

Reshaping the International Monetary and Financial Arrangements*

1. The changes in the Articles of Agreement of the International Monetary Fund (IMF), based on the decision taken by the Interim Committee at the Meeting held in Jamaica in January 1976, are, at the time of writing (February 1977), in the process of being approved by the member governments. It is expected that the necessary requirements for these changes to become effective will be met sometime around the middle of this year. However, even before the ratifications had passed the halfway mark of the minimum requirements, the following news report from Paris appeared in the press: "Diplomatic observers here believe that the first request the next United States President will get from allies will be to help convoke a major economic conference to reorganize the international money system which has deteriorated steadily since 1971..."¹. To outsiders this surely must have come as a shock even in our world of "built-in obsolescence". To insiders it was probably less of a surprise. The end result of four years of negotiations, usually referred to as the Reform of the International Monetary System, has been commented upon with varying degrees of enthusiasm. The feelings of achievement, in many ways understandable, embodied in the words used by the main

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¹ *The New York Times*, November 3, 1976.

protagonists² in announcing the end of this laborious exercise, have been watered down by articles published shortly afterwards. These include articles published by other participants in the long negotiations that speak either of a "non-reform of the system"³; of a mini-reform; of a partial (or provisional) reform⁴; or use the neutral expression "second amendment of the articles."⁵ This writer shares the view of those — apparently the majority — who believe that relatively little has been accomplished. He differs, however, from most commentators on the subject in two major respects: (i) the evaluation of the reasons for the limited results; and (ii) the direction in which, under the circumstances, efforts could have been more profitably directed. This paper deals essentially with this second aspect. The proposals contained in the later paragraphs concern chiefly the monetary system, but they cover also the international financial system. Before outlining them, however, some general comments will be made on (i) and (ii) above.

2. As to the reasons for the limited results, it can probably be safely said that few, if any, evaluations of the *substantive* nature of the problem have been made. What follows highlights three major trends in a set of unproven assertions which this writer proposes to substantiate on another occasion.

(a) In the late 1960's, and more in the early 1970's, it already was apparent (or should have been) that the international economy was in the process of showing certain *economic* maladjustments, as the development and diversification of the productive structure in certain parts of the world — particularly some

² The critical nature of some remarks in this article, in reference to the proposed Second Amendment should not detract from the laborious dedicated work done by the officials and staff of the IMF for the negotiations, and especially in restructuring the Articles after the Jamaica decision.

³ TOM DE VRIES, "Jamaica, or the Non-Reform of the International Monetary System", in *Foreign Affairs*, April 1976. The same theme is repeated in the article by the same author, "Amending the Fund's Charter: Reform or Patchwork?", in this *Review*, September 1976.

⁴ See: ALEXANDRE KAFKA, "The International Monetary Fund: Reform without Reconstruction," *Essays in International Finance*, No. 118, Princeton, N.J., October 1976, *passim*.

⁵ This is also the wording of the title of the official publication containing the proposed changes.

less developed countries — was not being accompanied and matched by corresponding changes in other parts of the world, particularly the more advanced countries. This process — which is attributable in part to multinational companies' shifting production lines, including those incorporating advanced technologies, to locations where labor and other input costs were lower — has been evidenced in recent years by cases of protectionism, some of them disguised (e.g., export restrictions at the request of importing countries), and by clamors for more overt ones. The phenomenon would be even more visible had the countercyclical expansionary policies in most countries not been so implemented as to encourage the purchase of "more of the same," particularly of durable goods. Such well established industrial practices as "built-in obsolescence," "face lifting," and "cosmetic" changes in general helped in the same direction.

(b) On a world-wide basis, the productive capacity of certain producers' goods and consumers' goods as well, has been rapidly increasing. Demand, however, has not moved in step with that expansion, in the sense that industry as a whole, and especially some of its components, have been adversely affected by the working of an "acceleration principle" of sorts: the *rate of increase* of consumers' demand *slowed down* as the markets were being gradually saturated.

(c) To overcome, or at least postpone, the effects of (a) and (b) above, a rapid growth of *real* purchasing power (as distinct from the consumption demand generated by fiscal stimulus) would have been necessary; but this was impeded by two phenomena. One was the emerging of widespread social and political restlessness, and, in a number of areas, of a disaffection from work and a stronger emphasis on leisure as a pattern of life (the latter not being matched by less desire for material goods). The other was the widespread use, as noted above, of a fashionable oversimplified brand of macroeconomics in favor of more and more consumption, in a situation where a shift to different lines of production, and to investments in general overhead projects, was called for.

In a situation where those forces were operating — and which was, of course, much more complex than described — individual efforts aiming at retaining or improving one's share of the market, or consumption, depending on the case, manifested themselves in

the form of increases of individual prices and wages. These increases, which fell, in a growing number, under the heading of "administered prices," were validated by expansionary monetary and credit policies. The bargaining power of different individuals and groups being different, changes in *relative* prices occurred which, along with changes in employment patterns, produced real income and wealth transfers in both directions. Exchange rate changes performed similar functions, both through their repercussion on the prices of imported goods, and as a vehicle of income and wealth transfers between countries. Moreover, since the end of 1973, the trends mentioned above were aggravated by the massive transfer of resources to OPEC countries, as a result of the large increase in oil prices. The task of carrying out these transfers fell in part, once again, on the domestic price systems — for the sharing of the burden inside each country — and on the exchange rates for the relations among countries (the rest of the real transfer being postponed via the mounting of international borrowing through a recycling process institutionally arranged or via the credit markets).

3. Whether or not the developments and situations mentioned in the preceding paragraph were (and are) the main or concomitant underlying problems in the *real* economy that surfaced in the form of larger than usual changes in prices, including exchange rates, the record of the "Reform" negotiations shows no evidence of a preoccupation as to the causes, other than the proximate (i.e., monetary) causes of the problems of the international monetary system. In fact, it would appear that, because of this absence of a search for a causation and of the common practice of focusing on averages, inflation continued to be viewed *solely* as a rate of change of the *general* price level, and thus to be treated as a purely monetary phenomenon. And so have been exchange rate movements. Because of this attitude attention has been focused on a variety of exchange rate schemes bearing different names, even borrowed from zoology, to the point that at times one has a feeling of dealing with gadgetry. Anyone who wishes to keep abreast of this exercise is confronted with such an array of proposals as to boggle the mind. Between the dreamy extreme of the "perfectly clean float" and the equally dreamy extreme of par values that remain unchanged forever, one finds, to cite only a few: an "essentially clean" float, a "managed float," a "more

viscous managed float," a "joint float," "sliding parities," "crawling pegs," and "stable-but-adjustable par values"; where the last three, and possibly most of the others, are combined with varying sizes of "bands," symmetrical or asymmetrical.

