The International Monetary Fund: use and supply of resources

In the twenty-three years since the inaugural meeting of the Board of Governors at Savannah, the International Monetary Fund has evolved into a complex instrument of financial co-operation. No comprehensive account of this evolution could possibly be given within the space of this article and the intention is to describe the origins and development of two major aspects of the Fund's operations which are closely connected with its role in the balance of payments adjustment process – namely, the conditions of access by members to its facilities (Fund drawings) and the means by which demands on these facilities have been financed (Fund liquidity). Clearly this treatment covers only a part of the whole subject of the Fund's role in the adjustment process.

Furthermore, the present article does not attempt to describe the Fund's operations in detail or in quantitative terms; the table at the end, however, does give some impression of the total use of the Fund's resources and of changes in the Fund's liquidity.

By the same token, there is no specific description of how Special Drawing Rights (discussed in the June 1968 *Bulletin*) will fit in with the Fund's existing credit facilities. It should also be noted that quotations from the Fund's Articles of Agreement are from the existing version and do not include the amendments approved by the Board of Governors on 31st May 1968 (simultaneously with the agreement on S.D.R.s) but not yet in force.

Fund drawings

Background

The immediate origins of the I.M.F. Agreement are to be found in separate proposals developed during the 1939-45 War by Harry Dexter White and John Maynard Keynes, proposals which in both cases were designed to avert a relapse after the war into the disorderly conditions which obtained in the international monetary system in the 1930's. In many respects the thinking of the two men was parallel – their plans were, as Keynes was later to say, ". . . plans which are born of the same climate of opinion and which have identical purpose." But there were, nevertheless, significant differences between White's scheme for an International Stabilization Fund and the proposal for an International Clearing Union developed by Keynes. One such difference, which is particularly germane to the present theme, concerned the degree to which the new organisation should be passive in the provision of assistance. Keynes envisaged automatic access to facilities within generous quantitative limits (25% annually of a quota adjusted each year and related to the average of imports and exports over several years). White, on the other hand, was thinking in terms of controlled and supervised access within much more restrictive limits.

This difference of approach stemmed from differing preoccupations. Keynes was concerned largely with avoiding the contractionary effects on world trade and prosperity of inadequate international reserves; in his words, ". . . we need a means of reassurance to a troubled world, by which any country whose own affairs are conducted with due prudence is relieved of anxiety for causes which are not of its own making, concerning its ability to meet its international liabilities; and which will, therefore, make unnecessary those methods of restriction and discrimination which countries have adopted hitherto, not on their merits, but as measures of self-protection from disruptive outside forces." Clearly, the more a facility was conditional and supervised, the less of a reassurance it would be. White's approach, on the other hand, was influenced partly by what he expected to be acceptable to the U.S. Congress and partly by the possibility of inflationary effects on the United States of more liberal proposals, assuming that the United States would be a large and persistent creditor.

By April 1944, however, overall agreement between the British and American sides on the structure of a new order for international monetary affairs was sufficiently far advanced for the publication of a Joint Statement of Experts recommending the establishment of an International Monetary Fund. This document, which reflected more of White's original ideas than it did of Keynes', formed the basis of discussion at the preliminary drafting conference at Atlantic City in June of that year and at the full-scale International Monetary and Financial Conference of the United and Associated Nations at Bretton Woods in July. During all these deliberations, there seems to have been no unequivocal agreement on the extent to which, if at all, the proposed Fund should police drawings by members, although at one point Keynes certainly seems to have believed that the Americans had accepted the view that the Fund should be ". . . entirely passive, except in the more extreme contingencies where countries were running towards the limit of the facilities of the Fund in one direction or another." However, the relevant provisions in the Joint Statement were not explicit on this point and it is clear that opinions were still divided at Atlantic City. Nor was the matter resolved at Bretton Woods. Indeed, the text of Article V (3) of the Fund Agreement, where the principal provisions governing the use of the Fund's resources are to be found, is very close both in language and substance to the corresponding paragraphs of the Joint Statement.

Interpretation and definition

Thus, when the Fund was established, the question of whether access to its facilities was to be a privilege or a right was undecided. This question was in fact to occupy the Executive Board of the Fund over a number of years before the conditional nature of Fund drawings in the credit tranches was firmly established.

The first move towards a clearer definition of the circumstances under which a member could avail itself of Fund facilities was made at an early stage. The U.S. Bretton Woods Agreement Act of 1945 instructed the

Article V Transactions with the Fund

SECTION 3 Conditions governing use of the Fund's resources (a) A member shall be entitled to buy the currency of another member from the Fund in exchange for its own currency subject to the following conditions:

(i) The member desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement;

(ii) The Fund has not given notice under Article VII, Section 3, that its holdings of the currency desired have become scarce;

(iii) The proposed purchase would not cause the Fund's holdings of the purchasing member's currency to increase by more than twenty-five percent of its quota during the period of twelve months ending on the date of the purchase nor to exceed two hundred percent of its quota, but the twenty-five percent limitation shall apply only to the extent that the Fund's holdings of the member's currency have been brought above seventy-five percent of its quota if they had been below that amount;

(iv) The Fund has not previously declared under Section 5 of this Article, Article IV, Section 6, Article VI, Section 1, or Article XV, Section 2 *(a)*, that the member desiring to purchase is ineligible to use the resources of the Fund.

