of the reform,[25] the outcome of negotiations in other fora such as the Tokyo Round of GATT will have major implications for the international monetary system.

The major advantage of the new Articles is that at least they accept and reflect the current reality with respect to exchange rate practices. In essence, they legalize the status quo and confirm the collective desire of the Fund's membership to maintain an international code of behaviour. The new Articles will no doubt improve the functioning of the IMF itself and, more fundamentally, give it the right to exercise surveillance—moreover, firm surveillance—over the exchange rate policies of its members and to establish principles or guidelines for their appropriate behaviour. But all this is rather generalized so far, to the extent that the Fund's future role with respect to exchange rate policies and adjustment generally remains uncertain. Details of the code of behaviour, and how it might work (or be enforced), have yet to be decided upon.

There is still no system of incentives (via objective indicators or otherwise) to promote adjustment of either deficit or surplus countries or reserve centres. The United States dollar inevitably continues to be the major intervention currency. It is widely held in substantial amounts in most countries' foreign reserves. Official convertibility of it remains suspended. Although the dollar overhang problem has eased or perhaps been eliminated, imbalances can still potentially occur between reserve centres and other countries. However, the possible solution to any potential problem in this area, that of asset settlement arrangements, seems to be a dormant issue today. Convertibility is assured only by a commitment to avoid restrictions on current payments (and not by any similar commitments to avoid either trade restrictions or controls on capital movements).

Furthermore, no exchange rate system as such has really been agreed upon as a replacement for the par value system. The revised Articles can do no better than describe the present system as simply that "of the kind prevailing on 1 January 1976". Nevertheless, this approach probably has much to be said for it. It imposes no straight-jacket on members of the Fund, and preserves the flexibility which is now, fortunately, an important part of international monetary arrangements.

On the question of reserve assets, the new Articles speak unconvincingly of the desirability of promoting the SDR as the principal reserve asset and an innocent bystander during the reform discussions might also have been led to believe that there was a genuine collective desire to reduce gradually the role of gold in the monetary system. But initial appearances can be deceptive.

The fact is that gold is widely held as a reserve asset, and in some cases the amount of the holdings is very large indeed, not the least of which is the Fund's own gold stock. Accordingly, despite the not inconsiderable problems surrounding gold in its use as a reserve asset—including a markedly fluctuating price and uneven distributional effects of price changes, with rises in price benefiting principally gold producers and existing holders—gold seems likely to continue for many years to be an important reserve asset. Perhaps this is not such an unsatisfactory state of affairs as some would suggest, since it has by no means been proven that the world economy would incur a net advantage from the total or partial elimination or replacement of gold as an international reserve.

Although the Fund's Articles contain no provisions which assure a diminished role for gold, the agreement between the members of the G.10 places some important temporary limitations on its use. When the two-year period covered by this agreement expires in late 1977, two interesting questions will arise: first, whether there should continue to be a global ceiling on official holdings of gold and, secondly, whether the major gold holders should continue to avoid actions either to peg the price or to agree on some common price for gold transactions. On the latter point, it is difficult to assess the real meaning of the present agreement given that in present circumstances most major gold holding countries apparently feel no compelling need to utilize their gold reserves, other than as collateral for loans, and given also the insistence of some European countries, most notably France, that the Bank for International Settlements should be able to bid at IMF gold auctions. It is generally assumed that, in the absence of any right for individual Fund members to bid under the present Articles, the BIS will operate in such a way as to assist indirectly in protecting the value of its member countries' gold holdings. In other words, it seems likely that the BIS will bid in order to maintain the price at whatever level is judged to be desirable by its membership.

