The Evolution of the International Monetary System and the Changing Role of the Fund

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The international monetary system comprises a set of arrangements that facilitate the conduct of trading and financial relationships among countries and their residents. For these arrangements to be operated efficiently and to be in the interests of all member countries, a number of rules and conventions observed by governments and their fiscal agencies have evolved in such areas of mutual concern as exchange rates, payments regimes, and reserve assets. The International Monetary Fund, which currently has 146 members, is an intergovernmental institution established by the international community to supervise the working of the international monetary system, to promote the adjustment of payments imbalances, and to serve as a forum for collaboration and for the study and resolution of problems in these areas.

The objectives of the Fund have expanded since it was established in 1945 but still include in essentially unchanged form those written into the original Articles of Agreement. The Fund aims to foster the balanced growth of international trade so as to facilitate the attainment of high levels of real income and employment in member countries and the development of their productive resources. The strategy for achieving these goals includes the promotion of exchange stability, an open and multilateral system of current payments and transfers, and balance of payments adjustment policies that are not detrimental to national or international prosperity. In 1969, the objectives of the Fund were enlarged to cover the growth of international liquidity on a path consistent with the attainment of full employment and price
stability through the allocation (or cancellation) of an international reserve asset, the special drawing right (SDR).

This paper discusses the changing role of the Fund against the background of the evolution of the international monetary system. Four aspects of the Fund's activities are analyzed: (1) the trade and payments regime; (2) the exchange rate mechanism; (3) the reserve-creating machinery; and (4) the adjustment process. These elements are, of course, closely interrelated in practice, and their separate treatment is for discussion purposes only. The Fund's evolving role is viewed in relation to each of these elements and as a forum for collaboration and consultation among governments. The paper concludes with a brief review of some of the issues concerning the Fund that are currently occupying the attention of its members.

The Trade and Payments Regime

The trade and payments system that prevailed during most of the 1930s was characterized by the widespread existence of restrictions. Countries were split into numerous trading and currency blocs; trade was channeled through bilateral trade and payments agreements; and there were extensive exchange controls, multiple currency practices, and discrimination. The Fund's founding fathers viewed these arrangements as being shortsighted and detrimental to the outward-looking and cooperative policies necessary for the preservation of political harmony among nations in the postwar period. They also feared that the ending of the war would be followed by an economic slump, as had occurred after World War I, and that this would add to the pressures to resort to restrictive trade and payments policies.

Accordingly, a code of conduct was negotiated at the Bretton Woods Conference in 1944 that attached considerable importance to the attainment of an open and multilateral system of payments and exchange. Members would ensure that payments for current transactions could take place freely and that balances arising out of such transactions could be converted into other currencies. They were to avoid restrictive bilateral and regional payments arrangements and to refrain from multiple currency practices and discriminatory currency arrangements.

Countries in a position to do so were expected to adopt the code on current payments and convertibility as soon as they joined the Fund. It
was recognized, however, that because of the dislocations suffered during the war, many countries would not be able to meet this requirement. A transition period was therefore allowed, during which members could retain the restrictions in force at the time they joined the Fund.1 From March 1952, the Fund was required to consult annually with members still retaining restrictions.

The Fund's code on exchange practices is also based on the premise that there are considerable administrative costs in the maintenance of restrictions. These are especially onerous for countries with scarce administrative resources. The code regards the price mechanism as a sound guide to rational decision making in the areas of international trade and transfers. In fact, it constrains the permanent use of exchange measures to interfere with the working of the price mechanism. This does not mean that governments are expected to accept the economic consequences of the unfettered interplay of market forces. However, adherence to the code does mean that they agree, when they wish to modify the free market result, to do so through the use of other, that is, nonexchange-type, measures. Trade measures are more "transparent" than exchange measures—that is, their effects, particularly the degree of protection they provide, are easier to observe—and are subject to close examination by another international organization established in the postwar period, the General Agreement on Tariffs and Trade.

Examination of the restrictive systems of members and consultations with members about the need to retain restrictions and the means and timing of their removal formed a major part of the Fund's operational work during the 1950s. However, in February 1961, the major European countries joined the United States and Canada in observing the Fund's code on exchange practices, and by the end of that decade, Japan and many developing countries had followed suit.

