CHAPTER III

Section 'A'

The Bretton Woods System from the point of view of the developing countries is discussed.

(1945 - 1971)
The Bretton Woods System as envisaged by its founders, was in existence, for nearly a quarter of a century. The system came to an end in August, 1971. The par-value system or the fixed exchange rates were abandoned by most of the industrial countries. The USA suspended the convertibility of the dollar into gold in August, 1971. Inspite of its several limitations the system was responsible for impressive growth in trade and development. The aim of currency convertibility was established by the industrial countries in 1958. There was general reduction in the restrictions on trade and payments. The system came under pressure especially in the latter half of the sixties. The pressure was manifested in the establishment of gold pool\(^1\), Swap Arrangements in the early sixties, the devaluation of the British Pound in 1967, the establishment of the Two-tier price system for gold in March, 1968, and the decision of West Germany and Netherlands to float their currencies in March, 1971. In December 1971, there was the Smithsonian Agreement\(^2\) among the members of the IMF. As a result of Smithsonian Agreement the dollar was devalued a little and the countries returned to the fixed exchange rates, which was the linchpin of the Bretton Woods System. The Smithsonian Agreement was in the nature of truce. Since then the system is in trouble. Infact the system as envisaged by its founders broke down in August, 1971;
when the USA suspended the convertibility of the U.S. dollar into gold. The working of the Bretton Woods System will be examined in the light of its original aims and the impact upon the developing countries.

Under the Bretton Woods System, there was no orderly growth of international liquidity. The two sources of liquidity provided for in the Bretton Woods System were to be monetary gold and pool of national currencies. There was provision to increase the price of gold, but it was never invoked. These sources of international liquidity proved inadequate in a world of expanding world trade. The reserve needs of the countries had to be largely met by the growth of currency reserves predominantly of dollars. The USA emerged from the Second World War as the dominant economic power in terms of production and capacity. It had the largest reserves of gold. Dollar was convertible into gold. Even it was preferable to gold. Because the holdings of dollar balances brought interest to the holders. During the 1950s US balance of payments deficits were welcomed as a source from which reconstructed nations of Western Europe could replenish their depleted stock of international liquidity (reserves). The deficits in the balance of payments of the USA
provided dollars to the rest of the world. These dollars were used as reserves. Thus the deficits in the balance of payments of the USA contributed to the growth of international liquidity. The Bretton Woods System in the absence of an orderly growth of reserves was converted into a gold exchange standard by accident (or dollar exchange standard), H.G. Johnson remarks, "In fact, since the war the noncommunist world has got into a gold exchange standard, based primarily on the dollar and secondarily on sterling. This development was not consciously planned, but has been the result of a natural evolution strongly influenced by certain features of War and Postwar economic history. The accumulation of sterling balances with the sterling area and the failure to fund these balances at the end of war; the inadequacy of International Monetary Fund as a means of providing liquidity especially in face of Postwar inflation and decision that the Fund should be inactive during the Marshall Plan; and the dollar shortage and the resulting central position of the United States as a provider of scarce goods and reconstruction capital. Nevertheless, it bears a close parallel to the efforts that were consciously made after World War I to establish a gold exchange standard so as to economise on the use of gold as a
monetary reserve - an effort which broke down
disastrously in the 1930s.\textsuperscript{3} The U.S. had without
a formal international agreement, taken on the role
of a World Banker and helped to sustain the Bretton
Woods System. The continued growth of the U.S.
dollars created a crisis of confidence. The
confidence in dollars was dependent upon the
ability of the U.S. to convert dollars into gold.
When the dollars accumulated abroad exceeded that
of the U.S. gold stock, there was demand for the
conversion of dollars into gold. The goldstock
with the U.S. began to be reduced. The continued
deficits in the balance of payment of the U.S.A.
and the reduction in the goldstock with the U.S.
led to doubts about the ability of the U.S. to
convert dollars into gold. The dollar came under
suspicion. The following table\textsuperscript{4} gives an idea
about the declining gold reserves against the
mounting U.S. short-term liabilities to foreigners.

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S. Gold stock</th>
<th>U.S. short-term liabilities to foreigners ($ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>21.7</td>
<td>12.9</td>
</tr>
<tr>
<td>1959</td>
<td>19.5</td>
<td>19.4</td>
</tr>
<tr>
<td>1960</td>
<td>18.0</td>
<td>21.3 $ under pressure</td>
</tr>
<tr>
<td>1967</td>
<td>12.06</td>
<td>29.7 $ under pressure</td>
</tr>
<tr>
<td>March</td>
<td>10.89</td>
<td>33.61 $ under pressure</td>
</tr>
<tr>
<td>1969</td>
<td>11.85</td>
<td>41.90</td>
</tr>
<tr>
<td>1970</td>
<td>11.07</td>
<td>43.27</td>
</tr>
<tr>
<td>March</td>
<td>10.96</td>
<td>43.70 $ under pressure</td>
</tr>
<tr>
<td>First half of 1971</td>
<td>below 10.00</td>
<td>above 47.00</td>
</tr>
</tbody>
</table>
The following table shows the balance of payments of the USA.