Under the amended Articles, IMF members will have the right not only to sell but also purchase gold free of any restrictions other than self-imposed ones. This has the obvious potential to activate currently idle gold stocks. Furthermore, although IMF gold sales will reduce its own holdings (by one third, when restitution is also taken into account), it could be suggested that such sales may promote rather than reduce the role of gold within the monetary system, especially if much of the gold eventually finds its way into official holdings. No decision has yet been made as to what should happen

[25] Other than a requirement that countries drawing under the oil facility should avoid resort to quantitative restrictions.

to the remainder of the IMF's gold stock. The essential point is that, if anything, there are likely to be more transactions in gold in the future rather than less transactions. Gold's role may well be enhanced, at least compared with the position prevailing in more recent years. Nevertheless, as in the case of exchange rate arrangements, the treatment of gold is probably now a more realistic one.

Much consideration has been given to the idea that special drawing rights should become the major reserve asset. However, SDRs currently comprise less than one tenth of total reserves and there seems to be little prospect of new allocations in the immediate future, given both the rapid growth of aggregate reserves and the inflationary experience of the past few years. If anyone is short of international liquidity, it is probably the developing countries, but this raises questions with respect to the distribution of—and not simply the volume of—reserves.

Unfortunately, little progress has been made in improving the attractiveness of existing SDRs, let alone in devising techniques for allocating new SDRs through, say, substitution arrangements involving either currencies or gold. The acceptance and reconstitution obligations remain, as does the balance of payments requirement of need other than for voluntary transactions between holders. The interest rate is also unattractive. Hence, despite the laudatory overall objective with respect to SDRs, the opportunity has been lost to enhance the quality of SDRs, or to increase their volume or alter their pattern of distribution.

It is difficult to believe that the bulk of the Fund's membership was really serious about the expressed desire to promote the SDR as a principal reserve asset and to reduce the role of gold. The most that can perhaps be said for the present situation is that at least it leaves the way open for future movements in these directions. Some, if not all, of the former legal inhibitions have been removed.

In a situation of floating exchange rates it could be argued that the need for centralized regulation of global liquidity is not so clear or at least not so pressing as was formerly thought to be the case. This situation, together with difficulties experienced in reaching agreement on any method of international regulation, led to the issue not being actively pursued in practice, despite the stated role for the IMF in the new Articles. The matter is complicated of course by the existence and growth of offshore currency markets, such as the Eurodollar market. Although things have changed as a result of floating exchange rates, the present monetary system probably continues to retain inflationary tendencies. Reserves are essentially demand-determined, with each country acquiring reserves by way of domestic policy changes, exchange rate variations, or borrowing operations. This implies that there may well be a need to return to the subject of international liquidity regulation at some stage in the future.

There has been much talk recently of a "new international economic order", especially within the United Nations and its various agencies, such as UNCTAD. But this seems to be an exaggerated and inappropriate form of words to describe either the changes which have been achieved with respect to improving the lot of the developing world, or those changes which are likely to come to pass in the foreseeable future. Although the special interests of the developing countries were extensively debated during the course of the reform exercise, no fundamental changes have been introduced which would be likely to increase substantially the transfer of real resources to these nations. The most the IMF has done—and the most it is probably able to do consistent with the one-world approach—is to make available additional finance through new or expanded Fund facilities. Although most of these facilities promise uniform treatment for all members, it is recognized that in some important cases the major beneficiaries are likely to be the developing countries.

In other areas the developing nations see themselves gaining little. For instance, as for the agreement on exchange rates, most of the developing countries wish to see greater stability rather than more flexibility in rates. They hold little gold and appear to have negligible prospects of receiving further SDR allocations in the immediate future. The "link" proposals failed to gain acceptance. As for their trade, the developing countries, many of which are primary producers, have suffered from a less than evenhanded treatment of agricultural restrictions vis-à-vis other import restrictions. Despite the recent agreement in UNCTAD, doubts persist about how much real progress will be made on the question of an integrated commodity package approach.

As far as the IMF is concerned, the desire to maintain the Fund as a monetary institution, and to resist any tendency for it to become a development organization, is entirely understandable. Indeed, given the political realities of the situation, the developing countries themselves are likely to gain more from this approach than from forcing the Fund into the aid business. The uniformity principle is probably the major assurance of the future financial strength of the Fund.