This broad progress in the liberalization of the exchange system continued in the 1970s. Participation in bilateral payments arrangements and use of multiple currency practices declined. However, restrictions associated with arrears on debt servicing payments emerged as an important problem during the mid-1970s. The number

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1 The Second Amendment of the Articles of Agreement gives all new members this privilege without reference to a general transitional period.

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of countries in arrears continued to rise, and by the end of 1982 about one fifth of the Fund's membership had payments arrears.

The accumulating arrears are, however, part of a larger problem of external indebtedness, especially of developing countries, and do not represent a reversal of the generalized progress toward a multilateral payments system that has taken place in the postwar period.

The Exchange Rate Mechanism

The origins of the par value system of exchange rates agreed at the Bretton Woods Conference lie in the high costs that were incurred by countries under the gold exchange standard of the late 1920s and that were imposed on countries by the exchange rate measures introduced during the 1930s. The gold standard, with its emphasis on fixed exchange rates and on changes in levels of economic activity as the mechanism for correcting external imbalances, was excessively rigid and forced countries to adjust too abruptly. The exchange rate policies adopted following the collapse of the gold standard, especially the competitive use of devaluation to promote domestic employment, imposed equally heavy burdens, provoking retaliatory measures and causing severe dislocations of world trade.

The par value system incorporated in the Fund's charter was designed to keep rates more stable than during the 1930s but also to allow them to be more adjustable than under the gold standard. Members could change their exchange rate but only to correct a "fundamental disequilibrium" and only after consultation with the Fund and normally with its concurrence. It was widely expected that members would use the exchange rate as one of the instruments of policy.

The par value system appeared to work satisfactorily during the 1950s and the first half of the 1960s. From the mid-1960s, differential rates of economic performance, reflected in divergent rates of inflation, led to payments imbalances in the major industrial countries, which these countries were reluctant to correct by adjusting their exchange rates. Some other countries found that the increasing ease of international capital movements made it impossible to maintain pegged exchange rates, and they adopted "floating" regimes. A series of exchange crises in the late 1960s and early 1970s culminated in the suspension of convertibility for the U.S. dollar in August 1971. By
early 1973, most of the major industrial countries had been forced to float their currencies.

Following the breakdown of the par value system, the Committee on Reform of the International Monetary System and Related Issues (Committee of Twenty) was established to advise on exchange rates and other aspects of a reformed international monetary system. The Committee’s early efforts focused on the restoration of the par value system with floating in particular situations to be validated and with modifications aimed in part at encouraging members experiencing payments imbalances to adopt early and adequate programs of adjustment, including prompt changes in par values. However, because of large payments imbalances associated with the first oil price rise and increased uncertainty about the future, it soon became apparent that agreement could not be reached on an early return to a par value system. Accordingly, the efforts of the Committee and of its successor, the Interim Committee of the Board of Governors on the International Monetary System (Interim Committee), shifted toward developing a more flexible set of exchange arrangements and of principles that would guide members in the conduct of their exchange rate policies. The results of these deliberations were formalized in the Second Amendment of the Fund’s Articles of Agreement that became effective in April 1978.

The rights and obligations of members with respect to exchange arrangements and policies, as specified in the Second Amendment, have three main aspects. First, members are free to choose the form of their arrangement. They may peg the value of their currency to that of another currency, they may peg to a composite or basket of currencies including the SDR, or they may allow the value of their currency to float. They may not, however, peg to gold—a restriction designed to facilitate a reduction in the role of gold in the international monetary system.

Second, members do not have freedom over policies affecting their exchange rate. They have a general obligation to collaborate with the Fund and with each other to promote orderly exchange arrangements and a stable system of exchange rates. They also have the more specific obligation of pursuing economic and financial policies that foster orderly economic growth and reasonable price stability. The focus has thereby been shifted from the stability of the exchange rate to the stability of the underlying conditions. Members are required, how-
ever, to eschew exchange rate policies that impede balance of payments adjustment or result in unfair competitive advantage. Members are also expected to intervene in exchange markets to counter disorderly conditions and to take account of the interests of other members in their intervention policies.