(b) A member shall not be entitled without the permission of the Fund to use the Fund's resources to acquire currency to hold against forward exchange transactions.

Governor and Executive Director for the United States to obtain promptly an official interpretation by the Fund of the extent of its authority to use its resources and, in September 1946, the Executive Board took an interpretative Decision in the following terms: "The Executive Directors of the International Monetary Fund interpret the Articles of Agreement to mean that authority to use the resources of the Fund is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations."

The temporary nature of Fund assistance was further emphasised in the first Annual Report of the Executive Directors, which made it clear that the Fund would not ". . . sell foreign exchange to a member when there is no reasonable prospect that the member will be able to repay the Fund. . . . The essential test of the propriety of the use of the Fund's resources is . . . whether the prospective balance of payments position of the country concerned . . . will be such that its use of the Fund's resources will be of relatively short duration."

This emphasis on the temporary nature of Fund assistance served to clarify a feature of the Fund's operations which was implicit in the thinking of those who had drafted the Articles, although it was expressed directly only in those Articles which were concerned with providing the basis for a balance of payments adjustment mechanism. Thus, Article V (8) provides for a scale of charges on the Fund's holdings of a member's currency in excess of its quota, the rate varying according to the amount of the excess and the length of time it is outstanding; once the charge applicable has reached a certain point (at that time 4%, which would have been reached after a period varying between four and seven years), the member has to consult with the Fund about ways in which the Fund's holdings of its currency can be reduced. Pressure may thus be exerted on debtors – just as Article VII (discussed later) allows pressure to be brought to bear on creditors. Normally, drawings were to be repaid by the operation of the 'compulsory' repurchase provisions of Article V (7) (the text of which is on page 46) which are related to changes in the Fund's holdings of a member's currency and in the member's monetary reserves. The intention seems clearly to have been that the full rigour of the adjustment mechanism embodied in Articles V (8) and VII (3) would be applied only in extreme cases – in which a change in the parity of either a creditor or a debtor member might also be appropriate to a situation of 'fundamental disequilibrium'; the Articles envisage that balance of payments disequilibrium would usually be corrected quickly enough to allow the Fund's resources to revolve at an acceptable rate.

The next stage in clarifying the conditions under which members might draw from the Fund was marked by an Executive Board Decision taken in 1947 which interpreted Article V (3) *(a)* (i) – the text of which is set out on the opposite page. The effect of this Decision was first to equate "represents" with "declares" and then to provide that such a declaration could be challenged if any of the prescribed elements in the declaration seemed to the Fund to be incorrect.

These two interpretations were in essence no more than clarifications, albeit significant ones, of conditions already written into or readily deducible from the Fund's Articles, and served to put beyond doubt two basic aspects of drawings from the Fund – that they were temporary, and that they could be challenged. These interpretations were not the subject of serious controversy. However, sharp divisions of opinion persisted on the extent to which other conditions, which it could be argued were not implicit in the Articles, should be applied to drawings so as to ensure that they would in fact be no more than temporary. Growing pressures for such rules arose out of increasing doubts about the effectiveness of the repurchase provisions – mainly because of a number of serious technical difficulties which emerged when these provisions began to operate.

Expansion of the Fund's operations

The failure to reach agreement on conditions of access to the Fund's resources in its early years increasingly hindered the expansion of its operations. For a time the practical need to resolve the issue was not so acute – partly because the Executive Board decided that European countries in receipt of aid under the European Recovery Programme should not normally draw U.S. dollars from the Fund, and partly because the outbreak of war in Korea went some way towards easing the world dollar shortage. Mainly as a consequence of this, drawings from the Fund were sharply reduced – as shown in the table at the end of this article – and in the calendar year 1950 no drawings at all were made. However, the growth of general dissatisfaction with the level of the Fund's activity made it increasingly urgent to break the log-jam and to demonstrate that the Fund was effectively able to fulfil the purposes for which it was founded.

A first move in this direction was made in May 1951, when the Board adopted a proposal under which members wishing to draw would consult with the Fund so as to ensure that the use of its resources would be temporary. Later that year, the Board also agreed to changes in the scale of charges for drawings, so as to encourage the shorter-term use, and discourage the longer-term use, of Fund resources. At the same time, the rate of charge at which consultations between member and Fund became obligatory was reduced from 4% to $3\frac{1}{2}$% (which would be reached after a period varying between eighteen months and three years). The changes in the provisions for charges were not in practice very effective; the Fund's annual consultations with members – including in recent years consultations with those which have undertaken the obligations of Article VIII – have come to be a more powerful means of influencing the policies of members, particularly of those with drawings outstanding.