Within the IMF itself some improvements will result from the new Articles, especially where functional simplifications have been introduced and where the benefit of past experience is now reflected in new legal provisions.

The future broader role of the Fund (beyond its day-to-day lending activities) must be indeterminate at this stage, since although it has the power now to introduce guidelines with respect to exchange rate policies and to exercise surveillance over both individual members' policies and the aggregate amount of international reserves, there must be some doubt about just how meaningful this will turn out to be in practice. Past experience is not necessarily encouraging in this respect. Members remain concerned with the preservation of national sovereignty. Although the IMF may be able to exert some influence over deficit members which need to come into the Fund for financial assistance, real problems may arise in exercising surveillance over surplus countries and reserve centres.

But even in the area of influence over deficit countries some subtle changes have been taking place, the most important of which is the reduced degree of conditionality which has been associated with some recent innovations in IMF credit arrangements. For example, the 1974 oil facility had few conditions associated with it, and the 1975 oil facility involved no more than first credit tranche conditionality for all its lending, despite the fact that many countries were able to borrow amounts substantially in excess of their first credit tranches. One of the major extensions of credit within the Fund, by way of the compensatory financing facility, has very light conditionality requirements.

As for conditionality itself, some interesting questions could be raised about both its effectiveness and its flexibility in coping with the different problems of widely different member states.[26] In particular, the pursuit of a specific monetary approach, and an unwavering attachment to credit ceilings,[27] raises possible complications in terms of economic analysis. This is especially so, for example, in individual cases where for various reasons the Fund may be unable to exert a comparable degree of influence over other important policy areas such as exchange rate management or interest rate policy. Of couse, the latter has implications for the former, since interest rate differentials between countries will influence — sometimes importantly — developments in exchange rates and foreign reserves. In the domestic area, where credit ceilings are imposed on a financial system where interest rate regulation[28] is pervasive, the Fund may well be unintentionally encouraging the disintermediation process, which promotes the growth of fringe financial institutions at the expense of those within the controlled sector and perhaps thereby reduces the efficiency and effectiveness of monetary policy. The question is really whether more effort should be made to modify the conditionality arrangements so that they encompass more satisfactorily policy measures other than those traditionally incorporated in the credit program arrangements; encourage more flexibility in handling inter-country differences, whether they be of a structural, social or policy character; and also provide sufficient flexibility to cope with inter-temporal differences, including the rather different policy stances which might be considered appropriate in a situation of widespread recession as compared with one of rapid economic expansion. But these are all substantial questions, to which no easy answers are possible.

Finally, another concern with respect to the IMF's operations must be the proliferation in recent years of such a wide range of financing facilities, including the ordinary credit tranches (now temporarily extended by 45 percent), the former oil facility, compensatory financing, the extended fund facility, the Trust Fund and the buffer stock financing arrangements (to say nothing of comparable arrangements outside the IMF, including the OECD support facility and the intra-EEC financing arrangements). The question is whether this is the most effective path for the IMF to follow. From the point of view of efficiency, to say nothing of ease of understanding, it could be argued that some rationalization of these facilities is probably desirable.

Of course, to some extent the diversified range of facilities reflects particular economic and financial problems.[29] Such a variety of ad hoc responses to special difficulties may indicate commendable flexibility, but it surely also raises some doubts about the adequacy of the Fund's normal credit arrangement (and hence its quotas) in the context of coping with the balance of payments financing needs of its members. Furthermore, the introduction of new facilities not linked to quota increases may involve ultimately serious implications for the Fund's overall liquidity position, since increased drawings may not be matched by a higher potential availability of currencies.