Third, the Fund is required to exercise firm surveillance over the exchange rate policies of members. This is conducted in the course of consultations with individual members against the background of the Fund's assessment of the world economic situation and outlook. Exchange rate policy is discussed within the broader framework of other economic and financial policies having a bearing on it and with special attention to the impact on other countries; this latter aspect is naturally stressed in the case of the major industrial countries with a large weight in the world economy. Recently, the interconnections among the principal countries whose currencies are included in the SDR basket (viz., France, the Federal Republic of Germany, Japan, the United Kingdom, and the United States) have been recognized as requiring a special surveillance exercise within a multilateral context, and these countries, together with Canada and Italy, have begun exploring ways of working with the Fund in a more intensive way to achieve a greater convergence of their policies.

The Reserve-Creating Machinery

In the period between the two world wars, the major international reserve assets were gold, pounds sterling, and U.S. dollars. In the negotiations that preceded the Bretton Woods Conference, the United Kingdom recommended that the proposed new international monetary institution be authorized to issue an additional reserve asset. The asset would be transferable among members, and there would be no limit on credit balances. However, the recommendation was opposed by the United States, which feared that it would be required to trade real resources for unlimited holdings of an untried reserve asset. The U.S. view prevailed and, under the original Articles, the Fund was not required to regulate, nor empowered to issue, reserve assets.

With the supply of monetary gold rising slowly, the price of gold in terms of dollars being fixed, and the United Kingdom experiencing balance of payments difficulties that made the pound sterling less attractive as a reserve currency than in earlier periods, the dollar
provided the bulk of the increase in reserve assets during the first two decades after World War II. This situation appeared tenable so long as the deficit in the U.S. balance of payments reflected capital movements in the sense that the United States was playing a banker’s role—accepting short-term deposits (which other countries regarded as reserves) and lending them out at longer term by way of direct and portfolio investment. However, a dilemma arose if the current rather than the capital account became the major source of the deficits: if these deficits did not continue, international reserves would grow too slowly to maintain world trade and growth at full employment level; if the deficits did continue, confidence in the dollar would be undermined and continuance of its official convertibility doubted. Besides, the system came to be regarded as inequitable since the reserve currency country could acquire real goods and services from abroad in exchange for financial claims on its monetary authorities while other countries had to use reserve assets.

The instability imparted by this currency-based reserve asset system led to a search for an alternative reserve asset. The United States was also becoming concerned about its deteriorating liquidity position vis-à-vis the accumulating short-term dollar liabilities owed to foreign official holders. The Fund’s Articles were amended in 1969 to authorize the Fund to create a new asset, the SDR, and the mechanism to allocate SDRs became operative the same year.

The early SDR lacked many of the attributes of a reserve asset. To some extent, it was constructed as an instrument for obtaining credit for a limited number of purposes. There were restrictions on its use, its yield was below that of alternative assets, and heavy users were required to reconstitute their holdings in order to maintain a minimum average level of holdings to allocations over time. These were a reflection of several factors—the need to proceed cautiously with the new asset, the resistance of the United States to an asset that would be too competitive with the dollar, and the desire of some countries to protect the role of gold as a major reserve asset.

In recent years, the characteristics of the SDR have been improved considerably. The Articles of Agreement envisage the SDR as becoming the principal reserve asset of the international monetary system, and, to this end, the Fund has progressively removed restrictions on the use of the SDR, has raised the interest rate on it to the market level, and has abolished the reconstitution requirement. It
has also simplified the valuation of the SDR by reducing the number of currencies in the valuation basket from 16 to 5; the valuation and interest rate baskets are now identical. These changes have reflected a strengthening view among most members that the SDR should become a genuine alternative reserve asset.

Annual allocations were made in 1970–72 and again in 1979–81. The total allocation of SDRs so far is 21.4 billion. Members' holdings of SDRs in mid-1982 constituted about 5 percent of their non-gold reserve assets. Clearly, this ratio will have to rise appreciably if the SDR is to become the principal reserve asset in the international monetary system. There is no consensus among Fund members at the present to permit new SDR allocations to be made. The use of the SDR as a unit of account in financial transactions is growing gradually, and its attractiveness as a store of value is enhanced by the increased variability of the exchange rates of the principal reserve currencies, since the SDR, as a composite, tends to vary less than its component currencies.