<table>
<thead>
<tr>
<th>Year</th>
<th>Balance of payments in billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-57</td>
<td>-10</td>
</tr>
<tr>
<td>1959</td>
<td>-3.9</td>
</tr>
<tr>
<td>1962</td>
<td>-2.7</td>
</tr>
<tr>
<td>1963</td>
<td>-0.2</td>
</tr>
<tr>
<td>1964</td>
<td>-1.6</td>
</tr>
<tr>
<td>1965</td>
<td>+1.3</td>
</tr>
<tr>
<td>1966</td>
<td>+0.3</td>
</tr>
<tr>
<td>1967</td>
<td>-3.1</td>
</tr>
<tr>
<td>1968</td>
<td>+1.6</td>
</tr>
<tr>
<td>1969</td>
<td>+0.27</td>
</tr>
<tr>
<td>1970</td>
<td>-10.7</td>
</tr>
<tr>
<td>1971 (first half)</td>
<td>-11.6</td>
</tr>
</tbody>
</table>

The above two tables make it clear that the USA was confronted with reduced gold stock and mounting short-term liabilities on account of continued deficits in the balance of payments. The ability of the U.S. to convert dollars into gold was doubted. The US could not run deficits continuously to provide reserves to the world. The system has built in instability. The use of national currency as international reserves constitutes a built-in destabiliser in the monetary system. The growth of international reserves (dollars) was haphazard and
irregular. The use of Key Currency creates exchange reserves as a byproduct of the Key Currency country's deficits in the balance of payments. It destroys reserves as a byproducts of the surpluses of the key country's balance of payments. So the growth of international liquidity was not orderly during the Bretton Woods System. The growth in the supply of dollars, as reserves has been associated with a deficit in the balance of payments of the U.S.A. (See Table I and II below).

Table No. 6

Composition of World Monetary Reserves: 1949-71
(in billions of U.S. Dollars).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Gold</td>
<td>33.5</td>
<td>39.1</td>
<td>37.2</td>
<td>39.2</td>
</tr>
<tr>
<td>II. Special drawing rights.-</td>
<td>-</td>
<td>3.1</td>
<td>6.4</td>
<td></td>
</tr>
<tr>
<td>III. Reserves in IMF</td>
<td>1.7</td>
<td>6.7</td>
<td>7.7</td>
<td>6.9</td>
</tr>
<tr>
<td>IV. Foreign Currencies</td>
<td>10.4</td>
<td>32.4</td>
<td>44.5</td>
<td>77.6</td>
</tr>
<tr>
<td>Dollars</td>
<td>3.2</td>
<td>16.0</td>
<td>23.9</td>
<td>50.7</td>
</tr>
<tr>
<td>Sterling</td>
<td>6.9</td>
<td>9.0</td>
<td>6.6</td>
<td>7.9</td>
</tr>
<tr>
<td>Euro dollars etc.</td>
<td>0.3</td>
<td>7.4</td>
<td>14.0</td>
<td>19.1</td>
</tr>
<tr>
<td>V. Total</td>
<td>45.5</td>
<td>78.2</td>
<td>92.5</td>
<td>130.1</td>
</tr>
</tbody>
</table>

United States.      26.0  17.0  14.5  13.2
Other countries.    19.5  61.2  78.1  116.9
### Table No.II©

**Gross and Net Reserves of the United States: 1949-71**

(in billions of U.S. dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Gross reserves</strong></td>
<td>26.0</td>
<td>17.0</td>
<td>14.5</td>
<td>13.2</td>
</tr>
<tr>
<td>of which gold</td>
<td>24.6</td>
<td>11.9</td>
<td>11.1</td>
<td>11.1</td>
</tr>
<tr>
<td><strong>II. External liabilities</strong></td>
<td>$-3.2$</td>
<td>$-17.0$</td>
<td>$-25.3$</td>
<td>$-53.5$</td>
</tr>
<tr>
<td><strong>to:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. IMF and SDR allocat.</td>
<td>$-$</td>
<td>1.0</td>
<td>1.4</td>
<td>2.8</td>
</tr>
<tr>
<td>2. Foreign central banks</td>
<td>$-3.2$</td>
<td>$-16.0$</td>
<td>$-23.9$</td>
<td>$-50.7$</td>
</tr>
<tr>
<td><strong>III. Net reserves (I+II)</strong></td>
<td>$+22.3$</td>
<td>$-0.1$</td>
<td>$-10.8$</td>
<td>$-40.3$</td>
</tr>
</tbody>
</table>

© **SOURCE:** IMF, International Financial Statistics


"There has been an increasing use of dollars as reserves, and this has permitted the amount of international liquidity to increase far beyond that which would have been provided by only increases in the total gold stock and Fund quotas. Table I and II indicate the growth in international reserves and the changing sources of international liquidity over the period 1945-71. As will be seen—the growth in the supply of dollars as reserves has been associated with a deficit in the U.S. balance of payments."
Since 1960 the percentage of gold as component of international reserves is on the decrease. (See Table No. III)

**Table No. III**

Composition of Adjusted Global Reserves, end of 1960 and first quarter of 1971.

<table>
<thead>
<tr>
<th></th>
<th>1960</th>
<th>First Quarter 1971</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Gold</td>
<td>61.4%</td>
<td>37.4%</td>
</tr>
<tr>
<td>(b) SDRs</td>
<td>-</td>
<td>5.9%</td>
</tr>
<tr>
<td>(c) Reserve Position in the Fund</td>
<td>5.8%</td>
<td>7.4%</td>
</tr>
<tr>
<td>(d) Foreign Exchange</td>
<td>32.8%</td>
<td>49.3%</td>
</tr>
</tbody>
</table>


From the above table it is clear that the foreign exchange component (mainly dollars) is on the increase. The gold component has fallen from 61.4% in 1960 to 37.4% in 1971 (first quarter). The foreign exchange component has increased from 32.8% in 1960 to 49.3% in 1971 (first quarter).

The foreign exchange component in the reserves of the less developed countries was 72% in 1970 (March). Where as for the industrial countries it was 26% (See Table No. IV below)
Table No. IV

Composition of reserves maintained with IMF by various Countries/areas at the end of March 1970.