4. Had the underlying real problems been given adequate recognition, it would have probably been realized that a more appropriate course was promptly to scale down the whole exercise to an organized attempt to keep some order under the general principle of international cooperation in exchange matters. More importantly, it would have been recognized that it was essential to develop a notion of a future set-up, in the same way as was done by the framers of the Bretton Woods arrangements. The latter shrank from any easy temptation to "be realistic," i.e., to solidify the *status quo*; and adopted instead, as their guide, a vision of a future that was totally different from the realities of the moment or of the recent past. These realities consisted of an armory of controls, discriminatory practices, multiple rates, and so forth; which, at Bretton Woods, were taken into account not to be legalized and codified, but rather to be eliminated after a period of transition, for which institutional and financial arrangements were devised. Pushing these comments a step further, it is to be hoped that we shall have a "Bretton Woods II" in a not too distant future, after the necessary basic intellectual and political groundwork has been completed. In a broad sense, the historical comparison that comes to mind is that the Second Amendment probably can be described, *mutatis mutandis*, as a rather elaborate "holding operation" similar to the Tripartite Agreement of 1936. On a much smaller scale, this was the first attempt to establish some international cooperation following the breakdown of the par value system, due to causes that, in the opinion of this writer, were, *in a broad sense*, not too dissimilar from those which recently have been prevailing. If this parallel had any validity, the thought that comes to mind in stretching it beyond the mid-1930's is the hope that this time the difficult journey leading to a reform of the international monetary system will be charted by man's wisdom.

5. Within the picture sketched above with *very broad* brushes, our major purpose is to outline proposals that could be implemented pending, and as a preparation for, the formulation of a new

system of international economic, monetary and financial relationships. To this end, we shall first take stock of the existing arrangements and of the evolution that has led to them during the past 30 years or so.

6. The "Bretton Woods" system that existed in 1971 was markedly different from the original arrangements. A number of important changes have taken place over a quarter of a century or so, and we shall review this evolution in a cursory manner and only to the extent necessary to establish a background for our purposes.

(1) The two broad functions — monetary and financial — and the respective institutions, have grown considerably in number, scope, and importance. This, however, has occurred in a rather uncoordinated manner, in the sense that *the institutional set up that we have today is more the result of a process of juxtaposition than of the implementation of an organic prearranged program.*

(2) Despite the enlarged number of institutions, *there is only a tenuous functional connection between the monetary institution, on the one hand, and the various financial institutions, on the other.* It consists of more or less frequent staff contacts for the day-to-day operations, of some *ad hoc* joint Committees, and of the largely ceremonial and perfunctory functions at joint Annual Meetings or meetings of UN coordinating agencies.

(3) *The ties which, at least in a conceptual sense, existed between certain basic features of the monetary system and the financial structure of the development institutions have been gradually eroded and eventually eliminated.* This refers to the par value system, exchange rate arrangements, the standard of values, and similar features.

(4) In the monetary field, there had been, in an early phase, a slow, gradual development of central banking functions on an international scale, centered on the IMF; but *this process has suffered a reversal during the last ten years, or so.*

(5) The function of the IMF as a "lender of last resort" has declined in importance largely because of the reduction in importance of its lending capacity relative to other outside sources of finance; and the other ingredient of central banking, i.e., *conditionality, has been eroded within the total lending power of the*

IMF, as a result of periodic additions of de facto automatic lending facilities, if one ignores procedural aspects.

(6) The above developments have correspondingly diminished the IMF power (limited, to be sure) to induce financial discipline in member countries.

(7) The most recently acquired central banking function, i.e., the management of *global* international liquidity, also has been crippled, largely by the (admittedly unexpected) vast increase in liquidity from sources outside the IMF control; i.e., dollar balances. Moreover, the only international reserve asset under IMF direct control — the Special Drawing Rights — has become quantitatively less important, and its standing, in this delicate infancy phase, appears to have suffered from its serious limitations as a standard of values, and from the non-participation of countries that have accumulated a large proportion of the newly created liquidity. Finally, recurrent pressures by certain countries to make additional distributions of SDRs under conditions of abundant global liquidity, have regenerated fears that such an asset may be used as a vehicle of real resource transfer.

(8) The stretching of the nature and the terms of the IMF lending operations apparently has moved this institution a step further toward being a channel of deliberate resource transfer — while creating, at the same time, some duplication with non-project lending of long - and medium-term international financial institutions.

7. In the following paragraphs we shall review more in detail most of the points made above. For each of them a proposal for a change will be made in accordance with the intent mentioned in paragraph 5. In essence, the aim of these proposals is: (i) to introduce a considerable simplification of the arrangements in the monetary field; (ii) to enhance the effectiveness of the International Monetary Fund as a lender of last resort and as a promoter of financial stability; (iii) to reallocate certain present functions as between the monetary and the financial institutions in accordance with their basic purposes and staff specialization; (iv) to adapt the financial structure of international financial institutions to the present new monetary arrangements; and (v) to facilitate the task of international financial institutions for the benefit of developing countries.

8. The function of the IMF as a promoter of monetary and financial stability in member countries was not explicitly envisaged by its Statute. It grew in the 1950's along with the development of policies on drawings on the credit tranches, as these policies aimed at assuring, as much as possible, the revolving character of the Fund's resources. The increasing degree of conditionality, as the use of the resources moved into the higher credit tranches, was the main characteristic of these policies. Moreover, the IMF was able increasingly to act as a lender of last resort, particularly after the 50 per cent increase in the quotas of member countries, decided upon in 1958. It probably can be stated that the two functions grew in importance until sometime around the mid-1960's⁶; and that, from this point of view, the institution grew with them. Although it is difficult to pinpoint the time of the reversal of that trend, the forerunner probably was the first decision on the so-called Compensatory Financing Facility (CFF) of February 1963. This decision, which aimed at permitting drawings by countries experiencing temporary export shortfalls of up to 25 per cent of their quotas, emphasized the need for a more readily available assistance, and subjected the drawings, *inter alia*, to a specific, though untestable, conditionality; namely, that "the member will cooperate with the Fund" in finding solutions to the balance of payments difficulties.⁷ It probably was an unfortunate turn of events that the first country to apply for a drawing under this arrangement was Brazil at a time (June 1963) when the country was going through one of the most difficult periods in its recent history, in terms of economic policies and balance of payments policies. Moreover, its political leadership was in no position, because of its orientation, to introduce measures to solve the balance of payments problems. In fact, early in the following year, the persistence of these problems led the Government to seek a refinancing of major portions of its foreign debt; and

⁶ Early in that decade, as a result of the establishment of external convertibility (1958-59), of other liberalization measures by the main European countries, and of the reversal of the Fund position on (in favor of) the use of Fund resources for capital transfers (1961), provisions were made to supplement the Fund liquidity to finance payment needs of countries participating in the so-called General Arrangements to Borrow.

⁷ IMF, "Selected Decisions of the Executive Directors," Third Issue, Washington, D.C., January 1965, p. 42.

shortly afterwards a military government took power as the domestic and external situations, including the balance of payments situation, kept deteriorating. The drawing was granted; and, whether or not additional reasons played a role, drawings under this facility became thereafter, *for practical purposes*, unconditional.

9. A number of decisions were taken after 1963 concerning drawing policies, and it is fairly safe to state that all of them had the effect of watering down the conditionality feature of the use of Fund resources.⁸ More specifically, in 1968 conditionality was *de facto* eliminated in the case of the use of the Fund resources under the first credit tranche⁹; but, the major changes resulted from the introduction of various "facilities," or amendments to existing ones, are outlined below.

10. In chronological order, the various "facilities"¹⁰ (in addition to the 1963 CFF) were introduced, or enlarged, as follows:

- 1966: enlargement of the CFF.
- 1969: financing of "Buffer stocks."
- 1974: establishment of the "Oil facility" (subsequently extended for another year).
- 1974: establishment of an "Extended facility."
- 1975: further enlargement of CFF.
- 1975: enlargement of the "Buffer stock" financing.
- 1976: establishment of a "Trust Fund."