The Adjustment Process

The changing nature of the Fund's role is perhaps most apparent in its function of promoting balance of payments adjustment. Major aspects of initial funding and lending policies were determined by early 1952, when the view that loans should be conditional on the adoption of satisfactory adjustment programs was accepted and the usefulness of the stand-by arrangement as a framework for the application of conditionality was recognized. These policies were largely unchanged during the following decade, a period when comparatively little use was made of the Fund's resources. However, from 1963, changes occurred at a rapid pace and affected most aspects of the Fund's lending policies, including the specific purposes of loans, the associated policy conditions, the maximum use relative to quota, the duration of disbursement and repayment periods, and the degree of concessionality. These changes also affected the sources that the Fund uses to finance its activities.

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2 The stand-by arrangement provides a member with a line of credit that it can draw on in installments during a specified period as long as it adheres to the terms of the arrangement.
Lending

The Fund’s early lending policies made no allowances for different types of balance of payments problems. This “one window” approach continued until 1963, when, in recognition of the special difficulties faced by a growing number of primary producing countries, the Fund introduced the compensatory financing facility to assist members coping with payments imbalances attributable to temporary shortfalls in export receipts. A basic innovation of this facility was the recognition that, where the balance of payments problem was of a clearly reversible character and was due largely to circumstances beyond the control of the country, it was unreasonable to expect the country to adjust. The country should have the means to bridge the period until the circumstances creating the problem are reversed. A third lending window was opened in 1969 with the creation of the buffer stock financing facility. This facility, which has been used only occasionally by members, and then for relatively short periods and in small amounts, helps members that have difficulty in financing expenditures associated with the establishment and operation of buffer stock arrangements.

A number of new facilities were established in the mid-1970s. The extended Fund facility was created in 1974 for the purpose of providing resources, in larger amounts and over a longer period of time than under the one-year stand-by arrangement, to countries that either are experiencing balance of payments difficulties of a structural nature or have external positions that are too weak to permit them to undertake an effective development program. This was the fourth regular window opened by the Fund, as distinct from the temporary oil facilities created in 1974 and 1975 to meet the increased costs of oil imports in that period. The latter were designed in part to help members avoid recourse to restrictions and to unduly deflationary demand-management policies following the large rise in oil prices in 1973–74. In 1975, the Fund also established an account to subsidize the interest costs of drawings under the 1975 oil facility by countries most seriously affected by the rise in oil prices.

In the following year, a Trust Fund was created for the purpose of making direct contributions and extending highly concessional loans to low-income developing countries. The Trust Fund was financed out
of profits from the sale of a portion of the Fund's gold holdings. In contrast to the origin of other facilities, where the identification of a lending need preceded efforts to establish the facility, the Trust Fund was created following the decision to reduce the size of the Fund's gold holdings as part of the program for gradually demonetizing gold. The subsequent sales of part of the Fund's gold to the public provided the initial funds for setting up the Trust Fund.

There has been a further widening of the range of the Fund's lending facilities in recent years, owing to the larger and more intractable payments imbalances associated with the 1973—74 and 1979—80 rises in the cost of energy. In 1979, the supplementary financing facility was established, and its successor, the enlarged access policy, came into operation in 1981. Both are designed to permit larger access to the Fund than would have been possible under the permanent facilities that were designed to be financed from the quota (or capital) subscription resources of the Fund. In May 1981, the Fund broadened the coverage of the compensatory financing facility to include the provision of assistance to members experiencing temporary increases in the cost of cereal imports.