The major breakthrough, however, came in February 1952, when what was known as the Rooth Plan (after the Managing Director at the time) was adopted. This was an Executive Board Decision that a statement by the Managing

Director, which was reproduced, should form the framework for discussions with members on the use of the Fund's resources. In his statement, the Managing Director emphasised that "The Fund's attitude toward the position of each member should turn on whether the problem to be met is of a temporary nature and whether the policies the member will pursue will be adequate to overcome the problem within such a period." The statement also stressed the importance of the general credit-worthiness of the member, particularly its record with the Fund, and foreshadowed the possibility of stand-by arrangements. The Decision went on to state principles which have governed members' access to the Fund's resources ever since. The most important of these was that ". . . exchange purchased from the Fund should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased from the Fund. The period should fall within an outside range of three to five years." Members with drawings outstanding on which charges were payable at $3\frac{1}{2}$% would be required to repurchase within five years of each drawing. The Fund undertook to consider extensions of time when unforeseen circumstances beyond the member's control would make unreasonable the applications of the principles laid down; but, when applying for a drawing, a member was expected to state that it would comply with these principles, which were to be ". . . an essential element in any determination by the Fund as to whether a member is using the resources of the Fund in accordance with the purposes of the Fund." The last significant provision related to drawings within the gold tranche, whose virtual automaticity was established: "Each member can count on receiving the overwhelming benefit of any doubt respecting drawings which would raise the Fund's holdings of its currency to not more than its quota." (However, such drawings would still have to be repurchased within five years.)

These provisions are now to be reflected in amendments to Article V which will refer explicitly to the temporary nature of access to the Fund's resources and will establish the legal automaticity of drawings in the gold tranche; at the same time – and in the spirit of the February 1952 Decision – an amendment will terminate the Fund's power to create new facilities for the unconditional use of its resources.

The February 1952 Decision marked the final resolution of the dispute between those who believed that access to the Fund's resources was intended to be in large measure automatic and those who believed that it was to be conditional and supervised. There was now an agreed maximum term to drawings and the Fund had to be satisfied that the policies pursued by a member wishing to draw could reasonably be expected to permit repurchase of the drawing within that term. However, although the question of principle was settled, the techniques of access to the Fund's resources and the conditions associated with them were to undergo further development; and demands for an unconditional facility were to re-emerge in different contexts at later dates.

Stand-by arrangements

During 1952 the Executive Directors turned their attention to the question of stand-by credit arrangements. This was to prove a major development in the procedures for access to the Fund's resources. A Board Decision of October 1952 stated that the Fund was prepared to consider requests by members for stand-by arrangements, designed to give assurance that, during a fixed period of time, drawings up to a specified amount would be made whenever a member requested and without further consideration of its position, unless the general provisions of the Fund Agreement on ineligibility had been invoked. Stand-by arrangements were to be limited to periods of not more than six months (with the possibility of renewal) and would be subject to " . . . the same policies that are applied to requests for immediate drawings, including a review of the member's position, policies and prospects in the context of the Fund's objectives and purposes."

In fact, only one stand-by had been granted under this Decision by the time it came to be reviewed by the Board at the end of 1953. One of the reasons for this was that the limitation of arrangements to six months had proved too restrictive. Fund policy on this point was, therefore, reformulated and the Fund undertook to ". . . give sympathetic consideration to a request for a longer stand-by arrangement in the light of the problems facing the member and the measures being taken to deal with them." However: "With respect to stand-by arrangements for periods of more than six months, the Fund and the member might find it appropriate to reach understandings additional to those set forth in this decision." Since 1953, the stand-by procedure has developed to the point where it has come to represent the usual means of access to Fund resources (as opposed to the immediate drawing). The history of this development is very largely one of the gradual elaboration of more or less standard types of ". . . understandings additional to those set forth in this decision." For the purposes of this article, it will be sufficient to summarise the principal types of undertakings which, in various combinations, countries are required to give when applying for a stand-by.

A prerequisite of a stand-by arrangement is the preparation by the member of a programme designed to correct the imbalance which is the occasion for the stand-by. The policies to be pursued under the programme, usually with specific commitments known as performance criteria, are set out in a Letter of Intent by the member concerned. Failure to meet such criteria (which may cover the level of bank credit, public sector borrowing, net foreign exchange position, and so on) can lead to automatic interruption of the member's right to draw under the stand-by until further consultations have been held. As a corollary to this, access to resources under the stand-by is normally made available at periodic intervals over the one-year life of the arrangement. Finally, members are required to remain in close consultation with the Fund during the stand-by period. More recently, this safeguard has been extended to provide for a continuation of close consultation, beyond the life of the stand-by, so long as the Fund's holdings of the member's currency remain above 125% of its quota.