⁸ The account given in the text of the various changes in the policies for the use of the Fund resources is inevitably very *sketchy*, and omits a large number of important details. This does not affect, however, the substance of the argument for the point under discussion.

⁹ IMF, "Selected Decisions of the International Monetary Fund," Eighth Issue, Washington, D.C., May 10, 1976. The decision endorsed its supporting paper which, *inter alia*, concluded: "Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche." This does not preclude, to be sure, that conditions be agreed upon prior to the arrangements; but failure to comply with them would not be an impediment to draw.

¹⁰ The term is used here in a broad sense, to include arrangements not formally designated as "facilities."

By and large, and subject to further specification, the major characteristics of these changes, and of their consequences, were:¹¹

(a) Maximum permitted drawings — expressed in most cases in terms of tranches (25 per cent of quotas) — were made additional (“floating tranches”) to the ordinary tranches, so that the normal credit limit of 100 per cent of the quota (equivalent to 200 per cent of Fund’s holdings of a country’s currency) could be exceeded without the need to examine the merit of granting an *ad hoc* “waiver” on each occasion.

(b) Every decision that introduced or enlarged a facility contained language that made the drawings subject to a certain conditionality; but, with the possible exception of one facility, drawings have been, in practice, not predicated upon the undertaking of effective corrective action; i.e., virtually unconditional.^{12, 13}

¹¹ The main features of these facilities are described in various issues of the IMF publication “Selected Decisions of the International Monetary Fund.” For a brief summary, see: “How Countries Draw on Resources of Fund under the Five Tranches and under Permanent Facilities,” in *IMF Survey, Supplement on the Fund, Fall 1976*.

¹² The expression “virtually unconditional” should not be understood in the sense that a country is allowed to draw even though it has no payment need. This condition must, of course, be met. What is meant is that, in practice, the policies of the country requesting a drawing are subjected to a considerably softer scrutiny than in the case of ordinary (higher) tranches drawings; and that comprehensive changes in them are not required. In fact the extraordinary large number of drawings made in 1976 (48 in all, for a total of 2,272 millions of SDR) after the December 1975 CFF Decision, seems to indicate that there was no negotiation (with some possible exception) with the countries’ authorities prior to the drawings. It is noted in this connection that at the 31st Annual Meeting the IMF Managing Director used the expression “light degree of policy conditionality” in reference to some of the facilities in question, including the CF Facility.

¹³ As an indication of the trend emphasized in the text, it also should be noted that the slightly more stringent condition that, in the wording of the 1966 Decision, was attached to CFF drawings within the second 25 per cent of quota, was removed from this tranche under the 1975 Decision. It was shifted to drawings under the third 25 per cent of quota. Furthermore, the latter Decision has made it possible for countries to draw even where there is no actual decline in export receipts. At least six countries (Australia, Greece, Ivory Coast, Korea, Rumania, and Turkey) drew in 1976 while their exports were growing, though at a lesser rate than in the past. This feature may allow some major oil exporting countries to benefit from the CFF on the strength of a trend influenced by the dramatic increase in export receipts between 1973 and 1974. This may be true in the near future of countries whose coffee exports represent a large proportion of total exports, as a result of the recent sharp increase in coffee prices.

(c) Through time, the “normal” ceiling of the permissible drawings on the IMF was repeatedly increased, both because of the “floating” mentioned above, and because of the increases of, or additions to, the facilities, as percentages of the quotas. As a result, by December 1976, the normal Fund’s holdings of a member’s currency (200 per cent of the quota) had been exceeded by 30 countries. Of these, seven countries had exceeded the 300 per cent mark, and one country the 400 per cent mark (Korea with 477 per cent).

(d) *On the whole*, there has been a tendency to stretch out the repayment period of the drawn funds, as evidenced by the repayment schedules of two of the above-mentioned facilities; thereby introducing a larger grant element in the drawings.

(e) While all the facilities, with one exception, ostensibly are available to all member countries, in practice, and as a policy intent, most are understood to be for the benefit of less developed countries.¹⁴

11. It is worthwhile to digress briefly at this point to highlight one of the main factors underlying the above-mentioned developments. It appears from historical records that, with the exception of the Oil Facility, none of the other facilities originated from within the institution. Their introduction, or modification, appears to have been more the result of outside pressures, particularly from developing countries, than of a preconceived design. Since the first UNCTAD Conference, those countries have been prodding the developed countries, in a relentless manner, to take steps to increase the transfer to them of financial and real resources. These efforts, however, have met more with frustrations than with success. The promise, in certain cases vaguely worded, to attain a net flow of financial resources of 1 per cent of GNP has apparently been met only in 1975 (with the possibility that this reflects in part the sluggishness of economic activity in various countries in that year; and, thus, that the percentage for 1976 will decline), and only for the DAC countries *taken as a whole*. In 1975, the target of 0.70 per cent of GNP for Official Development

¹⁴ This was implicit in an address by Mr. William B. Dale, Deputy Managing Director of the IMF, to the Fourth UNCTAD Conference (for excerpts, see *IMF Survey*, May 17, 1976). It should be noted, however, that in 1976, for the first time, *developed* primary producing countries, such as Australia and New Zealand, drew under the CF Facility.

Assistance had not yet been met by a half. In these circumstances, part of the pressure from the developing countries has been turned on the international institutions in the form of requests for the introduction of special schemes. In these forums, the developed countries appear to have found it expedient to adopt an accommodative attitude by agreeing in part to such requests; and, as it appears, the IMF turned out to be the line of least resistance.¹⁵ Whether intentionally or unintentionally, this institution has been pushed toward the position of being the provider of a large amount of resources, virtually unconditionally, and away from its slow movement in the direction of becoming eventually an international central bank.

12. Various measurements may be used to quantify the relative importance of drawings under the various facilities, and of other virtually unconditional drawings. It may be noted, in the first place, that in 1976 the drawings under the CFF alone (SDR 2,272 million) were nearly as large as those under ordinary tranches (SDR 2.5 billion). Moreover, if drawings within the first credit tranche¹⁶ were excluded from the latter figure, it would appear that conditional drawings were well below drawings under the facilities plus first tranche drawings. Furthermore, at the end of 1976, outstanding drawings other than those under ordinary credit tranches represented 76 per cent of total drawings. Finally, as to conditional drawings (i.e., those beyond the first credit tranche), it should be noted that, among the developed countries, only Italy at the end of 1976 had such drawings outstanding. It is probably even more revealing that, taking the less developed countries as a group (with the exclusion of the oil exporting countries), these countries, by the end of December 1976 had used net IMF credits to the extent of 72.4 per cent of their total quotas; but that, of this only 10.3 per cent was under the ordinary tranches. Taking the countries in this group individually, only five

¹⁵ The IBRD has been subjected to similar pressures through proposals for the introduction of such major special schemes as the "Horowitz Proposal" and "Supplementary Financing." This institution, however, judged that its lending practices, under the Group broad arrangements, were adequate to cover the specific purposes of those schemes.

¹⁶ A detailed account of these drawings is not available to us at the time of writing; but the United Kingdom, South Africa and Zaire alone accounted for nearly SDR 820 million of the above total.

had exceeded the first credit tranche and two of them (Chile and Sudan) only marginally.