The concept of Fund conditionality has also evolved over the years. When the Fund was established, it was not even clear that the use of its resources would be subject to policy conditions. In fact, virtually all countries except the United States were initially opposed to the idea. However, it soon became apparent that, if the Fund was to have confidence that the resources it lent would be repaid and be available for the use of other members, it would either have to deny certain requests outright or require that the members adopt policies aimed at correcting their payments imbalances within a definite period. Conditionality practices changed as the Fund gained experience with adjustment programs. The main targets and instruments came to be expressed in quantitative terms in order to make the programs more precise and thus easier to monitor. The practice developed of phasing disbursements over the period of the arrangement. Performance criteria, or tests that determine whether members can continue to draw under stand-by arrangements, were included from 1957.

Until recently, members could borrow from the Fund until the latter's holding of their currency reached 200 percent of quota. Since own-currency subscriptions are at least 75 percent of quota, members
could thus draw up to 125 percent of quota.\textsuperscript{3} This ceiling could be waived, but only in exceptional circumstances. To start with, the compensatory financing facility did not raise members' total access to Fund resources; drawings made under it reduced potential borrowings under the regular tranche policies by an equal amount. However, the introduction of this facility was accompanied by a relaxation of the approach toward requests for waivers beyond the 200 percent limit, and such requests came to be granted almost automatically. This practice led the Fund to decide, in 1966, to exclude currency holdings resulting from transactions under the compensatory financing facility in determining a member's maximum access under the tranche policies.

The access of members to Fund resources has been increased over the years by extending the exclusion principle to holdings attributable to net drawings under other special facilities (e.g., the oil facilities) and by increasing members' potential access relative to quota. In 1974, access under the extended Fund facility was raised to 140 percent of a member's quota but counting this access from the end of its first credit tranche. In the meantime, however, quotas were declining as a proportion of imports, and the decline became even more pronounced following the second oil price rise in 1979–80. The Fund was clearly in danger of becoming unable to mobilize the "critical mass" of finance necessary to support deficit countries in their adjustment efforts. In mid-1980, the Fund adopted a policy of allowing members implementing strong adjustment programs to draw up to 200 percent of quota in a year. Following the increase of 50 percent in quotas under the Seventh General Review, which became effective at the end of 1980, members can borrow up to 150 percent of quota in a year with a maximum of 450 percent of quota over three successive years. The ceiling on cumulative access is 600 percent of quota. These amounts

\textsuperscript{3} A drawing that increases the Fund's holdings to no more than 100 percent of a member's quota is a "reserve tranche" transaction that does not have to be repaid. Drawings beyond the quota are credit transactions that have to be repurchased (repaid) and are divided into four tranches, each tranche equal to 25 percent of quota. Thus, drawings that would raise the Fund's holdings beyond 100 percent of quota to 125 percent would be in the first credit tranche. Further drawings would be in the "upper credit tranches" except where certain holdings are excluded under special policies.
are independent of borrowings under the compensatory financing, buffer stock financing, and oil facilities and of scheduled repurchases. They are, of course, also independent of assistance made available through the Trust Fund and the interest subsidy accounts. By liberalizing access in the face of declining quotas and rising payments imbalances, the Fund has demonstrated the importance it attaches to the role of providing adequate financial assistance to countries pursuing appropriate policies of balance of payments adjustment.

The Fund has adapted its disbursement and repayment period to the changing needs of its members. During the 1950s and 1960s, most requests for Fund assistance came from countries with payments deficits that were small relative to their economies and that could be corrected through an appropriate combination of demand-reducing and demand-switching measures. These measures could be implemented quickly and could bring about an early restoration of external balance. Consistent with this situation, disbursement periods were one year or less and repayment periods were three to five years.

With larger current account deficits relative to gross domestic product (GDP) from about the mid-1970s and the frequently structural character of balance of payments problems, it became necessary to lengthen disbursement and repayment periods. The demand for longer disbursement periods was associated with the need to phase the adjustment over a period longer than one year. The disbursement period was set at three years for the extended facility and could reach up to three years in stand-by arrangements as well. The need for longer repayment periods reflected partly the greater time required to eliminate deficits that had increased sharply relative to trade and GDP, as well as the bigger role assigned in the programs to "supply-side" measures, which depended on new investment designed to move resources from the domestic sector into the external sector and on raising internal savings to match the additional investment. The upper limit to the repayment period was set initially at eight years but was subsequently increased to ten years for the extended Fund facility (but was held to seven years for amounts financed from borrowed resources). It was also set at ten years for the Trust Fund; this reflected the concessional nature of Trust Fund loans rather than the nature of the programs these loans supported.
Funding

As noted above, quota subscriptions and borrowings form the basis of Fund resources. A major development of the last two decades has been the relatively slow increase of quotas, and this has been reflected in the growing importance of borrowing as a source of Fund resources since the mid-1970s.