Capital movements

One particular aspect of members' access to the Fund's resources merits separate treatment in this article – drawings to meet outflows of capital. The Articles of Agreement are at present far from clear on the whole subject of capital transactions and the Fund's attitude has never been fully clarified. The 1946 interpretation, mentioned earlier, on the extent of the Fund's authority to use its resources was, for instance, difficult to reconcile with Article VI.

Section 1 *(a)* of this Article prohibits the net use of the Fund's resources to meet a large or sustained outflow of capital; it would, however, be reasonable to infer from it that the Fund could help to finance a capital outflow that was not large or sustained – particularly in view of the provisions of Section 1 *(b)* (i), which make it clear that the prohibition does not extend to the use of the Fund's resources for capital transactions of reasonable amount required for the expansion of exports and so forth.

During the 1950's, the Fund did in fact approve a number of drawings to help finance deficits which were associated to a greater or lesser degree with capital outflows. However, with growing liberalisation of capital transfers towards the end of that decade, the introduction of convertibility by a number of countries in 1958 and their acceptance of the obligations of Article VIII in 1961, international short-term capital flows re-emerged as a de-stabilising factor. The Fund was therefore led to consider its role in financing balance of payments deficits arising in such circumstances and to review the 1946 Decision. After lengthy discussion, the Board recognised that this Decision was defective and in July 1961 approved a new Decision clarifying it. The earlier Decision, it was now stated, did not "... preclude the use of the Fund's resources for capital transfers in accordance with the provisions of the Articles, including Article VI." The principles of the 1961 Decision will be taken further when the proposed amendments to the Fund's Articles come into force; the Fund's ability to finance capital outflows will be somewhat extended as a consequence of legal automaticity for drawings within the gold tranche, since members will be allowed under a new Section 2 of Article VI to make such drawings even for the purpose of meeting a large or sustained outflow of capital.

The 1961 Decision, however, cannot be said to have removed all uncertainties about the role of the Fund in relation to capital flows. There remains an area of difficulty which arises from a fundamental lack of congruence between the provisions of the Articles on the one hand and the international payments system as it has developed on the other. This is because the Articles were drawn up on the basis of assumptions about capital movements which have not proved generally valid. For example, the limitation on the use of the Fund's resources for meeting a capital outflow presupposes that it is always possible, at a time when a country's reserves are declining, to distinguish clearly between the parts played by current and capital transfers. It

Article VI Capital transfers

SECTION 1 Use of the Fund's resources for capital transfers (a) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

(b) Nothing in this Section shall be deemed

(i) to prevent the use of the resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking or other business, or

(ii) to affect capital movements which are met out of a member's own resources of gold and foreign exchange, but members undertake that such capital movements will be in accordance with the purposes of the Fund.

SECTION 2 Special provisions for capital transfers If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2 *(a)*, shall be entitled, notwithstanding the provisions of Section 1 *(a)* of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired.

SECTION 3 Controls of capital transfers Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3 *(b)*, and in Article XIV, Section 2.

seems also to have been assumed that capital transfers would normally be subject to control and hence unlikely to give rise to large or sustained outflows; in practice, however, members have preferred since the advent of convertibility to allow a significant degree of freedom for capital transfers. It should not be concluded, however, that to change the Articles so as to remove the limitation on the use of the Fund's resources to finance capital outflows would by itself represent a sufficient answer to the problem of disruptive capital movements; recent events have shown that such movements can reach amounts considerably larger than the Fund quotas of the members affected.

Compensatory finance facility

The question of automatic access to the Fund's resources came into prominence again in the discussions leading up to the introduction by the Fund of a facility for compensatory financing of export fluctuations of primary producers. Proposals for greater automaticity of drawings to cover export fluctuations had often been made in international discussion in the early 1960's. The possibility of completely automatic drawings was rejected by the Fund but, nevertheless, the new facility introduced in 1963 was perceptibly more liberal than existing facilities. Thus, members, particularly primary producers, would be able to make drawings to compensate for temporary shortfalls in export receipts where the Fund was satisfied:

a that the short-fall was of a short-term character and largely attributable to circumstances beyond the control of the member; and

b that the member would co-operate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments problems.

Drawings under the facility were not to exceed 25% of quota and would normally be repurchased within three to five years, unless an unexpected rise in export receipts permitted earlier, voluntary, repurchase. However, the policies of members drawing would not have to meet the tests that the Fund would apply in the case of a non-compensatory drawing in the same tranche; moreover, the Fund would be prepared to waive the normal limit on drawings of 200% of quota to the extent that drawings for compensatory finance were outstanding.