6. CONCLUSION

For the past four years international monetary reform has been the subject of intensive (and extensive) discussion at the highest official and political level. Yet the reform which has finally emerged is very much a partial one. This is not to say that important changes have not been made; rather, it is simply a reflection on the number of matters which essentially remain unresolved. Major innovative measures—such as asset settlement, gold or currency substitution accounts, the "link"—have been avoided. In one sense, compelling justifications for such changes were absent. Many issues, important though they may have been in terms of their economic content or their implications for particular groups of countries, were easier to leave aside than to resolve. In some cases, enabling provisions in the amended Articles will facilitate future decisions if agreements can one day be reached.

The changes that have been made tend either to confirm events which have already effectively taken place—for instance, the legalization of present exchange rate arrangements, and the removal of gold from its central role within the IMF itself—or alternatively respond to pressures which were felt to be sufficiently persuasive (on either economic or political grounds) to merit some action. This category would include the many important recent improvements in the IMF's financing facilities.

Beyond this, although the administrative functioning of the IMF will be improved by the new Articles, its broader role with respect to the management of international liquidity and surveillance of its members' exchange rate policies must remain indeterminate. Despite its new highly generalized powers it must be doubtful whether the Fund will be able to exercise any greater influence in these areas than in the past, especially in relation to surplus countries and reserve centres.

In these areas, as in others, the new Articles probably promise more than the Fund will be able to deliver. There is no better illustration of this problem than the provisions on SDRs and gold, where despite assurances to the contrary, the Articles do not guarantee a significantly enhanced role for the SDR or a much reduced role for gold. The most that can be said is that it may be possible to take some(but, without additional amendments, only some) further moves in these general directions in the future. To a greater extent than previously, the future place of gold in the monetary system is now more in the hands of the gold holders than it is the responsibility of the IMF. The Fund will gradually move out of gold; but there are as yet no signs that the gold holders will accompany it.

On a more optimistic note, some of the changes must be seen as strengthening the Fund not only administratively but also in a more fundamental sense. Despite facing some challenge, the uniformity principle has been substantially preserved, confirming the Fund's continued role as a world monetary institution rather than allowing it to develop into something more akin to an aid organization. The programme of gold sales, the forthcoming quota increase, and the widened usability of currencies which the new Articles assure, will each add

[26] Further applied research on these matters could be helpful, especially since a substantial body of historical data must now be available on the implementation and outcome of Fund programmes.

[27] These ceilings normally cover both private and government sector credit.

[28] That is, regulation either directly by interest rate controls or indirectly by domestic security market intervention.

[29] Including oil price increases (the oil facility), fluctuating primary product prices (the compensatory financing facility), and the special difficulties of the developing members (the extended fund facility).

to the Fund's liquidity. This will form the basis for increased lending activities which in turn should extend the influence of the Fund.

And, after all, this is what the IMF is all about—the international community co-operating to assist individual countries to finance their external deficits while simultaneously encouraging them to pursue appropriate adjustment policies. The real extent to which the Fund can further expand its influence along the lines foreshadowed by its amended charter must remain to be seen. In the very broadest sense, the framework has been prepared. But in formulating and—more importantly — in implementing the detailed surveillance arrangements, the necessary political will may unfortunately not be so readily forthcoming.

Perhaps inevitably then, monetary reform must be a continuing evolutionary process although, hopefully, the "reform" label will now be given a rest. Participants in the exercise of the last few years will undoubtedly be glad of that.

APPENDIX

SOME IMPLICATIONS FOR NEW ZEALAND

Although the wider implications of the reform exercise for a country such as New Zealand—and other members of the Fund—are likely to flow from any general enhancements which may take place within the international financial system as a result of the amended Articles and other agreements on the monetary system, there are some specific implications which could be recorded.

First, with respect to the exchange rate arrangements, all member countries of the IMF will be free to pursue exchange rate mechanisms of their own choice. In effect this will legalize the situation as it exists today. New Zealand's exchange rate is "fixed" in terms of a trade-weighted basket of currencies, and this system will be permitted to continue under the amended Articles. Even if a revamped par value system was to be reintroduced, countries such as New Zealand would be free to opt out of such arrangements if they so desired.