<table>
<thead>
<tr>
<th></th>
<th>Gold</th>
<th>SDRs</th>
<th>Reserve position in Fund</th>
<th>Foreign Exchange</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Industrial Countries.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S.</td>
<td>77%</td>
<td>6%</td>
<td>17%</td>
<td>-</td>
</tr>
<tr>
<td>U.K.</td>
<td>54%</td>
<td>11%</td>
<td>-</td>
<td>35%</td>
</tr>
<tr>
<td>Industrial Europe</td>
<td>61%</td>
<td>3%</td>
<td>8%</td>
<td>28%</td>
</tr>
<tr>
<td>Canada</td>
<td>24%</td>
<td>4%</td>
<td>14%</td>
<td>58%</td>
</tr>
<tr>
<td>Japan</td>
<td>12%</td>
<td>3%</td>
<td>17%</td>
<td>68%</td>
</tr>
<tr>
<td>Total Industrial countries.</td>
<td>59%</td>
<td>4%</td>
<td>11%</td>
<td>26%</td>
</tr>
<tr>
<td>(B) More Developed Areas</td>
<td>46%</td>
<td>4%</td>
<td>8%</td>
<td>42%</td>
</tr>
<tr>
<td>(C) Less Developed Areas</td>
<td>20%</td>
<td>4%</td>
<td>4%</td>
<td>72%</td>
</tr>
</tbody>
</table>


From the point of view of the developing countries the system was inequitable. These foreign exchange resources were earned by these countries. There was a transfer of resource from the poor to the rich countries mainly the USA. Triffin remarks "The building up of foreign exchange reserves involved the making of loans from depositor countries which are frequently poor to banker countries which are generally rich." The world was actually on the dollar standard. The dollar played the role formerly played by gold. However
there was a difference between the traditional Gold standard and the dollar standard. An outflow of dollars from the USA did not automatically reduce money supply the way the traditional gold standard is supposed to have done. The USA was not a dollar losing country but dollar creating country. The system had a prolonged "inflationary bias". J. Rueff remarks "What has been wrong in the U.S. is the failure of aggregate demand to respond to a deficit in the balance of payments..... Since 1960 this phenomenon has been prominent; and the fact that there has never been a contraction of aggregate demand corresponding to the deficit in the US balance of payments explain why this deficit has continued and will continue as long as there are countries ready to increase their dollar balances"? If the USA inflated, other countries also inflated. The USA though a deficit country was not compelled to deflate. The other countries had to earn reserves while the USA could create reserves out of nowhere and could give its citizens higher standard of living at the expense of other countries. The developing countries suffered most as compared to the developed countries because the foreign exchange component constituted nearly three-fourth of their reserves. From the point of view of the developing countries the reserves fell short of demand. The
ratio of reserves to imports was only 0.128 in 1971 as compared to 0.33 for the industrial countries (See Table No. 3). The difference becomes more marked when we notice that the reserve needs of the developing countries are more than that of the developed countries. In 1975 the ratio of reserves to imports of the less developed countries was 0.23 as compared to industrial countries which was 0.22. Even then considering the reserve needs of the developing countries, the reserves fell short of demands.

Exchange stability was one of the main features of the Bretton Woods System. The initial parities were to be fixed by agreement with the Fund and changes in parities were to be made only after consultation and with the approval of the Fund. The Fund believed that the balance of payments problem could not be solved merely by permitting the exchange rates to fluctuate. A country was allowed to change the exchange rate only in the case of "Fundamental Disequilibrium". But in practice exchange rates became rigid. The concept of "Fundamental disequilibrium" was vague. The countries were unwilling to change the exchange rate. The maintenance of the exchange rate was considered sacred. All sorts of methods were used to maintain the exchange rate of the country. Stable exchange rate was considered
necessary for the expansion of world trade. All sorts of restrictions were imposed upon the international trade to maintain the rate of exchange fixed. Stability was replaced by rigidity. The fixed exchange rate instead of becoming the means to liberalise trade became an end in itself. So that the ends were sacrificed for the means. The countries follow divergent economic policies. This gives rise to difference in the cost price structure of different countries. The divergent exchange rates and the structural changes in demand and supply call for a change in the exchange rate of a country. But under the Bretton Woods System industrial countries in particular were reluctant to change the exchange rate. The Bretton Woods System lost flexibility because of the rigid exchange rates. The supply of international liquidity provides flexibility to the monetary system. But the provision of liquidity by the IMF was limited, and of marginal nature. The countries had to depend upon their own resources primarily for meeting the deficits in the balance of payments. The drawings under the 'Gold Tranche' were automatic. But the drawings under the 'Credit Tranches' were conditional because of the heavy conditions laid down by the IMF. The drawings under the 'Credit Tranches' remained unutilized. The liquidity provided under the special drawing rights was limited. An elasticity in the inter-
national monetary system through increased provision of liquidity would have helped the developing countries. The Fund provided liquidity to meet a deficit which was of a temporary nature. In the case of deficits of a structural nature, the liquidity was not provided. The Fund advised the countries to devalue. Most of the developing countries, which had deficits of a structural nature had to devalue the currencies. The devaluations were larger. The devaluations worsened the balance of payments position of the countries. Instead of asking the developing countries to devalue, had the Fund provided international liquidity of larger amount and for a longer period, the problem of the developing countries would have been eased to a great extent. The period of repayment for drawings under the credit tranches was three to five years. Where as the need of the developing countries is for a longer period.