There is widespread agreement among the Fund’s membership that quotas should be the main source of the organization’s funds. They generate resources from all members and are thus closer to the internationally cooperative character of the institution. Also, these resources have generally been less costly to the Fund than borrowed funds. However, quotas determine not only subscriptions but also potential access to Fund resources, the pattern of SDR allocations, and the distribution of voting power. The determination and ratification of general and selective increases is a time-consuming process, and a large and unexpected rise in the need for resources between quota revisions (which take place every five years at the latest) can be met by borrowing. Furthermore, while quota increases do augment the Fund’s resources, they increase by an equal amount its potential liquid liabilities because claims on the Fund held by its creditor members are reserve assets that are immediately encashable in case of balance of payments need. Thus, higher quotas do not improve the balance between available resources and potential demands on the Fund if there is a large difference between the distribution of quotas and the distribution of surpluses among countries.

The Fund’s first borrowing arrangement was concluded in 1962 when, under the General Arrangements to Borrow (GAB), ten industrial nations, which subsequently formed the Group of Ten, agreed to lend to the Fund for on-lending to other members of the Group. The interest rate on these borrowings by the Fund, and thus the charges levied by the Fund when it used resources under the GAB, was quite low, in line with the cooperative nature of the Arrangements.

During the 1970s, the Fund borrowed a total amount of SDR 6.9 billion to finance the two oil facilities (now almost entirely repaid) and entered into agreements with 13 industrial and oil exporting countries to borrow the equivalent of SDR 7.8 billion for the supplementary financing facility. Amounts under these agreements have been almost
fully committed, except for certain residual amounts arising from stand-by or extended arrangements that have been canceled. In order to finance the current enlarged access policy, the Fund has entered into bilateral borrowing agreements with the Saudi Arabian Monetary Agency for SDR 8 billion and with the Bank for International Settlements and the central banks and official agencies of 18 industrial and developing countries for an additional SDR 1.3 billion.

Further borrowing arrangements will be necessary if the Fund is to meet prospective demands of its members in the period before quotas are increased under the Eighth General Review of Quotas. There is a strong preference among members that borrowings should, as far as possible, be from official sources, but the possibility of a direct approach to the private market is not precluded.  

The Fund as a Forum

The Fund's Articles of Agreement require that it provide machinery for members to collaborate and consult on international monetary issues. Many observers regard this as the most important of the Fund's functions and its effectiveness in promoting the clarification and resolution of difficult issues as among the most satisfactory aspects of its work. At present, representatives of 146 countries, with widely differing economic systems, income levels, and patterns of production, discuss and deliberate over a wide range of issues related to individual economies and the international economy. The discussions take place in a collegial atmosphere and with an almost complete absence of rhetoric.

The major forums for consultation and collaboration are the Board of Governors and the Executive Board. The Board of Governors, which normally meets once a year, consists of a representative from each member country, usually its minister of finance or the governor of the

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4 On January 18, 1983, the Ministers and Central Bank Governors participating in the GAB announced that they strongly supported a substantial increase of resources available to the Fund and had decided to raise their aggregate credit commitments under the GAB from SDR 6.4 billion to SDR 17 billion. Moreover, the scope of the GAB would be expanded significantly by opening its use to countries other than the GAB participants.
central bank. The Governors have delegated many powers to the Executive Board, which is in continuous session at Fund headquarters in Washington. Most decisions of the Executive Board are taken by consensus rather than on the basis of voting. The Board's work is facilitated by reports prepared by the staff of the Fund, in particular, reports on consultations with member countries in the exercise of surveillance over exchange rates.