On the question of gold, there are two matters of significance with respect to New Zealand's interests. On the one hand, New Zealand stands to gain from the agreement to restitute to members in proportion to quotas 25 million ounces of the Fund's gold. For New Zealand this should yield 172,878 ounces, from which a return could be expected equivalent to the difference between the market price for gold and the old official price of SDR 35 per ounce. For example, if the "profit" was in the region of US$85.00, the overall return would approach US$15 million.[30] Members would have to pay the IMF the equivalent of the official price for gold which is restituted to them.

On the other hand, a further 25 million ounces of the IMF's gold is to be sold for the benefit of developing countries. The profits from these sales will be used primarily to finance the Trust Fund. New Zealand supported this arrangement which, in effect, means that the Trust Fund will be financed by the IMF selling part of the gold originally subscribed to it by the developed members.

The major benefit which New Zealand seems likely to derive from the changes which have taken place recently within the context of the Interim Committee agreements is with respect to an enhanced use of IMF resources. Under the Sixth General Review of Quotas, New Zealand's quota will increase by 14.85 percent from SDR 202 million to SDR 232 million. Although this implies a decline in its quota share from 0.69 percent to 0.59 percent,[31] it nevertheless means an increase in New Zealand's access to the ordinary credit tranches to the extent of the rise in the quota. Furthermore, in the period prior to the formal implementation of the increased quotas, New Zealand has available additional ordinary credit lines in the Fund because of the agreement reached in January 1976 to increase access by 45 percent to the Fund's normal credit tranches. Thus, New Zealand could draw up to SDR 292.9 million rather than the amount of its quota of SDR 202 million under these tranches. Ironically enough, this means that prior to the quota review becoming effective, New Zealand's access to ordinary credit will be significantly greater than after the date of the introduction of the new quotas. This results from the fact that the 45 percent increase in access is applicable across the board to all members, whereas the percentage increases in quotas varied substantially between both different categories of members and individual countries.

The various special financing facilities available within the IMF have already been described. There are two of these from which New Zealand has benefited in a significant way. First, substantial drawings totalling SDR 239 million were made under the 1974 and 1975 oil facilities.[32] Secondly, New Zealand is one of those countries which is likely to be a major beneficiary of the revised compensatory financing facility, under which members can draw up to 75 percent of quota[33] to help finance export shortfalls, especially those relating to primary products.

As things stand at present, it is unlikely that New Zealand would utilize either the extended fund facility or the buffer stock financing facility.

Table 7 sets out New Zealand's transactions with the IMF over the past decade, and table 8 provides further details on the maximum access by New Zealand to the IMF's general resources.

[30] The amounts are illustrative only, based on the market price in mid-May 1976 of US$128 per ounce.

[31] The reduced share is partly a consequence of the increased share granted to the major oil exporters and the maintenance of the relative position of the other developing countries, as discussed earlier in the Paper.

[32] New Zealand has also promised to contribute SDR 1.7 million to the oil facility subsidy account, which will subsidise the interest cost of borrowing under this facility by the low-income MSA developing countries.

[33] This means that at present New Zealand's maximum access would be SDR 151.5 million (75 percent of SDR 202 million). Under the new quotas, the maximum entitlement will be SDR 174.0 million.