The adjustment mechanism under the Bretton Woods System was defective. The adjustment process concerns the capacity of countries to eliminate imbalance in their balance of payments. Deflation as a method to cure a deficit was ruled out, because of its adverse effect upon income and employment in a country. Most of the countries had full employment as their goal. The changes in the exchange rates were not used to cure a deficit. Devaluations were used as a last resort to cure a deficit in the balance of payments.
The Fund provided its resources to cure a deficit of a temporary nature. In the case of "fundamental disequilibrium" the Fund asked the members to devalue the currency. The Fund exercised a mild pressure upon the countries to resort to adjustment policies. The Fund asked the members to take some suitable fiscal and monetary measures before allowing them to use their drawing rights. The Fund, through its resources could police the deficit states to some extent; but there was no effective provision to police the surplus states. Only provision was that of the "Scarce Currency" clause. The Fund had the right to declare any currency as "Scarce". But this clause was never invoked by the Fund. Most of the developing countries were running a deficit in the balance of payments. The Fund asked the countries to take some adjustment measures. In suggesting adjustment measures, the Fund had a preference for market-oriented solutions to the economic problems. The ideological bias for market-oriented solutions creates problems for the countries which are trying to pursue non-capitalist path of development. Very often it suggested the countries to devalue the currency. But devaluations to cure a deficit in the balance of payments of a developing country is not a proper solution always. It is difficult to increase exports because of inelastic supply. The demand for imports is inelastic. For example, the Indian rupee was devalued in June, 1966. The prime aim was to stimulate exports. But
after devaluation our exports have not increased to the extent necessary. On the other hand the imports could not be cut down. The trade gap was Rs. 603 crores in 1965-66. The trade gap continued even after devaluation. There was marginal decline in imports. The increase in exports was also marginal. The effect, if any was marginal and shortlived. This is more or less the case with all the developing countries. Devaluation helps the developed countries to reduce the trade gap because of elastic supply of exports and elastic demand for imports.

The IMF could not compel the surplus countries to reduce the surpluses in their balance of payments. Had the Fund had enough powers to police the surplus states, the surplus states (mainly the developed countries) would have taken measures to allow more imports from deficit countries (mainly the developing countries & some developed countries such as the USA) and greater flow of capital to the deficit countries. The USA though a deficit country was not compelled to devalue. It was a reserve currency country. The deficits in the balance of payments led to the increase in the reserves of other countries. As the developing countries are not reserve centres, their currencies are not accepted as reserves. The adjustment mechanism was asymmetrical. It was heavily biased in favour of surplus countries and also the deficit country like

*(See Table No. 32).*
the USA which had the power to create international reserves. When USA was in deficit, it did not lose gold, when it was in surplus it got gold. This was the case throughout the fifties when the European countries allowed the dollars to add to their reserves. It was the period of dollar shortage. The adjustment mechanism did not work properly. Instead of asking the developing countries to devalue, had the Fund provided resources to the developing countries on a larger scale and for a longer period; the problems of the developing countries would have been eased to a great extent.

The drawings are related to the quotas in the IMF. The developing countries which have four-fifths of the population have less than one third drawing rights. As on May 31, 1975 the developing countries had 8089 millions SDRs whereas the industrial countries had 18,365 millions SDRs as their quota. (See Table No. 33). Only developing country which has place in the top ten countries ranked by IMF is India. It had eighth place among the top ten countries. When the Articles of Agreement was signed at the Bretton Woods, India (with its quota of $400 million) was fifth. Till 1970 it maintained its position. Japan, Canada and Italy which had earlier smaller quotas than India, have moved up ahead of India. The big five countries with the biggest quotas in the IMF have a right to appoint
a member of the Fund's Executive Directors. India has lost the right to appoint an Executive Director. The position of the developing countries has not been taken into account in revising the quotas. When IMF was founded, there were thirty-nine members of whom twenty-nine were the developing countries. Since then more and more developing countries are joining the Fund, and yet their relative share in IMF has not changed. This is one of the reasons why the Fund has occasionally been described as a "rich nations club". The Quotas have significance. They seek to define the legitimate need of a member for access to the resources of the Fund. They take into account the fund's need for currencies. They reflect the weight that nation has in the decision making process of the IMF. The quotas penalised the poor countries for their poverty. The formula which determines the quota of every country and voting formula which is based upon the quota. This formula has not been subjected to proper scrutiny or discussion. The formula is only a guide to the determination of quotas. The Articles of Agreement of the Fund do not provide any guidance or advance any criteria for the determination of members' quotas or of changes in them. While subscribing to the quotas, the countries had to pay 25% of its quota either in gold or convertible foreign currency. For the countries this represented a surrender
of real resources. For the developing countries such a provision was disadvantageous. Since the borrowings are related to the quotas, they are not related to the needs of the countries. The developing countries can not borrow more because the borrowings are related to the quotas of member countries. "In the nine years 1947-55 total Fund drawings amounted to $1.2 billion; more than half of which were made in 1947-48 alone by the rich countries; the U.K. $300 million, France $125 million, the Netherlands $75 million and Belgium $33 million. The use of Fund resources by the less developed countries much larger in number averaged around one third of the total drawings, the major users being India ($100 million) and Brazil ($170 million). The Fund's drawings during 56-58 rose to $2 billion, of which the U.K. took $562 million, France $394 million, Japan $152 million. The share of less developed countries in these drawings went up only marginally to 40%, the major users were Argentina ($75 million), Brazil ($92 million), Cuba ($73 million), India ($200 million), and Indonesia ($55 million). During 1959-65 convertibility arrangements were consolidated and extended to cover short-term capital movements, known as hot money flows. As a result, the annual use of Fund resources averaged at one billion dollars over two-thirds of which went to
the rich to enable them to preserve their convertibility status. The chief users were the UK ($3,900 million), the United States ($960 million) Canada ($300 million), and Australia ($175 million).\textsuperscript{11} If years of the high in the sixties drawings/are examined; it will be seen that the main reason for the high total is to be found in U.K. drawings. Thus 60 per cent of the 1961 total went to Britain, more than 50 per cent of the 1964 total, and 40 per cent of the 1968 total. The United States accounted for 73 per cent of the total in 1971.\textsuperscript{12} (See Table No. 35). The table shows that the resources of the Fund and their use are determined mainly by the balances of payments of a few countries and in particular those with key-currency responsibilities. Though there is a gradual rise in the drawings by the developing countries, only 27% of the Fund's drawings have gone to the developing countries. The main reason is that the drawings are related to the quotas of member countries. The drawings under the 'Credit Tranches' are conditional liquidity. If the developing countries draw under higher credit tranches that they have to accept the conditions laid down by the Fund before the drawings are made.