The Interim Committee, which was created in 1974, provides an important forum for mobilizing a consensus at the political level. The Committee is an advisory body to the Board of Governors and has the same composition as the Executive Board—its 22 members reflecting the constituency groupings of the Fund. Its members are ministers or central bank governors. It normally meets twice a year—in the spring and at the time of the Annual Meeting of the Board of Governors in the fall. The Articles of Agreement provide for a Council with decision-making powers, but so far no steps have been taken to replace the Interim Committee.

The Next Steps

The issues that currently occupy the attention of member governments of the Fund span all its functions. In the regulatory field, the modalities for the surveillance of exchange rates by the Fund remain under scrutiny. The recent experience with floating exchange rates has demonstrated their inability to wholly insulate the domestic economy from the effects of policies in other countries and has re-emphasized the need for the major industrial countries to pay due regard to the consequences, for their principal trading partners, of their economic policies and, in particular, of the mix of their monetary and fiscal policies. Growing realization of the Fund's potential as a forum is evidenced by the willingness expressed by the seven principal industrial countries at the Versailles summit in June 1982 "to strengthen . . . cooperation with the IMF in its work of surveillance and to develop this on a multilateral basis taking into account particularly the currencies constituting the SDR."5

In the area of the financial role of the Fund, a number of issues are emerging. The fact that no developed country has drawn on the Fund since 1978 has raised questions whether the Fund is not being transformed ineluctably into a development financing agency. The gradual lengthening of the time period of Fund-supported programs has brought it somewhat closer to the interests of its sister institution, the World Bank, which, in turn, has moved its structural lending into some areas of adjustment policy not dissimilar to those of the Fund. A harder question is whether the Fund's conditionality standards need to be modified. A less exacting standard carries the danger of moving the Fund into a "surrogate" donor's role for countries that are really in need of concessional flows to maintain their viability. A more exacting standard might be regarded as contributing to the strains that are already severe in countries seeking to adjust in an environment far more difficult than was envisaged only a short while ago.

Even more complex is the question of the Fund's relationship with the commercial banks, especially in member countries that turn to the Fund for assistance when their normal sources of bank financing are disturbed.

Another set of issues relates to the size of the Fund in the 1980s. It is important that the resources of the Fund be perceived as being adequate to the needs of all its members, including those which have not used the Fund in recent years because of their access to international bank credit. There is also a "systemic" role to be played if large-scale financial turmoil were ever to place at risk an international credit structure built on a vast interbank network and spanning financial centers in a number of countries.\(^6\)

Several new concepts are yet to be explored, such as a Fund based fully on the SDR and the possibility of the Fund's evolving in the direction of a genuine international central banking authority. Many political and economic considerations must be reconciled before decisions can be reached on such questions. What the Fund's record to

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\(^6\)At a meeting in Washington, D.C., on February 10–11, 1983, the Interim Committee agreed that Fund quotas should be increased under the Eighth General Review of Quotas from about SDR 61 billion to about SDR 90 billion. Forty percent of the overall increase would be distributed to all members in proportion to their existing quotas, and the balance would be distributed in the form of selective adjustments.
date indicates is that the institution has the capacity to respond to changing circumstances in a manner that enables it to play a useful role in the evolution of the international monetary system.

Related Reading


Summary of Discussion

Participants recognized that the growth of the Fund's membership, particularly the increase in the number of primary producing and developing country members, as well as changing economic circumstances, had led to considerable adaptation of the purposes, policies, and practices of the Fund. Nevertheless, many felt that the Fund could go further toward meeting the needs of its members. In particular, the Fund's surveillance could be strengthened, its financial resources could be enlarged, and its function as a forum could be expanded. Other issues raised were the merits of alternative exchange rate regimes, the relationship between the Fund's prescriptions of rate adjustments and the objective of promoting exchange rate stability, and the likelihood of a return to a fixed exchange rate system.

Under the Second Amendment of its Articles of Agreement, the Fund is required to exercise "firm surveillance" over the exchange rate and related policies of its members. Participants observed, however, that such surveillance had not been effective in producing reasonable stability of exchange rates; in fact, rates among the major currencies had fluctuated much more than would seem to have been required by purely balance of payments considerations. Several argued that this "overshooting" of rates indicated the need for a strengthening of the Fund's surveillance function.