13. The growing importance over time of the drawings under the various facilities can be seen by comparing net credits (i.e., after repurchase) extended under those facilities with total net credits extended by the Fund, all expressed in millions of SDRs. These data may, in certain cases, be misleading in either direction because of the effect of repayments (repurchases); but in all likelihood the *general* trend shown by the figures would not be different if gross figures were utilized.

Year end	Total net credits	Total net credits under "facilities"	B as a per cent of A
	A	B	
1963	1,061.7	76.0	7.2
1964	1,398.6	76.0	5.4
1965	2,959.7	87.3	2.9
1966	2,900.5	95.6	3.3
1967	2,292.9	261.2	11.4
1968	3,435.9	251.3	7.3
1969	3,698.5	226.5	6.1
1970	3,011.3	132.0	4.4
1971	1,113.2	146.3	13.1
1972	1,057.3	403.6	38.2
1973	992.6	473.9	47.7
1974	3,617.4	2,255.5	62.3
1975	7,314.6	5,493.4	75.1
1976	12,565.1	9,512.9	75.7

Source: Various issues of *International Financial Statistics*.

It should be noted that the percentages for the years 1974-1975 and, to a certain extent, for 1976 reflect gross drawings under the Oil Facility. Nevertheless, even if allowance is made for this fact, the trend remains clear: excluding Oil Facility drawings from both columns A and B, the percentage would be 47.9 in 1976.

14. As mentioned earlier, the function of the IMF as a promoter of monetary and financial stability in member countries

is connected with ordinary drawings in the credit tranches, particularly those in the tranches beyond the first 25 per cent of the quota. As also noted in paragraph 12, this occurrence of late has become a rarity even among developing countries; with the consequence that only on a few occasions was the IMF able to exercise that function effectively. On the basis of the above quoted figures of *total* net credits, it could be suggested, through a simplistic reasoning, that to remedy the mentioned shortcoming it would be sufficient to abolish the various facilities. Leaving aside the consideration that, taken in isolation, a proposition of this type would run into unsurmountable obstacles¹⁷, the important fact to be born in mind is that, on the basis of the existing quotas — and even of the quotas that would go into effect in connection with the adoption of the Second Amendment — the IMF would not be in a position effectively to exercise the function of lender of last resort. This impediment would derive from the smallness of the quotas in relation to the greatly expanded dollar value of world trade and, more importantly, from the considerably increased lending powers of the commercial banks, particularly multinational banks, and from their preparedness to accede rather readily, at least so far, to loan requests from governments, including those of developing countries. In certain cases this preparedness is influenced by the banks' existing exposure in the countries to which loans are extended, as the granting of an additional loan outwardly appears as a lesser evil than a publicized default on previously extended ones. In addition, private banks would be ill equipped for the formulation of comprehensive financial programs if they wished to do so, and for the monitoring of their implementation.^{18, 19} Under

¹⁷ The opposition would come not only from those countries that would lose the benefits but probably also from developed countries because of fears of increased pressures for direct resources transfers.

¹⁸ The reported formulation by a major U.S. bank, early in 1976, of an IMF-type program in the case of Peru should be treated as an exception rather than the rule, insofar as the technical capability is concerned of private banks to engage in this type of exercise.

¹⁹ The dangers inherent in easy financing by commercial banks of payment deficits of developing countries have been emphasized, during the last two years or so, in many quarters, including the IMF itself. (See, for instance, the Annual Address of the IMF Managing Director on October 4, 1976, in *IMF Survey*, October 18, 1976, p. 312. See also, Alfred Hayes, "Emerging Arrangements in International Payments," Lecture delivered under the Per Jacobsson Foundation on August 31, 1975, pp. 11-12.)

these circumstances, a move aimed at placing the IMF back in its tracks toward becoming eventually an effective world central bank²⁰ would consist of implementing the changes proposed below.²¹

15. It should be noted at the outset that none of the following proposals would require, by themselves, changes in the Articles of Agreement (with the possible exception of (5) (b) below) particularly if they were implemented, as here suggested, in connection with the Seventh General Review of Quotas.

(1) *To increase the quotas of all member countries by such a percentage as to cover the Compensatory Financing Facility and the Buffer Stock Facility; and abolish these facilities.*

(2) *To implement the objectives of those two facilities through appropriate operating policies on a case by case basis and applying a degree of conditionality as required by attending circumstances.*

(3) *To restore the previous conditionality for drawings under the first credit tranche.*

(4) *To eliminate the Extended Facility, as it largely duplicates the functions of international development institutions, which, however, are better equipped to apply resources toward the solution of "structural" problems.*

(5) *To reach an understanding among all member countries to the effect that no initiative will be taken, or supported, deliberately to make the IMF a channel of transfer of resources to less developed countries. To this end (a) the Trust Fund would be terminated after the existing arrangements have been carried out; and (b) any possible future "profits" from gold sales or other transactions would be allocated to the soft-lending subsidiaries of the IBRD and the Regional Development Banks. As to the*

²⁰ This cannot simply be accomplished, under the present circumstances, by inducing the commercial banks "to gear their lending to Fund stand-by arrangements" (a "tendency" which was noted by the IMF Managing Director in his address to the 31st Annual Meeting). There is a danger that the IMF, given its present limited lending capacity, will be subject to unberable political pressure to soften the conditionality of its drawings on the ground that insistence on "strict conditions," declared *politically* unacceptable by the borrowing government, would block a much larger flow of funds than the IMF itself can provide.

²¹ The proposed changes would, however, do little in helping the IMF to regain some control of global international liquidity, which would require other steps.

"Subsidy Account," related to the "Oil Facility," it would be closed once the drawings under the Facility were repaid.

Considerations in support of the above proposals are stated below.

16. The percentage increase of the quotas under (1) above would be of the order of 125 per cent. This would not cause any hardship to member countries, since, under the Second Amendment, gold payments have been eliminated and the new provisions allow broad flexibility. It would:

(a) Produce no hardship for those countries that have made large use of the to-be-abolished facilities²², in the sense that the percentage of new Fund holdings of such countries' currencies, including holdings for drawings under the two facilities (but excluding those under the Oil Facility), would leave comfortable room for further drawings.

(b) Increase the drawing capacity of countries that have made minor use, or no use, of the two facilities. This is particularly true of developed countries which, in practice, have no access to those facilities.

(c) Enlarge considerably the Fund resources, which not only would eliminate recurrences of present liquidity strains, but also would allow the institution to replace commercial bank financing, to a considerable extent. It would, in addition, reduce, *pro tanto*, the need to make recourse to the GAB and offer an opportunity to reconsider the need to maintain these arrangements.

The quota increase need not be exactly equal to 125 per cent, particularly in view of the fact that, in practice, only a relatively small number of countries has access to Buffer Stock financing. An across-the-board increase could be in the range of 100-125 per

²² For instance, in the case of Argentina, which, at the end of 1976 had net outstanding drawings under the CFF of SDR 220 million, and net total drawings (other than those under the Oil Facility) of about SDR 380 million, an increase of 125 per cent of its quota (over and above the SDR 535 of the Sixth General Increase) would bring the quota to SDR 1,200 million. Taking into account the local currency payments to be made in connection with the quota increase, the Fund's holdings of pesos would remain, on the basis of the above data, approximately at the present percentage of the quota. The end result would be similar in the case of Zaire which, at the end of 1976, had outstanding drawings under the CFF of more than 50 per cent of the quota.

cent, perhaps close to 100 per cent^{22a}; and, if needed, upward adjustments could be made in special situations. Moreover, in implementing operating policies, the practical limit of 200 per cent of the quota could be enforced less rigidly; i.e., waived occasionally, though under truly special circumstances, and in such a manner as not to create precedents for granting such waivers on a broader, systematic basis.