Even the special Drawing Rights are allocated on the basis of IMF quotas. There is already a maldistribution of international reserves. The decision to issue SDRs was regarded as a spectacular achievement
in the field of international monetary co-operation. The SDRs should have been issued to remove the present defects and deficiencies in the international monetary reserves. No doubt a deliberate attempt has been made to reform the international monetary system; but the way the SDRs are allocated is not in the interest of the world community. Since they are allocated on the basis of the IMF quotas, the major share of the SDRs have gone to the developed countries. The criteria of need is not followed. The twenty five developed countries got 72% of SDRs and eighty six developing countries got only 28% of SDRs. The remarks of Triffin are pertinent here. He says "It is morally repugnant to assign the lion's share of the SDRs to the twenty-five richest and the most capitalised countries of the world." The allocation of SDRs has further increased the maldistribution of reserves. The developed countries are ever at a pressure to spend SDRs. The used up SDRs obviously flow to the developed countries which as a group come to acquire SDRs in excess of the original allocations (See Table No. 36) Canada, Belgium, Germany, Japan, Netherlands, Norway etc. have more than 100% of SDR holdings. The use of SDRs swell the reserves of the developed countries thus, accentuating further the maldistribution of international reserves.
The IMF quota is the basis on which the voting power of the country depends. The rich countries have more voice in the decision making process of the IMF. "A great built-in weakness in the Bretton Woods system has been the undemocratic and typically capitalistic character of international agencies which discarded the principle of one-nation one-vote (adopted for the U.N. General Assembly) and chose to shower quotas and voting power according to the untenable criterion of richness. Even the SDRs, tied as they were to the apron-strings of IMF quotas, were allocated on the same consideration, thus highlighting the inequity that already existed. A regressive structure of this nature has been highly prejudicial to the interests of poor nations. Paradoxically enough, nearly 80% of the strength on the Fund Board consisted of representatives of developed countries, even though about 80% of its constituents (member countries) belonged to the developing world. The voting formula is biased in favour of the rich countries. As a result the developing world has no effective representation in the decision making process of the IMF.

During the era of Bretton Woods the problems of the developing countries were not paid sufficient attention they deserved. The developing countries were excluded from the "Group of ten" which played an important part in amending the Fund's Articles of Agreement in 1969 which led to the issue of special Drawing Rights. The goldprice in terms of dollars, the deficits in the
balance of payments of the USA and UK, exchanged rates of industrialised countries were the main concern of the authorities of the IMF. In attempting to reform the system the developing countries were not associated. They had no voice in the decision making process relating to International Monetary Reform (IMR). It is rightly said that the main driving force behind the reforming of the International Monetary System during the sixties was the deficit in the balance of payments of the USA. The Bretton Woods era was the era of indifference towards the developing world. Only measure which merit some mention is the IMF credit facility known as the compensatory Financing Facility (CFF) created in 1963 to provide balance of payments support for countries suffering from fluctuations in receipts from exports of primary commodities caused by circumstances beyond their control. This facility was little used in the years immediately following its introduction, due to sharp increase in the commodity prices during the mid sixties. "By 1966 only three developing countries, Brazil (SDRs 60m), Egypt (SDRs 16m), and Sudan (SDRs 11.3m) had purchased a total of SDRs 87.3 million. In 1966, it was amended to increase the limit on outstanding purchases and
to give greater weight to the projections of export shortfalls in determining the amount of composition a deficit country could draw. These amendments led to some improvement in its use. By 1975, 31 developing countries had drawn a further SDRs 913 million, bringing total drawings to more than SDRs 1 billion since its inception.16

In short the Bretton Woods System was confronted with liquidity, confidence and adjustment problems. The growth of liquidity was dependent upon the deficits of the balance of payments of the USA. It was disorderly and haphazard. The growth of liquidity did not keep pace with the expansion of world trade. An attempt was made to supplement international reserves by issuing SDRs. Since the SDRs allocation was made on the basis of IMF quotas, the creation of liquidity from the point of view of the developing countries was inequitable. No attempt was made to remove the maldistribution of liquidity. The Bretton Woods System was established on the hegemony of the dollar. It relied upon dollar thinking that dollar like Caesar's wife was above suspicion. The increase in dollar liabilities abroad on one side and the reduction in the gold stock of the US led to the suspicion about the ability of the U.S. to convert dollars into gold. The dollar came under attack. The persistent surplus
in the balance of payments of Germany and Japan created a feeling that Mark and Yen would be revalued in terms of dollars. There was a demand to convert dollars into Mark and Yen. With the switching of dollars into gold, Mark and Yen the system was confronted with what is known as the confidence problem. The system had no satisfactory adjustment mechanism. It relied upon the exchange rates to correct a fundamental disequilibrium. For removing disequilibrium of a temporary nature the Fund relied upon the provision of liquidity in the case of deficit countries and scarce currency clause in the case of surplus countries. The Fund advised the deficit countries (mainly developing) to devalue the currency before it allowed them to make drawings. The devaluation, instead of reducing the deficit worsened the situation. Its orthodox policy of devaluation - the success of which depended upon market mechanism and the assumption of elasticity of exports and imports - was harmful to the developing countries. The system was characterised by greater degree of co-operation among the developed countries. In maintaining the stable exchange rates among the developed countries, in enabling the USA to maintain the gold dollar convertibility and in issuing SDRs, the Group of Ten played an important
part. The system was successful in maintaining high level of employment and income in the developed countries. But the system did not meet the requirements of the developing countries. It failed to provide the external environment needed for the attainment of the feasible growth rates. The trade and payments system failed to accommodate the structural shifts that take place during the process of development in the developing countries. "The Post-War System was remarkably successful in its basic objectives, namely the maintenance of high level of employment in the industrialised countries and the expansion of world trade and output. The success was cumulative in character and closely associated with the progressive liberalisation of world trade and payments; its avoidance by and large of competitive devaluation of currencies and the expansion of international lending. It was nevertheless not without its limitations, since it was not established to tackle the special trade and financial problems of developing countries. The establishment of UNCTAD may be seen as an attempt to correct that situation."
NOTES AND REFERENCES