During its first three years, drawings under the new facility were made by only three countries; in September 1966 the Executive Board made a number of changes in the facility, since when it has been more widely used. The quantitative limit was raised at that time to 50% of quota (although not normally more than 25% of quota would be available in any twelve-month period) but drawings under the facility beyond 25% of quota could be made only if the Fund was satisfied that the member had been co-operating so as to find, where required, appropriate solutions for its balance of payments difficulties. This was a compromise between those who wanted much stricter discipline on countries going beyond 25% of quota and those who thought that access to both tranches should be equally automatic. In addition, it was agreed that such drawings would not be taken into account when applying tranche policies to a member making an ordinary drawing; the compensatory facility was thus completely separated from normal facilities.

Currencies used in drawings

It will be recalled that the first condition governing the use of the Fund's resources in Article V (3) *(a)* requires the member concerned to represent that it needs the currency to be purchased for the purpose of making payments *in that currency.* The terms in which this condition is couched reflect the bilateral outlook in which it (as well as certain other provisions of the I.M.F. Agreement) was originally conceived. It also carries the clear implication that the wishes of the member seeking the drawing will have at least an important influence as regards the choice of currency to be drawn. In the Fund's early years the apparent meaning of the condition gave rise to no difficulty; the currency in greatest need for the purpose of making payments was the U.S. dollar and all but a small proportion of the drawings made were in that currency. However, after most European currencies became convertible in 1958, and as U.S. balance of payments deficits continued, the U.S. dollar came to be used less, and other currencies more; to meet this situation, broad criteria for selecting currencies to be used in drawings were gradually developed. These criteria, which were given formal approval by the Board in 1962, take account of the balance of payments and reserve positions of countries whose currencies are considered for drawings, as well as of the Fund's holdings of those currencies.

As a result of this system of selection, drawings, other than small ones, tend to be made up of a number of currencies (in the last U.K. drawing, the number of currencies involved was as many as sixteen). In practice, however, the drawing country will usually need for the purpose of making payments not a variety of currencies but its intervention currency – in most cases, the U.S. dollar; arrangements thus have to be made to convert the currencies drawn into U.S. dollars.

The meaning of the condition in Article V (3) *(a)* (i) has thus had to be stretched in order to accommodate it to the way in which the international monetary system has developed. Otherwise the Fund could hardly have continued to finance drawings out of its own resources. However, although the procedure outlined above was undoubtedly necessary, there have been occasions on which the criteria have been adhered to even when the individual needs of drawing countries could have been met in other ways; for example, greater use might have been made of the U.S. dollar in certain recent drawings without weakening the dollar's position in foreign exchange markets. The increased conditionality of access to the Fund's resources which was discussed earlier, has thus been complemented by the development of a policy on currencies to be used in drawings; a policy which – for good practical reasons – has had to depart from the letter of Article V (3) *(a)* (i).

Article VII Scarce currencies

SECTION 1 General scarcity of currency If the Fund finds that a general scarcity of a particular currency is developing, the Fund may so inform members and may issue a report setting forth the causes of the scarcity and containing recommendations designed to bring it to an end. A representative of the member whose currency is involved shall participate in the preparation of the report.

SECTION 2 Measures to replenish the Fund's holdings of scarce currencies The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency, take either or both of the following steps:

(i) Propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the approval of the member, the Fund borrow such currency from some other source either within or outside the territories of the member, but no member shall be under any obligation to make such loans to the Fund or to approve the borrowing of its currency by the Fund from any other source.

(ii) Require the member to sell its currency to the Fund for gold.

SECTION 3 Scarcity of the Fund's holdings (a) If it becomes evident to the Fund that the demand for a member's currency seriously threatens the Fund's ability to supply that currency, the Fund, whether or not it has issued a report under Section 1 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action.

(b) A formal declaration under *(a)* above shall operate as an authorization to any member, after consultation with the Fund, temporarily to impose limitations on the freedom of exchange operations in the scarce currency. Subject to the provisions of Article IV, Sections 3 and 4, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by, or accruing to, the member in question: and they shall be relaxed and removed as rapidly as conditions permit.

(c) The authorization under *(b)* above shall expire whenever the Fund formally declares the currency in question to be no longer scarce.

Article V Transactions with the Fund

SECTION 7 Repurchase by a member of its currency held by the Fund (a) A member may repurchase from the Fund and the Fund shall sell for gold any part of the Fund's holdings of its currency in excess of its quota.

(b) At the end of each financial year of the Fund, a member shall repurchase from the Fund with gold or convertible currencies, as determined in accordance with Schedule B, part of the Fund's holdings of its currency under the following conditions:

(i) Each member shall use in repurchases of its own currency from the Fund an amount of its monetary reserves equal in value to one-half of any increase that has occurred during the year in the Fund's holdings of its currency plus one-half of any increase, or minus one-half of any decrease, that has occurred during the year in the member's monetary reserves. This rule shall not apply when a member's monetary reserves have decreased during the year by more than the Fund's holdings of its currency have increased.