17. The major objection which, *prima facie*, could be raised against the elimination of the above-mentioned facilities is that, by reintroducing conditionality, it would make it difficult, for countries at 100 per cent of the quota or above, to draw promptly and quasi-automatically in cases of export shortfalls due to causes outside the control of the country. It is not difficult to dispose of this objection. In brief, the way to avoid the unwanted consequences consists of changing the application of the policy considerations underlying the facilities from an across-the-board basis to a case-to-case basis. This would not be, however, a change for the sake of change, as explained below, and it would produce some healthy results.

18. From an operational point of view, it would appear that, since the facilities under discussion were introduced by decisions of the Executive Directors, this body of the IMF could follow the same principles underlying the facilities in deciding upon each single application. More specifically, a drawing prompted by an externally caused shortfall and which would bring the requesting country into the credit tranches, could be granted promptly and without conditions attached to it if the balance of payments and other policies pursued by the country at the time of the event causing the shortfall were deemed satisfactory. In fact, this would not be without precedents. For instance, even before the liberalization of the first credit tranche drawings, Colombia was allowed,

^{22a} This would amount to total quotas of about SDR 80 billion. To a possible impressionistic reaction that this is "too large a figure" the following data are offered as a rough indication of the relevant magnitudes. (i) The quotas set in 1944 for the original members (excluding those which are now not members) amounted to a total of SDR 7,368 million. The quotas of the same countries after the Sixth General Increase will amount to a total of SDR 25,000 million; i.e., a 3.4 multiple. (ii) A further increase by, say, 110 per cent, would bring the multiple to 7.15. (iii) As against this, world imports in 1976 (estimate) were about 13 times those in 1948.

in 1954, to draw 50 per cent of the quota following a rapid fall in coffee export receipts which was attributable to negative reactions of the world coffee market to earlier reports of exaggerated losses of the Brazilian crop. At that time Colombia was following sound policies, and the drawing was approved promptly. There have been other cases of rapidly arranged drawings connected with foreign exchange needs genuinely attributable to outside circumstances; though technically they were different from those under discussion in that the import side, rather than the export side, was adversely affected due to natural calamities. A Nicaragua drawing in 1973, following the disastrous earthquake of December 1972, falls into this category. The drawing was in the higher credit tranches, and the country, like Colombia, was following satisfactory financial and balance of payments policies. Finally, it should be recalled that a November 1968 IMF Decision on a related matter (drawings under stand-by arrangements) stated, *inter alia*: "...in exceptional cases phasing need not be used in stand-by arrangements that go beyond the first credit tranche when the Fund considers it essential that the full amount... be promptly available."²³ The essence of our proposal is, in other words, that more flexibility be introduced, *in appropriate cases*, in implementing the conditionality of tranches drawings. It entails two major changes with respect to the present situation under the facilities. One of them is represented by the emphasis on the words "in appropriate cases." This would allow differentiation between cases of shortfalls *genuinely* attributable to outside circumstances, which would be acted upon promptly, and cases where the shortfalls were *also* due to equally important concomitant causes. Under such a selective policy, the IMF would be placed in a position to exercise more influence on less-than-satisfactory domestic and exchange rate policies, where these were to coexist with a weakening demand for exports, or other circumstances such as a crop failure.²⁴ Moreover, in the case of countries with formally declared

²³ *Selected Decisions of the International Monetary Fund*, Eighth Issue, Washington, D.C., May 10, 1976, p. 48.

²⁴ A recent case that fits into this category is that of Argentina. In announcing a stand-by arrangement in support of a comprehensive program introduced on April 2, 1976, the IMF Press Release (no. 76/69) described in rather unfavorable terms the performance of the Argentine economy during the 12 months ending March 1976, as well as the improvements after the adoption of

fluctuating exchange rates, a selective policy of the type mentioned above would avoid a potential conflict — which could arise under the present quasi-automatic arrangements — between allowing drawings for shortfalls due, at least in part, to undue market interventions preventing a currency from finding its proper level, and a criticism of the exchange rate policy under Article IV. To put it differently, if the facilities were maintained as at present, the IMF could find itself in a position of providing a country with the resources to carry out interventions which it would look upon with disfavor under a different (surveillance) policy.

19. The other major change that the proposal under discussion entails is to the advantage of the beneficiaries of the present facilities. Especially in genuine cases of crop failures, mine floodings, and the like, it would be possible for the IMF to act promptly, as in the Colombian case recalled above, rather than waiting for sufficient data to determine both the trend and the amount of the shortfall. Even under the more generous provision of the 1975 Decision, the procedure under the latter would be more time consuming. Once again, this would not apply to "mixed cases," where other important concomitant controllable causes are at work; but, in these cases the new policies could result in the introduction of healthy changes in domestic and other policies.

20. The restoration of the previous conditionality for drawings in the first credit tranche is in line with the broad theme of this paper, and requires no further elaboration. The suggestion to eliminate the Extended Facility, requires, on the contrary, supporting considerations. The basic feature of this Facility is that it aims at the solution of "structural" problems. The two other features; i.e., the (maximum potential) amount of the drawings and the longer periods of disbursement and repayment, appear to be corollaries of the first. Unfortunately the word "structural" has been used, more often than not, in the economic literature with an

the program. A rapid examination of the basic statistics shows, *inter alia*, that the exchange rate policy during that period grossly overvalued the peso. The devaluation introduced in March cannot be considered as a fully redeeming policy change, as demonstrated by the more substantive broad-ranging measures adopted in April and the following months. As against the IMF's own evaluation, the country was able to make two equal drawings of SDR 110 million under the CFF during the four months preceding the program referred to above.

impressionistic, rather than a clearly understandable meaning, and neither the 1974 Decision of the IMF Executive Directors nor its supporting paper throw much light on this point. Within the context of a country's economy, a plausible notion of a "structural problem" requiring external financing is the existence of sectoral imbalances coupled with a *recognized* inability of the economy to generate adequate resources to carry out investments necessary for the correction of the maladjustments. To be effective, an outside financing ought to be tied to the implementation of sectoral measures (including changes in specific prices of goods and services, an appropriate institutional financial set-up, and so forth); and ought to have flexible repayment schedules, within the medium and long-term, dovetailed with the time pattern of the productivity of the contemplated investments. From this point of view, the arrangements of the Extended Facility appear to be grossly inadequate. The Fund staff has no expertise in sectoral programs to be able to judge the adequacy of specific corrective measures; the phasing of the disbursement is not, as it appears, conditional upon the implementation of those measures; and, more often than not, the pre-established repayment period may not be coterminous with the income stream expected to be yielded by the invested resources. These purposes appear to be better accomplished by international financial institutions. On the other hand, it is possible that the word "structural" is used in the Decision under discussion in the simpler, though undefined, sense of "persistent"; in which case the IMF simply entered, through this Facility, into the medium-term financing of development efforts. If this were the intent, such a function is more congruous, once again, with the purposes of international development institutions. It may be added, incidentally, that the lamented little use that developing countries have made of this Facility²⁵ is not altogether surprising. On the one hand, its repayment schedule is much less favorable than the terms of loans by soft-lending international development institutions; and, on the other hand, its use encumbers to a large extent the access to ordinary IMF financing.