CHAPTER III SECTION I

1. Gold Pool - formed in 1961 to support the gold market against temporary heavy demands. Initially there were eight members - Great Britain, the U.S., West Germany, Switzerland, The Netherlands and Italy - but later France withdrew. Fear of devaluation of U.S. dollar led in March 1968 to an exceptionally heavy demand for gold. At a meeting in Washington D.C; a two-tier system was agreed upon, where by there should be a market for gold open only to Central Banks in which price of gold was to remain fixed, and a free market in which the price would be determined by the usual market forces of supply and demand. The Gold Pool, therefore, was no longer required.

2. Under this agreement, dollar was devalued a little (7.9%) and the countries returned to the system of fixed exchange rates. There was a realignment of these exchange rates. The price of gold was raised by 8.57% from $ 35 to $ 38 per ounce. Another feature of the agreement was a broadening of the bands around the parity. Exchange rates in which nations agreed to keep their currencies. The old IMF regulations has specified ± 1.0%. The new bands were ± 2.24 percent.


4. International Monetary Development (1931-71) Edited by Om Prakash - Page 171 .

5. Ibid page #72.


10. The voting formula can be summarised as follows:

(a) General formula - Member's vote = 250 + \frac{X}{100,000}

(b) Voting on Art. V, Sec. 4 or 5 - Member's vote = 250 + \frac{X}{100,000} + \frac{Y}{400,000} - \frac{Z}{400,000}

where X = member's quota in United States dollars;
Y = net sales of its currency to date,
and Z = net purchases of other currencies to date.
(The voting formula is biased in favour of surplus countries).


15. Group of Ten - Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Great Britain & the United States. This group is referred to as the group of Ten.

17. The Confidence Problem arises about the co-existence of several widely acceptable reserve assets; and hence the possibility of disturbing shifts in Central Bank portfolios especially shifts out of dollars and sterling gave rise to confidence problem. In order to avoid capital loss there was a shifting of assets from dollars to gold, Mark and Yen. The confidence problem of the World Monetary System is the modern version of old Gresham's Law.

CHAPTER III

Section 'B'

1) The working of the Bretton Woods system since 1971.

2) A Note on the I.M.F. Loan to India.
Since the collapse of the Bretton Woods System in 1971, vigorous efforts are being made to reform the international Monetary System. A welcome feature of the reform is the increasing participation of the developing countries. Before 1971, the powerful group of IMF, the Group of Ten represented by highly developed countries played an important part. The developing countries had practically no voice. The following factors are responsible for the increasing participation of the developing countries since 1971.

The Cairo Conference on the developing countries held in July 1962 on the problems of economic development passed the (Cairo) declaration of developing countries calling for the convening of the United Nations Conference on Trade and Development to consider questions relating to the international trade of the developing countries. In July 1963 the UN Economic and Social Council adopted a resolution for UNCTAD to be convened at an interval of not more than three years. The United Nations General Assembly accepted the recommendations and UNCTAD was established as a permanent organ of the UN General Assembly. The UN General Assembly also defined the functions activities and membership of UNCTAD. The UNCTAD has set up a Trade and Development Board as a policy making body to make policy making decisions
when the conference is not in session. The main purpose of establishing UNCTAD was to gear up speedy development of the developing countries by solving the problems of sluggish expansion of their trade, deficits in the external balance of payments, excessive burden of foreign debt etc. The First UNCTAD was held in Geneva from 23rd March to 16th June, 1964. The First UNCTAD succeeded in increasing the interest in developed countries regarding the problems of the developing countries. For the first time the countries with the free market economies and centrally planned economies came together and co-operated in examining the problems of the developing countries. The developing countries have shown a remarkable sense of unity in forming a common platform for working in concert and for confronting the developed countries. Since the establishment of the UNCTAD the developing countries are playing a more positive role in the reforms of the international monetary system. It is due to the UNCTAD's efforts, the GSP has been introduced. They have demanded that SDRs should be linked with development finance. They have succeeded in drawing the attention of the developed countries towards problems such as IPC (Integrated Programme for Commodities) debt problems of the developing countries, Official Development Assistance (ODA) etc. In fact
all the problems pertaining to trade, monetary, finance and development of the developing countries are discussed in the UNCTAD conferences. The UNCTAD has succeeded in making the developed countries to enter into a dialogue with the developing countries on these issues. It has fostered unity among the developing countries. The credit should go to UNCTAD for the change in the attitude that we find today in the developed countries towards the problems of the developing countries.