(ii) If after the repurchase described in (i) above (if required) has been made, a member's holdings of another member's currency (or of gold acquired from that member) are found to have increased by reason of transactions in terms of that currency with other members or persons in their territories, the member whose holdings of such currency (or gold) have thus increased shall use the increase to repurchase its own currency from the Fund.

(c) None of the adjustments described in *(b)* above shall be carried to a point at which

(i) the member's monetary reserves are below its quota, or

(ii) the Fund's holdings of its currency are below seventy-five percent of its quota, or

(iii) the Fund's holdings of any currency required to be used are above seventy-five percent of the quota of the member concerned.

Fund liquidity

Basic provisions

The automatic access to the Fund envisaged by Keynes had its corollary in an 'internal stabilising mechanism'. Debtors would pay charges, have compulsory repurchase obligations and be encouraged or even required to devalue; creditors would also pay charges and if necessary would be encouraged as appropriate to expand, revalue and/or make international development loans. White's plan, on the other hand, being conceived in terms of controlled access, contained a much less comprehensive adjustment mechanism; debtors only would pay charges and, if a currency became scarce, the Board of Directors would make proposals for its equitable distribution and suggestions for helping to equate demand and supply. Parity changes would be permitted only in circumstances of 'fundamental disequilibrium' and then only with a four fifths majority vote. The Joint Statement had provisions governing parity changes substantially the same as those which were eventually written into the I.M.F. Agreement. It said nothing about charges but extended the scarce currency provision of White's plan to include the possibility of exchange restrictions against a scarce currency. These provisions subsequently emerged as Article VII of the Fund Agreement.

It will be seen that this Article embodies two separate concepts, which will not necessarily always be in harmony – the general scarcity of a currency and the scarcity of the Fund's holdings of a currency. It is only in terms of the latter that sanctions in the form of discriminatory restrictions may be imposed on the scarce currency country. It is also open to doubt whether, with the major currencies convertible and the U.S. dollar generally used as the intervention currency in foreign exchange markets, the power ". . . to impose limitations on the freedom of exchange operations in the scarce currency" would be very effective in restoring equilibrium. For these and other reasons, Article VII has never been operated, apart from the use of Section 2 to supplement the Fund's liquidity, as noted later.

The normal method of ensuring the Fund's liquidity is set out in the provisions of Article V (7). The concept underlying these is that the I.M.F. is essentially a pool of currencies – with the 25% gold subscription affording a certain amount of flexibility to the management of the Fund's liquidity; the size of the pool changes only when quotas are increased or new members join, but within the total there are, or should be, frequent changes in the amounts of different currencies held by the Fund. The Fund's holding of a currency would increase when the member concerned made a drawing and would decrease either when that currency (being convertible) was drawn by another member or as a result of the operation of Article V (7) – the compulsory repurchase rules. Furthermore, it was expected that, once the post-war transitional period provided for in Article XIV was over, all members would accept the convertibility obligations of Article VIII; in principle, therefore, all currencies would become of equal use to the Fund.

However, when these rules came to be operated, not only did it prove difficult to secure timely reporting of changes in members' monetary reserves but other serious technical difficulties also emerged. For instance:

a so long as sterling was inconvertible, sterling area countries which held most of their reserves in sterling largely escaped automatic repurchase obligations;

b the limits on repurchases in Article V (7) *(c)* were so framed that any repurchase obligation had to be cancelled to the extent that the limit might otherwise have been breached. This proved particularly significant in the case of the requirement that no repurchase be carried to a point at which the Fund's holding of any currency to be used was above 75% of the quota of the member concerned. For long periods the Fund's holdings of sterling have been above this level and in recent years the same has been true of its holdings of U.S. dollars; during these periods, repurchase obligations incurred in these currencies have, therefore, been cancelled.

One other aspect of the repurchase provisions eventually became a matter of concern to some members. Under the rules for calculating monetary reserves, members were allowed to deduct amounts of their own currencies held by foreign government agencies and other official institutions as well as by banks in other member countries. In consequence, the monetary reserves of the United Kingdom have always been less than its quota and, therefore, under the terms of Article V (7) *(c)*, no automatic repurchase obligation could be incurred. This has been true also of the United States since 1960.

These technical problems did not at first cause great difficulty for the management of the Fund's liquidity, although there was undoubtedly concern about the Fund's almost entire dependence for usable resources on the currency portion of the U.S. quota – supplemented, in 1957, by purchases of $600 million of dollars from the United States for gold. Since 1960, however, the number of other convertible currencies available for use in drawings has steadily increased. During this period, on the other hand, only relatively small amounts of U.S. dollars and sterling have been usable; the Fund's effective liquidity has therefore not been improved as much as would appear from the total of quotas.