21. The specific suggestion made above not to use the IMF

²⁵ See, for instance, the Press Communique of the Ministers of the Group of 24 (paragraph 6) in *IMF Survey*, October 18, 1976, p. 313.

resources for medium-term development financing through the Extended Facility is one aspect of the broader issue of deliberately using the international monetary system, and institutionally the Fund, as a channel for transfer of resources to developing countries.²⁶ This point was included, in an affirmative sense, in the *Outline of Reform*; and was taken up again in a recent *post-mortem* of the Reform exercise.²⁷ The celebrated "link" appears to have been seen, by those who favored such a function, as a major instrumentality. It is not part of the Second Amendment; but the failure of its adoption has not cleared the field. Our argument against assigning that function to the monetary system and to the IMF is based both on institutional grounds and on a proposal to define clearly and responsibly arrangements for resource transfers to less developed countries.

22. A steady, adequate and functionally appropriate flow of resources from developed to developing countries is necessary and advantageous to both sides, subject to the condition that the resources are used in an efficient manner. The volume, terms and channels should be agreed upon, however broadly; and on the part of developed countries, this should consist of *firm* commitments rather than of vaguely phrased promises. Perhaps an extension of the Conference on International Economic Cooperation, or something similar, could be the appropriate forum for reaching such an understanding. A specific part of it should be (i) that both sides refrain from attempts to use the IMF as a channel of resource transfer, however disguised; (ii) that international financial institutions should be adequately endowed with resources; and, accordingly (iii) that the developing countries, once satisfied that the new commitments will be adhered to, and that a reasonable appropriate flow of resources is forthcoming, refrain from proposing schemes of different types that have the same ultimate purpose of resource transfers, and that, as historical records

²⁶ The word "deliberately" is used here and elsewhere in this paper to exclude central bank-type monetary accommodations at "low" interest rates, or charges, applied to loans or drawings, which, undoubtedly, give rise to a "grant element" in favor of the borrower.

²⁷ See: ALEXANDRE KAFKA, "The International Monetary Fund: Reform without Reconstruction?", *Essays in International Finance*, No. 118, Princeton University, Princeton, N.J., pp. 2, 15, 22.

show, more often than not produce the sole effect of keeping national and international officials occupied.

23. Admittedly, there is nothing axiomatic about the position taken here against mixing the monetary function and that of transferring real resources. Our position is argued, as stated, on institutional grounds and as a matter of consistency, with the following considerations. (a) The experience of national banking systems shows that traditional discretionary central banking functions are weakened by that mixing; and, from this angle, our position is consistent with the broader objective to strengthen those functions in the Fund. (b) The world institutional set-up has evolved in such a way as to include arrangements and institutions, both at the national and international levels, designed to promote the transfer of resources to developing countries. This broadly mirrors the domestic institutional set-up in many countries. It appears, therefore, appropriate to confine the resource transfer function to those arrangements and institutions; and if these should prove inadequate, to improve them, as is suggested, for certain aspects, in subsequent paragraphs. Nevertheless, if it is desired to adopt the contrary position, i.e., making the IMF deliberately a soft-lending agency and a channel of transfer of resources to developing countries, this position should be argued openly and directly, and it should be implemented with full awareness of its consequences, rather than in a piecemeal fashion through intermittent additions of "facilities" and similar arrangements.

24. An important corollary of the above position relates to the IMF Trust Fund. This Fund is fed with "profits" from the sale of gold, and is used to assist specified low income countries by granting them concessionary loans. The "grant element" of these loans is, however, much lower than, e.g., that of IDA credits. Thus, should another decision be taken in the future to dispose of further portions of the IMF gold, the "profits" resulting from these sales ought to be transferred to the IDA and to the soft-lending funds of the Regional Development Banks. These institutions are better placed than the IMF to ensure the effective use of those resources, and some of them have flexibility in their terms so they can apply those that are more in tune with the repayment capacity of the beneficiaries. Another corollary is that the effectiveness of international financial institutions should be

enhanced. To that end it is necessary, as a first step, to take a close look at the consequences of the changes introduced in the international monetary system for the financial structure of those institutions.

25. A few sketchy historical references are in order. They focus on the provisions of the Statute of the IBRD (and Regional Development Institutions) for the "maintenance of value" of currency holdings. These provisions, as well as the size of the capital subscriptions, are affected by changes in international monetary arrangements, and both are of great importance for the lending activities of those institutions. It probably is not unreasonable to infer from the "maintenance of value" provisions of the IBRD that their initial intent was to maintain an *approximately* constant purchasing power of the paid-in resources. Within the construction of the Bretton Woods arrangements, the mechanism for this purpose was based, insofar as each individual member was concerned, on the par value system. For the membership as a whole a provision was included to cover "a uniform proportionate change in par values... made by the International Monetary Fund," but adjustments in this case were made optional.

26. This whole construction appears to be based on the expectation that the purchasing power of the U.S. dollar would remain approximately constant in terms of goods and services and that the uniform changes in par values would depend, if necessary, on the behavior of the price of gold as affected by its specific demand and supply conditions. Events, however, took a different course, as is well known. The par value system no longer exists; inflation has prevailed, being particularly rapid over the recent past; and there has been an aversion, largely of a political and emotional nature, to gold and to changes in its official price. Moreover, as will be shown later, the SDR, intendedly a gold substitute, is an inadequate standard of values. Whether or not the above inferences as to the intent of the provisions concerning the financial structure of the IBRD are correct is, in a way, immaterial. The fact is that the changes in the international monetary system, including those under the Second Amendment, coupled with actual developments, affect adversely the lending capacity of the IBRD and other international development institutions. It should be added that a by-product of the changes in the interna-

tional monetary system has been a relaxation of domestic financial discipline, permitted by the adoption of flexible exchange rates, and as long as this prevails, it entails the continuation of more rapid inflationary developments than originally anticipated.

27. The collapse of the monetary underpinnings of the IBRD and of Regional Financial Institutions calls for remedial action. The extent of the consequences, to appreciate the need for such an action, can be measured in broad terms by comparing the rate of adjustment of the paid-in capital with the inflation rates that have prevailed in the industrial world. Leaving aside the numerous technical complexities of the subject matter, it emerges from the Balance Sheet of the IBRD that adjustments could be made only in the cases of currencies for which a new par value (or "central rate") was established; and that for other currencies a "contingent asset" was included under "Other Assets."²⁸ Confining our indicative measurement to the U.S. dollar, which belongs to the former group of currencies, the adjustment for the purpose of "maintenance of value" of the paid-in capital consisted of an additional payment of about 20 per cent, corresponding to the change in the official (non-effective) par value of the dollar from \$35 per ounce of fine gold to \$42.22 introduced in 1973. As against this, consumer prices in the United States rose by 90 per cent from 1963 (to take only the period of more rapid inflation) to December 1976; and the prices of industrial goods rose in the same period by 98 per cent. This may be sufficient to obtain an order of magnitude of the erosion of the IBRD resources. Under these circumstances, part of the annual profits allocated to reserves can be viewed as actually serving the purpose of compensating for the real loss resulting from inadequate value maintenance of the paid-in resources. The same considerations apply to the callable capital, and thus to the capital subscriptions as a whole. As is known, that portion (90 per cent) of the subscriptions sets the limit to the indebtedness of the institution (the practical limit is even lower), and in that sense, an insufficient adjustment of the subscriptions limits the resources that the institution can obtain in the financial markets.