The second factor which is responsible for change in the attitude of the developed countries is the oil crisis. The oil crisis has changed the pattern of the world payment system and working of the international money and capital markets. It has added a new dimension to the international monetary system. The oil exporting countries have formed a cartel type of organisation known as OPEC (Organisation of the Petroleum Exporting Countries). Most of the developed countries are major oil importers. (See Table 37). The USA, Japan, West Germany, France and Italy are the major importers of oil. The Arab countries are the major exporters with Saudi Arabia occupying the first place, followed by Iran and Iraq. The OPEC countries have succeeded in increasing the
price of oil. They decided to quadruple the price of oil towards the close of the year 1973. Since then the oil price is on the increase. The price of oil has increased from $3.7 per barrel in 1973 to $32 per barrel in 1980 (See Table No. 38). As a result the OPEC countries are running huge surpluses in the balance of payments. The capital surplus oil exporters had $85.5 billion as surplus in the balance of payments in 1980 (in 1978 dollars). The surplus is likely to continue. (See Table No. 2(B)). The developed countries can not dispense with the import of oil in the near future. At the most they can curtail the consumption of oil. The balance of payment of the OPEC countries will be in surplus in the years to come. The reduction in the size of the surplus will depend upon the extent the developed countries curtail the consumption of oil. The OPEC countries may have a deficit in the balance of payments for any particular year; but if the long run trends are considered, the OPEC countries will be running a surplus in the balance of payments. The OPEC countries have a virtual monopoly over oil. The hike in oil prices has up set the payment position of the developed countries although the
developing countries have suffered more than the developed countries. The huge surpluses of the oil producing countries which is pouring into the Euro dollar market has made the Arab money an important factor in world monetary reforms. From 1973-1980 the placement of dollars by the oil exporting countries amounted to 136 billions of US dollars (See Table 2(C). The stability of dollar, sterling, Mark, Yen etc. is closely linked with the Arab money (or what is known as petro-dollars). The Arab countries have become the creditors. The shifting of Arab money from one financial centre to another effects the exchange rates of the major industrial countries. Most of the surpluses of the OPEC countries are deposited in the Western financial centres. The OPEC countries fell in the category of the developing countries till recently. Even now the OPEC countries have a close affinity for the developing countries owing to historical, cultural and religious factors. The OPEC countries have demonstrated that the raw material producing countries can not be exploited. They have set an example to other raw-material producing countries to form associations to prevent the deterioration in the terms
of trade. It is true that OPEC type of associations are difficult in other commodities, yet the OPEC countries have shown that the developed countries can not afford to ignore the raw material producing countries (mainly developing). "The oil crisis has not only brought to light the close knit nature of the international financial mechanism but has widened the scope of international monetary cooperation."1

The third factor which is responsible for increasing participation of developing countries in the international monetary reform is the growing realisation among the developed countries that problems of liquidity, trade, finance for development are interdependent. They can not be solved by ignoring the developing countries. The UNCTAD's efforts are responsible for this. The fact that to paraphrase Lincoln "The world half rich and half poor can not long endure" is being accepted and the significance of the developing countries for the health of the world economy is being recognized. As a result of all these factors, the participation of the developing countries in the reforms leading to reforms in the international monetary system is increasing. As a result the IMF has become more considerate to the developing countries. Since 1971,
some measures are undertaken for the benefit of the developing countries. The IMF Articles of Agreement have been amended. The Committee of 20 (consisting of nine developing countries and eleven developed countries) played an important part which led to this amendment. Some changes in the structure and working of the IMF which have a close bearing upon the developing countries is discussed below:

1) The IMF is providing its resources on a larger scale and for a longer period. The IMF though reluctantly has recognized the structural character of the balance of payment deficits of the developing countries. Before 1971, the IMF used to provide resources for a maximum period of five years. With the establishment by the IMF of an Extended Fund Facility it provides assistance for correcting structural imbalance and its recent liberalisation to enhance the repayment period to ten years are helpful to the developing countries.

The principle IMF credit facilities established after 1971 are as follows:-

a) The Oil Facility:— The oil facility was established in June, 1974 for the purpose of helping members to meet the initial impact of increase in the cost of imports of oil and oil products, on
their balance of payments. The facility was financed from borrowed funds. The purchases under the 1974 oil facility were permitted up to the smaller of 75 per cent of the member's quota or the amount of its calculated balance of payments need in 1974 as a result of the rise in petroleum prices. The latter was based on a formula that included the estimated rise in the cost of the member's net imports of petroleum and petroleum products and the level of its international reserves. Members were required to draw their reserve tranche (then the gold tranche) before making purchases under the facility. Drawings under the oil facility did not affect the amount that members could purchase under the credit tranche policy. Periodic charges on outstanding purchases were set at 6.275 per cent per annum for the first three years, 7 per cent for the fourth year, and 7.125 per cent per annum for the following three years.

As the balance of payments difficulties faced by oil importing countries persisted, the Fund adopted a decision on April 4, 1975 to establish a Second Oil Facility. The facility for 1975 was also financed with borrowed funds. There were however, some important differences between the 1974 and the 1975 facilities. First, the relative importance of
quota was reduced, and that of balance of payments need was correspondingly increased, in determining maximum access to the facility. It was specified that maximum outstanding purchases should be proportional to the smaller of 125 per cent of quota and 85 per cent of the increased cost of petroleum and petroleum product imports in 1975. This change in emphasis was made to assist countries whose quotas were small relative to the rise in cost of their oil imports. Second, more emphasis was placed on adjustment. It was recognized that the rise in energy prices would be largely non-reversible and that financing should therefore be accompanied by positive efforts of adjustment. The degree of conditionality was stronger than for drawings under the 1974 facility, but it was milder than for drawings under upper credit tranche or extended arrangements. Under 1974 facility the conditionality was the same as it is applied to the drawings rights under the first credit tranches. Under 1975 facility, the members were required to outline any recent or proposed measures to conserve oil and to develop alternative sources of energy. However, the program did not include performance criteria, and there was no phasing of drawings. Thirdly, charges were slightly higher, reflecting the increased cost of borrowings - 7.625 per cent for the first three years; 7.75 per cent per annum for the fourth year, and 7.875 per
-cent per annum for the last three years. The IMF borrowed close to SDR 7 billion from 17 countries to finance its operations. The principle contributors were Saudi Arabia (SDR 2250 million) Iran (950 million) Kuwait (SDR 685 millions) and Venezuela (SDR 660 million). Both developed and developing countries have made use of this facility. The amount drawn by both the group of countries is shown in table No. 39. The amount drawn by the developing countries was about SDR 3642 million as compared to SDR 3260 million by the developed countries.