Table 7
NEW ZEALAND'S TRANSACTIONS WITH THE INTERNATIONAL MONETARY FUND

	General Account						*Special Drawing Rights*[1]		
	Drawings		*Repurchases*		*Drawings Outstanding*	*Fund Holdings of N.Z. Currency*	*Acquisitions*[2]	*Utilization*	*Total Holdings*
	SDRs m	*NZ$m*	*SDRs m*	*NZ$m*	*NZ$m*	*% of Quota*			
1967 — May 10	29.2[3]	26.1	—	—	88.6	138			
Oct. 31	45.0	40.2	—	—	128.8	167			
Dec. 5	15.0	13.4	—	—	142.1	176			
1968 — Mar. 26	—	—	35.0	31.3	110.9	154			
May 8	—	—	35.0	31.3	79.6	132			
Nov. 12	—	—	0.1	0.1	79.6	132			
Dec. 13	—	—	29.2	26.1	53.5	113			
1969 — Aug. 20	—	—	20.6	18.4	35.0	100			
1970 — Jan. 1	—	—	—	—	—	100	23.6	—	23.5
Sep. 16	—	—	39.2	35.0	—	75	—	23.2	0.3
1971 — Jan. 1	—	—	—	—	—	75	19.3	—	19.6
Oct. 19	—	—	—	—	—	75	5.4	—	24.8
1972 — Jan. 1	—	—	—	—	—	75	19.1	—	43.9
Jan. 18	—	—	—	—	—	75	3.6	—	47.5
June 16	—	—	—	—	—	75	4.5	—	51.6
Sep. 12	—	—	—	—	—	75	0.4	—	52.1
1974 — July 15	—	—	—	—	—	75	—	50.9	0.8[4]
Aug. 30	50.6[5]	45.1	—	—	45.1	100	—	—	0.8
Sep. 30	—	—	—	—	45.1	100	—	—	0.8
Oct. 31	—	—	—	—	45.1	100	—	—	0.9
Nov. 30	85.7[6]	78.5	—	—	124.8	142	—	—	0.5
Dec. 31	—	—	—	—	124.8	142	—	—	0.5
1975 — Jan. 31	23.6[6]	21.6	—	—	146.4	154	—	—	0.4
Feb. 28	—	—	—	—	146.4	154	—	—	0.4
Mar. 3	—	—	—	—	146.4	154	5.6	—	6.0
Mar. 11	—	—	—	—	146.4	154	—	—	4.8
May 31	—	—	—	—	146.4	154	—	—	0.6
July 28	50.5[3]	47.2	—	—	193.6	179	—	—	0.3
Aug. 12	49.5[6]	55.3	—	—	248.9	204	—	—	0.1
Aug. 29	—	—	—	—	248.9	204	6.7	—	6.8
Nov. 6	33.0[6]	37.0[6]	—	—	285.9	220	—	—	4.5
1976 — Feb. 27	—	—	—	—	—	—	13.4	—	14.3
Mar. 30	46.9[6]	52.9[6]	—	—	338.8	243.1	—	—	14.1

Source: Reserve Bank of New Zealand, *Bulletin,* April 1976.

[1] The difference between the total, as indicated by netting acquisitions and utilization, and total holdings is due to the deduction of various charges from the Special Drawing Rights Account.

[2] Includes both allocations to New Zealand from the IMF and SDRs received by way of transactions with other countries.

[3] Drawing under a compensatory finance arrangement.

[4] From 1 July 1974 the exchange rate of SDRs 1.12 = NZ$1.00 was replaced by a system of fluctuating rates determined by the IMF in consultation with participating nations.

[5] Gold tranche drawing.

[6] Drawings under IMF oil facility.

Table 8
MAXIMUM ACCESS BY NEW ZEALAND TO THE IMF's GENERAL RESOURCES[1]

	Under present quota		*Under new quota*	
	% of quota	*SDR millions*	*% of quota*	*SDR millions*
Gold tranche (reserve tranche)	25	50.5	...[2]	...[2]
Ordinary credit tranches	100	202.0	100	232.0
Temporary extension of ordinary tranches[3]	145	292.9	--	--
Compensatory financing facility:				
In any single 12-month period	50	101.0	50	116.0
Overall maximum	75	151.5	75	174.0

[1] It is assumed that New Zealand would not normally borrow under facilities other than those mentioned above (such as the buffer stock financing facility or the extended fund facility). The table does not cover allocation or use of Special Drawing Rights through the SDR Account. No reference is made to the oil facility since this arrangement applied only during 1974 and 1975.

[2] The percentage and amount of the reserve tranche after amendment will be determined later, but it may be less than the present 25 percent of quota.

[3] Temporary extension applies until new quotas become effective.

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