²⁸ See: *World Bank*, Annual Report, 1976, Appendix A, pp. 116-117; and, in particular, Note B, pp. 126-127.

28. As to the appropriate remedial action, we shall confine ourselves to the "maintenance of value" of the paid-in capital, as growth factors enter into the question of the appropriate capital. It is clear that the provisions of the Articles of Agreement on this matter have to be changed. There are, of course, numerous solutions to the problem. Each of them has its shortcomings and its degree of arbitrariness. Our proposal consists of three elements. (i) The adjustments in the paid-in capital should be carried out at pre-established fixed dates (e.g., at the end of each fiscal year) in view of the continuing inflation. (ii) The basic yardstick should be the change in the index of export prices of industrial countries taken as a group, as of those dates. (iii) For each individual member there should be a correction of the adjustment resulting under (ii) above, to be carried out at the same dates, based on the relative value of the member's currency with respect to a unit of account, which could be the SDR.

29. The rationale of part (ii) of the proposal is that the *bulk* of the foreign procurements under the loans granted by the institutions under consideration is in the industrialized countries. This, obviously, leaves out procurements elsewhere, including in the borrowing countries, and in addition the proposed index, besides its inevitable technical shortcomings, is not representative of the cost of services. Nevertheless, we believe that among the various publicized indices the one proposed above is the closest ready indicator — it is regularly published by the IMF — of the cost of projects financed by the institutions under consideration. Space limitations do not permit the examination of other possible solutions in support of our statement above. A few words are in order, however, with respect to one alternative: i.e., the Special Drawing Rights.

30. It was stated in paragraph 26 that this unit has serious limitations as a standard of values. In a nutshell, the reason is the following. The valuation of the SDR established by the IMF Decision of June 13, 1974, is *essentially*²⁹ independent of *uniform* rates of change in prices in the countries whose currencies enter into the "basket," regardless of *the size* of the price changes.

²⁹ The word "essentially" intends to convey the idea that exchange rate movements may not necessarily reflect exactly relative domestic price movements (i.e., a nonsubscription to the purchasing power parity theory).

Thus, a 25 per cent annual increase in domestic prices in each of those countries (which were reflected in unchanging exchange rates between the various currencies) would maintain a constant valuation of the SDR in terms of each currency, and vice versa. At the same time, the SDR would depreciate by a corresponding amount in terms of goods and services. This is, no doubt, an oversimplified case; but the result would not be materially different where there are different rates of inflation in the various countries which yield a significant "average" rate of inflation for the group. In these cases, subject to the mentioned reservation as to the purchasing power parity theory, there would be changes in both directions in the value of different currencies in terms of the SDR, while all of them, and the SDR would depreciate in terms of goods and services. To give two examples of actual cases, between 1970 and December 1976, the U.S. dollar had depreciated in terms of domestic goods and services (using as basis the Consumer Price Index) by 33 per cent, and the SDR had depreciated in terms of U.S. goods and services by 23 per cent. The same calculation for the *deutsche mark* indicates that during the same period of time the SDR depreciated by 47 per cent in terms of German goods and services. This being so, a maintenance of value clause based on the SDR valuation of the various currencies would allow a continuation of the erosion of the real lending capacity of the institutions under discussion.³⁰

31. The second major aspect that we intend to cover in relation to international financial institutions concerns their operational financial relations (or lack of them) with the monetary institution (IMF). Since the establishment of the IBRD in 1944, there has been a multiplication of institutions of this type^{31,32} in

³⁰ These shortcomings of the SDR as a standard of value are attenuated in the case of the SDR held as a reserve asset, because of interest payments on these reserve holdings.

³¹ This multiplication has caused, *inter alia*, a certain functional overlapping in a number of cases. There are, for instance, three layers in the case of countries members at the same time of the IBRD, the Inter-American Development Bank, and the Caribbean Development Bank (e.g., Trinidad and Tobago).

³² The multiplicity of institutions could create certain problems whenever a global scheme, such as the "gold profit" distribution proposed above, were to be implemented through such institutions. For an illustration of those problems in the case of the "Link," see our "Ripartizione di oneri e benefici nel 'link' tra creazione di liquidità e finanza di sviluppo," in *Quaderni dell'Economia Sarda*, marzo 1974.

response to common interests in Regional and sub-Regional areas, which, in a number of cases, reflected what had been done at the political level. In addition to the number, each institution has grown in importance as a channel of resources to the less developed countries; and the time has perhaps arrived to take an organic approach and to establish, under appropriate safeguards, operationally meaningful financial connections between the IMF and the whole family of these institutions. To this end we shall highlight, once again in a cursory manner, past developments and certain relevant present features, as a basis for a proposal. For brevity, this will be done solely with reference to the IBRD, but similar considerations apply, *mutatis mutandis*, to the other institutions, as their financial structure and their operations are largely patterned after the former.³³

32. The intellectual and political background of the creation of the IBRD, marked, as it was, by aspirations and expectations of a return of private initiative as the main factor in the field of foreign investments, and by a built-up aversion to government interference, was reflected in the fact that the main function attributed to the institution was that of assisting and guaranteeing private lending and investments. This emerges both from the reading of the Purposes of the institution (Article I) and of other provisions of the Statute, and from comments and statements made at the time of the Bretton Woods Conference.³⁴ As is known, things went differently. The Bank never guaranteed a single loan, or participated in private loans: its whole financial activity has consisted of making loans of its own, and, if anything, of allowing private financial institutions to participate in its loans. Having thus become a long-term lender, and a large one at that, and relying largely on market issued bonds for its resources, the IBRD has had to observe the canons of financial orthodoxy. At

³³ This includes the fact that the Regional Banks have, under different names, IDA-type soft-lending adjuncts.

³⁴ In his address at the closing of the Bretton Woods Conference, the U.S. Secretary of Treasury, Henry Morgenthau, Jr., stated: "The chief purpose of the Bank for International Reconstruction and Development is to guarantee private loans made through the usual investment channels." *U.N. Monetary and Financial Conference, Final Act and Related Documents*, U.S. Government Printing Office, 1944, p. 9. At that time private financial institutions objected to the entry of a public entity in what they considered their natural preserve.

the same time, having become, by force of events, also a "development institution" and an important channel of transfer of resources, the IBRD has taken steps to enlarge the resources at its disposal so as to expand that role, and to keep its lending rate as low as possible, besides transferring part of its annual net income to the International Development Association.

33. While the latitude afforded by the Articles of Agreement has made it legally possible for the IBRD to carry out its activity as a major lender, rather than as a guarantor, one of the practical implications of that orientation has been the need to maintain a liquid reserve of a magnitude compatible with potential requirements on account of loan disbursements and of bond repayments. That level is influenced not only by the size of those commitments but also by the features of the original financial structure of the institution. In essence, such a structure provides for two sources of funds: the financial markets, and the membership, through capital increases and calls on unpaid portions of the subscriptions. This was perhaps suitable for a guarantor, but with the present activities neither of those sources is a feasible proposition to meet the requirements of current operations. Recourse to the second source is administratively too complex to be implemented speedily, whereas it would be awkward, to say the least, and costly to go at any one moment to the market to obtain badly needed funds, particularly where such a need were to arise out of an obligation to repay the market itself on account of previously issued bonds coming to maturity.