Quota increases

Both Keynes' and White's original ideas provided for the adjustment of quotas, although Keynes' proposal for an annual increase, so as to keep the expansion of international liquidity in line with that of world trade, did not survive in the eventual Article III (2). However, increases in Fund quotas – whether special or general – now involve not an increase in international liquidity but in international conditional credit facilities. Even the increase in automatic gold tranche drawing rights is matched by equivalent gold payments from members' reserves to the Fund.

Quota increases by convertible currency countries necessarily improve the Fund's effective liquidity and there have been two general increases – in 1959 and 1964 – both of which have been accompanied by a number of special increases; the Decision on compensatory finance also pro-

Article III Quotas and subscriptions

SECTION 2 Adjustment of quotas The Fund shall at intervals of five years review, and if it deems it appropriate propose an adjustment of, the quotas of the members. It may also, if it thinks fit, consider at any other time the adjustment of any particular quota at the request of the member concerned. A four-fifths majority of the total voting power shall be required for any change in quotas and no quota shall be changed without the consent of the member concerned.

vides for special quota increases for primary producers, but these tend to reduce rather than to increase the Fund's effective liquidity. Effective liquidity would clearly be improved if surplus countries took special quota increases – if necessary during the five-year period between the reviews provided for in Article III (2). If carried to its logical conclusion, this process could make the General Arrangements to Borrow (which are discussed below) unnecessary, which is no doubt one reason why the surplus countries were not willing to go very far in this direction at the time of the last general increase in quotas; it could, however, in certain circumstances, make a useful contribution to the adjustment process. This could be enhanced if it were possible for Fund policy on currencies used in drawings to be applied more flexibly.

The consequences of the Rooth Plan

The difficulties with the compulsory repurchase rules were, as pointed out earlier, partly responsible for the pressure to define more closely the conditions to be attached to drawings in order to ensure their repayment. The Rooth Plan in effect recognised that the compulsory repurchase provisions needed to be supplemented by additional undertakings from drawing members; in the event the rule that repurchases should be made within three to five years after drawings has become the norm, and the bulk of repurchases is now made under this provision.

The Rooth Plan, with its encouragement of greater use of the Fund's resources, might have had serious consequences for the Fund's liquidity had it not been for the move to convertibility in 1958 by a number of major countries – formally recognised in 1961 by their assumption of Article VIII status. At the beginning of the 1960's, however, there was one main source of anxiety as regards the Fund's liquidity – the effects of a possible drawing by the United States; this was allayed by the establishment in 1961 of the General Arrangements to Borrow.

The General Arrangements to Borrow

Under these arrangements ten countries[1] agreed, under certain general and specific conditions (the latter relating to the participants' balance of payments and reserves positions), to lend stated amounts of their currencies to the Fund to be used for drawings by other participants; such loans, like gold tranche and 'super-gold tranche' claims on the Fund, carry a gold-value guarantee. The legal basis for these arrangements is to be found in Article VII (2) (the scarce currency provisions); their scope is narrower than that of Article VII, however, in that they are to be used only when the Fund needs "... supplementary resources ... to forestall or cope with an impairment of the international monetary system ...". This phrase had been held to imply that the G.A.B. were usable only for drawings by the two main reserve currency countries, but use of the G.A.B. in connection with the drawing by France last year marked a new willingness to have recourse to it for drawings by other

1 Belgium, Canada, France, Italy, Japan, the Netherlands, Sweden, the United Kingdom, the United States and Western Germany.

members of the Group of Ten. Before making a proposal to call for supplementary resources under the G.A.B., the Managing Director of the Fund must consult the participants in the arrangement; and a proposal becomes effective only if it is accepted by the participants. These provisions have enabled potential G.A.B. lenders to oversee in some degree the conditions which the Fund wished to attach to the underlying drawing, and to require the Fund to sell them gold, under the terms of Article VII (2) (ii), for part of the currencies which it needed. For example, the United Kingdom's drawing of June 1968 was financed as to $476 million from the G.A.B., $365 million by sales of gold and $559 million from the Fund's own holdings of currencies.

In obtaining this addition to its resources, on a basis which was more conditional than it had originally envisaged (its use of those resources having also tended to become more conditional), the Fund in effect recognised that the original intentions of Article VII were not capable of being achieved through the provisions of that Article. Even shortly before the G.A.B. were established it would have been very difficult to bring pressure to bear on persistent creditors through the scarce currency provisions – in part because they had not been implemented in any way in respect of the U.S. dollar and in part because the view had already prevailed in international discussion that the main – if not the whole – weight of adjustment should rest on countries with balance of payments deficits. One can argue, therefore, that the Fund sacrificed nothing of substance in 1961 and was merely recognising the realities of the international economic situation; however, that there is at least the possibility of a different kind of solution was shown in 1966, when the Fund borrowed $250 million of lire from Italy outside the G.A.B. but under the terms of Article VII (2) (i).