The Fund staff attributed the instability of exchange rates to large changes in underlying conditions owing to, for example, increases in the price of energy, the need to use monetary policies more intensively to moderate the effects of other policies in some countries, and rapid changes in technology, especially communications, as these affected the working of financial markets. They noted that the Fund was endeavoring to strengthen its surveillance through more frequent consultations with members and was experimenting with a multilateral approach. It was encouraging member countries to adopt a more balanced fiscal-monetary policy mix to achieve their aggregate demand targets, rather than to rely on monetary policies alone, and to be more
sensitive to the effects of their domestic policies on the economies of other countries. The Fund could not impose operational sanctions on members but did have considerable moral authority in the area of exchange rate policies. Through the quality of its economic analysis and the power of persuasion, the Fund could contribute to the convergence of economic and financial policies among its principal members, thereby promoting a more stable system of exchange rates.

Participants expressed concern about the ability of the Fund to continue to meet the needs of its members for balance of payments assistance on reasonable terms. They pointed out that, particularly in the last decade, there had been a marked fall in the ratio of Fund quotas to current account deficits. Borrowings by the Fund had only partially offset this fall and had increased the cost of Fund resources to members. These developments suggested the need for a substantial increase in quotas.

The Fund staff agreed that the amount of assistance the Fund could make available to members experiencing payments difficulties was important for its function of promoting external adjustment. They explained the concept of the "critical mass" of resources that had to be assembled to assure that appropriate adjustment programs were undertaken and to enable countries to attract additional funds from the international commercial banks and other sources. The Fund had been able to offer larger amounts, relative to quota, under its policy of enlarged access. It was also noted that the Eighth General Review of Quotas was well under way and that other proposals for increasing the Fund's resources were being considered by member countries.

One of the most important, if perhaps also the least discussed, of the Fund's functions was to provide a forum in which members could discuss international monetary problems and explore possible solutions to them. Participants pointed out that the magnitude of such problems had increased sharply in recent years. The decline in the terms of trade of non-oil developing countries, the emergence of debt servicing problems in more than one fourth of these countries, the overshooting of exchange rates, and the intractability of stagflation in the industrial countries were just some examples of these problems. Solutions to such problems required close collaboration and cooperation among countries. The Fund's regular consultations with its member countries as well as the meetings of its governing bodies provided an appropriate framework within which to discuss these problems.
Several participants argued that fluctuations in exchange rates considerably increased the difficulties faced by national authorities in managing international reserves and external debts and by enterprises in making decisions about production and investment in the tradables sector. In view of this, they suggested, it would be useful to explore the possibility of a return to a system of fixed exchange rates. The Fund staff noted that the Second Amendment of the Articles of Agreement provided for the adoption of a par value system by the whole or by a substantial part of the Fund's membership. However, there had been no serious efforts to activate this provision. The prevailing view among the authorities of the major industrial countries seemed to be that, while the experience with floating had been less than satisfactory, a fixed exchange rate system also gave rise to major difficulties. Accordingly, emphasis was being placed on ways of making the present system work more effectively rather than on trying to restore a fixed exchange rate system.

The adjustment programs supported by the use of Fund resources frequently included devaluation of currencies of the members implementing the programs. It was argued that the Fund's support of such measures might be inconsistent with its objective of promoting a stable system of exchange rates. The Fund staff agreed that the Articles of Agreement included the promotion of exchange stability among the purposes of the Fund. They also noted, however, that the Articles enjoined the Fund to "facilitate the expansion and balanced growth of international trade" and argued that, for this purpose, it was stability of real, not nominal, exchange rates that was important. For example, if a country was maintaining a fixed nominal exchange rate and its costs were rising faster than those in the rest of the world, its real exchange rate would be rising and the competitiveness of its export and import-competing sectors would be declining. To protect its foreign trade sector, the country needed to stabilize its real exchange rate by allowing changes in its nominal rate to offset its higher rate of inflation. Such changes would promote an efficient and stable pattern of world trade and would thus be consistent with the purposes of the Fund.