34. To put it differently, while most national credit and financial institutions have access to "accommodations" from pre-arranged sources, and thus can meet temporary needs without recourse to their creditors and shareholders, no such source of funds exists for the IBRD and other international financial institutions. As a consequence, the level of liquid reserve that they have found necessary to maintain has been quite large. At the end of the last three fiscal years, the absolute dollar amount of the IBRD reserve and the percentage that it represented in relation to total undisbursed loans and to total outstanding borrowings, were as shown in the following table. (Amounts are in millions of dollars.)

This obviously is a costly, though apparently necessary, practice. Broadly speaking, the cost is a function of the spread

IBRD LIQUID RESERVE*

	End of fiscal years		
	1974	1975	1976
Total amount	3,853	4,944	6,170
Total as per cent of undisbursed loans	63	64	67
Total as per cent of outstanding borrowings	40	40	42
Total as per cent of combined borrowings and undisbursed loans	24	25	26

* This was obtained by adding up the following two items in the Assets side of the Balance Sheet: "Due from Banks and other Depositors," and "Investments." The figures would be slightly smaller if the "restricted currencies" holdings (\$67-69 million) were excluded.

between the long-term interest rate and the short-term rate, and therefore it fluctuates particularly because of the higher degree of variability of the short-term rate. Admittedly, under exceptional circumstances, the cost may be nil or even negative; but it may also become exceedingly high. It differs, moreover, as between Development Banks, depending, *inter alia*, on the sources of borrowing and on the types of instruments used for investments. A *very approximate* measure of that cost for each Bank can be obtained by calculating the average cost of borrowing in any one year and the average yield of investments in liquid assets. As an example, for the fiscal year 1976, the spread in the case of the IBRD was between 1.5 and two percentage points, depending on whether or not capital gains from the sale of assets are included.³⁵ It was probably within the same range in the case of the other Development Banks, due to the close inter-relationships between capital markets in various financial centers. On this rough basis, the annual cost of maintaining a reserve of \$1 billion would be in the neighborhood of \$15-20 millions. If the reserve could be considerably reduced it would be possible to use the resources thus obtained for the benefit of the developing countries.

³⁵ The differentials were obtained by subtracting from the cost of borrowing of 8.48 per cent (World Bank, *Annual Report*, 1976, p. 86) the percentage of "Income from Investments" in terms of the amount of the liquid reserve.

35. To reduce the size of the reserve it would be necessary to make arrangements for a third source of funds of an extraordinary nature. This source should be quickly accessible and at low cost; and recourse to it should be truly temporary, in the sense that it would be designed solely to allow time for an orderly access to the other two ordinary sources, primarily the financial markets. Our suggestion is that the IBRD and the Regional Development Institutions should be allowed to pledge certain predefined assets at the IMF in order to obtain an equivalent amount of SDRs which could then be offered to member countries in exchange for the needed currencies. These arrangements should be legally possible after the Second Amendment becomes effective, subject to a Board decision to be taken with a high (85 per cent) majority (see Article XVII,3). It should be clearly understood, however, that an arrangement of this type ought not to become either a systematic or a substantial source of funds for International Financial Institutions. Its basic purpose should be *to give confidence* to the latter (and to the financial markets) that, should their (smaller) liquid reserves prove insufficient to meet certain commitments, the Institutions would have access to a *stop-gap* source while arrangements for tapping traditional sources are being worked out. More explicitly, the IMF should not become indirectly, through these arrangements, a deliberate channel of resource transfer to developing countries. The various provisions of Section 3 of Article XVII of the revised Statute appear to be sufficient to ensure that characteristic. In practice, that objective could be attained, *inter alia*, by establishing a time limit (e.g., six to nine months) for the repayment of the advances against collateral.

36. It is now time to review rapidly the field covered in the preceding paragraphs, and to make some concluding remarks. The world economy has experienced for some years certain maladjustments whose symptoms have been inflationary developments and wide exchange rate movements of a dimension to which we had been unaccustomed during the preceding decade, or longer. These maladjustments entail deeper seated economic (and not only economic) problems than their outward manifestations would suggest. They appear to generate increasing pressure toward protectionism, while additions to already near unmanageable foreign debts appear to be in most countries the chief response to persistent energy

deficits. These problems are not going to be solved by such oft-proposed "quick-fixes" as the maintenance of constant rates of change of money supply, fine-tuned exchange rate schemes, injections of model-calculated fiscal stimuli, and new petrodollar recycling schemes. They ought to be attacked at the root, which requires farsightedness, detachment, wisdom, courage, and time as well. The need for a coordinated approach makes it increasingly apparent that agreement ought to be reached among all countries, developed and developing alike, on essential principles of a new economic and financial order, including, *inter alia*, a radically different pattern of energy consumption and production and the transfer of appropriate technology consistent with continued progress in developing countries. It is hoped that negotiations to work out these principles will be initiated in the near future. Because of the complexity of the problems it is to be expected that those negotiations would be protracted and laborious. In the meantime, a useful undertaking would consist of readying an institutional framework that is purposefully clear, strongly based, adequately interrelated, and capable of further expansion. The institutional embryo created in 1944 has undergone a number of important changes. Many of them were evolutionary, but others were not. A degree of blurring has occurred in the IMF function as a conditional source of assistance and as a lender of last resort, because of a relative loss of lending power and of an increase in importance of arrangements that *de facto* erode conditionality in lending. There have been institutional proliferations and duplications of activities in the financial area, especially in the last few years, revealing the absence of a coordinating principle; and certain changes in the monetary system, in a broad sense, have weakened the financial structure of development institutions. The suggestions made in this paper include a notion of an organic approach toward the whole family of international institutions entailing the establishment of meaningful interrelations among them. Most of the specific suggestions relate to the monetary aspects. They aim essentially at re-establishing the International Monetary Fund on its track leading slowly toward the exercise of effective central banking functions in an international setting, compatible with national sovereignties; to endow it with adequate resources to carry this assignment out; to reassign certain of its present activities to international financial institutions, as being

more akin to the latter's purposes; to introduce a more meaningful standard of values that would eliminate or reduce the erosion of their capital resources; and to give these institutions temporary, limited, extraordinary access to international money so they can use their resources more effectively. In relation to these proposals, explicit mention should be made of the fact that the concept of one-world underlies them throughout. This was done not without an awareness that there are a number of forces that operate in the opposite direction. They include the reappearance of spheres of influence on a geographical basis, reflecting emerging sharing of political and military power; formations of institutionalized economic unions or groupings of different dimensions in different continents; stronger than usual resistance to outside influence in most countries, but especially in recently formed sovereign countries; affirmation of national social philosophies in real or imaginary opposition to those prevailing elsewhere. At the same time there are, however, centripetal forces based on rediscovered notions of interdependence, intensifications and improvements in communication systems, the gradual rising of cultural levels on a broad geographical basis, cultural exchanges, and others - forces that in the longer run should prevail. While the outcome of these opposing forces in the shorter run is not predictable, an attempt to move in the direction consistent with the one-world scheme appears to be a worthwhile undertaking.

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