Conclusions

In both aspects of the Fund's activities discussed in this article there have been considerable changes from the intentions of some at least of the founding fathers of the I.M.F. There were a number of issues which the drafters did not resolve at Bretton Woods, so that the Articles remained vague and could not be operated until the Board of Directors had in effect 'interpreted' their meaning; these interpretations were based partly on what were understood to be the drafters' intentions, partly on current circumstances and partly on legal precedents – of which a formidable corpus has been built up.

Although some observers have felt that increasing reliance on legal precedents has tended to make the Fund too rigid in some of its attitudes, the process of legal interpretation has allowed the Fund to adapt itself to the changing needs of the international monetary system and to deal with problems which were not fully taken into account at Bretton Woods – mainly because the negotiators there did not have the gift of being able to look twenty years into the future. With the benefit of hindsight one may say that:

a they envisaged a world in which the main danger would be from deflation rather than inflation;

b they did not foresee the possibility of a prolonged U.S.

balance of payments deficit, and of a surplus, rather than a shortage, of dollars in the world;

c the unification of financial markets and the growth of international non-financial corporations have contributed to a far greater than expected volume of capital movements – to which the Fund's attitude, as we have seen, has been ambivalent;

d the real problems of the underdeveloped world were of a size and complexity certainly not appreciated in 1944.

One of the most striking differences between the Fund today and the Fund envisaged at Bretton Woods (certainly by Keynes) is the slowness with which its resources revolve. Indeed, so far as the Group of Ten countries are concerned, the decreasing automaticity and increasing formalisation of Fund drawings outside the gold tranche (as well as the growing scale of the problem) have led to the replacement of the Fund as a source of short-term balance of payments assistance by various central bank swap arrangements; Fund experience has also shown that the problems of developing countries in particular tend to require adjustment periods of – and hence Fund assistance for – longer than five years.

The Fund has not found itself in serious liquidity difficulties on this account, while difficulties which might have arisen from large drawings, such as those by the United Kingdom, have been obviated partly by the existence of the General Arrangements to Borrow and partly by the Fund's purchases for gold of the currencies of surplus countries. The price which the Fund has paid for this, however, has been the abandonment in practice of that part of the machinery for balance of payments adjustment which is written into Article VII. It is idle to speculate whether the full use of the whole of this machinery by the Fund would have been effective in producing a better international adjustment process, although it seems reasonable to suppose that additional institutional arrangements, such as were envisaged at the time of Bretton Woods – in the international trade field in particular – would have been necessary to complement the I.M.F. It is certain, however, that even before the G.A.B. came into existence in 1961, the Fund and its principal members – reflecting the increased economic strength of continental Europe – had veered towards the proposition that the greater part of the burden of adjustment should fall on countries in balance of payments deficit. This is a concept which runs counter to some of the ideas underlying the I.M.F. Articles; but, as mentioned above, the fact that in the post-war period governments, with few exceptions, have tended to err on the side of inflationary rather than deflationary policies has inevitably falsified some of the assumptions on which Article V (governing the use of the Fund's resources) was originally based.

Given that the Fund has moved away, for whatever reasons, from the intentions of its original Articles it is noteworthy that demand for an unconditional facility has nevertheless persisted and that, when abandoned in one context, it has arisen in another. There is a natural conflict between the desire of deficit countries to receive assistance with as few strings as possible attached and the equally understandable reluctance of surplus countries to provide assistance without a suitable measure of control to ensure its proper use. However, the amount of unconditional facilities which is adequate in a generally inflationary situation may well not be so if a deflationary situation begins to emerge; the need for more unconditional facilities will then become more apparent and its satisfaction will be in the interests of the whole international community. Although conditional facilities for assistance to deficit countries are necessary to help bring about desirable balance of payments adjustments, an adequate supply of unconditional liquidity also has a role to play in easing the burden of adjustment. Without such a supply, efforts by deficit countries to move towards balance and into surplus not only become much more difficult but also tend to lead to a slower growth of world trade and prosperity.

U.S. $ millions

		Drawings		Fund liquidity		
	Quotas (end-period)	Normal	Under compensatory finance facility	Re-purchases	Borrowing (net)	Gold sales (excluding gold investment)
1947/8	8,034	676		—		
1949	8,047	101		2		—
1950	8,037	—		24		—
1951	8,137	35		46		—
1952	8,737	85		102		—
1953	8,739	230		163		—
1954	8,728	62		210		—
1955	8,750	28		232		—
1956	8,928	692		113		—
1957	9,016	977		64		600
1958	9,193	338		348		—
1959	13,958	180		573		—
1960	14,741	280		654		—
1961	15,043	2,478		754		500
1962	15,189	584		1,306		—
1963	15,560	257	76	267		—
1964	15,850	1,950	—	510	+405	250
1965	15,977	2,422	11	391	+525	400
1966	20,647	1,424	24	480	+250	148
1967	20,988	628	206	920	−405	—
1968	21,198	3,553	65	1,179	+521	547