A notable feature was the establishment of the Subsidy Account. It was set up for subsidising interest payments for the most seriously affected (MSA) countries. The Subsidy Account was to be funded by subscriptions from 24 member countries and Switzerland totalling about SDR 160 million over its lifetime. Saudi Arabia contributed about 25% of its total. Other principle contributors were the Federal Republic of Germany, France, UK and Japan. The effective rate of interest for the MSA countries was between 2 to 3%. The developing countries could make use of oil facility because of simpler conditionality for drawing rights. The major users under the developing countries were Chile, India, Korea and Pakistan constituting nearly one half of the drawing drawn by the developing countries.
The subsidy payment under Subsidy Account to MSA countries in the financial year ended April 30, 1980 is shown in table No. 40.

b) The Extended Fund Facility:— The second major form of assistance which the Fund has provided since the oil crisis is the Extended Fund Facility established in 1974 for the purpose of providing medium term assistance for balance of payments purposes under certain circumstances namely (i) An Economy suffering from serious balance of payments imbalances relating to structural maladjustments in production and trade and where prices and cost distortions have been widespread. (ii) An economy characterised by slow growth and an inherently weak balance of payments position which prevents pursuit of an active developmental policy.

The Extended Fund Facility is thus intended to benefit the developing countries particularly those that depend upon the export of one or two basic commodities or lack the necessary financial and monetary institutions and instruments for mobilising and allocating domestic savings or for implementing the appropriate trade and exchange rate policies in support of their long term development. To this end it was to provide assistance for longer periods; and in greater amounts in relations to quotas than the
existing Credit Tranche facilities. The drawings under this facility require the representation of a medium term 2 to 3 years programme to solve existing structural problems. Any member applying for assistance had to satisfy the fund, that the solutions to its balance of payments required a longer period of time than permitted under existing tranche facilities. The Extended Fund Facility is to provide assistance up to three years provided that purchases outstanding did not exceed 140% of member's quota; or raise the Fund's holdings of any member Country's Currency above 155% of member's quota. (Excluding the holdings relating to compensatory Financing, Buffer Stock Financing and financing of the impact of the increased cost of imports of petroleum and petroleum products). The repayment period is 4 to 8 years (recently it has been increased to ten years). The rate of interest is between 4 to 6½ percent per annum. The amount drawn under this facility is shown in Table No.39A. SDR 388 million have been drawn till April 30, 1978. The whole of the amount has been drawn by the developing countries. For conditionality regarding drawings under the extended facility see Annexure No.3.
Supplementary Financing Facility: Widening payments imbalances resulted in large balance of payments needs relative to quotas for many members of the Fund from the late 1970s. Following a recommendation by the Interim Committee, the Executive Board decided on August 29, 1977 to establish a supplementary facility by borrowing from surplus countries to help meet these needs. The facility became operational on February 23, 1979. The facility has been financed by borrowing arrangements with seven industrial and six oil exporting member countries and Guatemala, as well as with the Swiss National Bank, for SDR 7.8 billion in six different currencies. (See Annexure No. 6).

The member can use supplementary financing up to 12.5 per cent of quota when it draws in the first credit tranche, plus an additional amount up to 30 per cent of quota for each of the higher credit tranches. For an extended arrangement, supplementary financing is available up to 140 per cent of quota in a 1:1 ratio with use of ordinary resources. Supplementary resources are granted only in connection with upper credit tranche stand-by and extended arrangements, and the conditionality is the same as that applied to purchases under such arrangements. The supplementary facility permits a member with a stand-by or an extended arrangement to obtain a large amount of resources from the Fund with the same conditionality (though for differing periods) as
under the regular facility. The rate of interest charged to members on outstanding balances under the facility are higher than on balances resulting from drawings made wholly from the Fund's ordinary resources. The rate of charge is the rate paid by the Fund to lenders plus a margin ranging from 0.20 percentage point for purchases outstanding up to three and one-half years to 0.325 percentage point for purchases outstanding longer than four and one-half years. Repurchases under the supplementary facility are to be made in eight equal semiannual installments during the period three years and six months to seven years after the corresponding purchases have been made.

New loan commitments under stand-by arrangements and extended arrangements and other use of Fund resources are shown in Table No. 39 (B). The new loan commitments under stand-by arrangements and extended arrangements and other use of Fund resources amounted to SDR 9.5 billion in 1980 as compared for SDR 34 billion in 1979, it was SDR 5.7 billion in 1977. There was three fold jump in new commitments— all for developing countries, undertaken by arrangements and extended arrangements.

Trust Fund: The other source of finance available for balance of payments purposes is the Trust Fund. The Fund was established in May 1976 for providing
resources on a medium term basis for the low income countries i.e. those with a per capital income in 1973 of less than US $ 375. Some 61 non-oil developing countries are qualified for assistance from the Trust Fund. Until 30-6-78 SDR 841 million were drawn under this facility. The Fund amount is made up of profits realised from sale of one-sixth of the Fund's gold holdings and voluntary contributions and investment income on the amounts realised at the auctions. The rate of interest is 0.5% and the repayment period is 6 to 10 years. The Fund expected to get SDR 2.5 billion from gold auctions.

In May 1980, the IMF completed the four year gold sales programme through which 50 million ounces or one third of the Fund's gold holdings at the beginning of the period were sold. One sixth of the Fund's Gold (25 million ounces) were sold at the former official price of SDR 35 an ounce directly to the 127 member countries and one sixth sold at public auctions for the benefit of the developing countries. The profits totalled $ 4.64 billion of this $ 1.3 billion was distributed directly to 104 developing countries. Iraq, Kuwait, Libya, Qatar, Saudi Arabia, the UAE and Venezuela made a irrevocable transfers of their share of the profits to the Fund; a partial
transfer was made by Yugoslavia; and Romania lent part of its share to the trust Fund. The amount that was available for Trust Fund was SDR 3 billion including investments and from loans made. The Trust Fund was terminated in April 81. A total of SDR 2991 million was disbursed over four years to 55 member countries. Following the termination of the Trust Fund, the first SDR 750 million equivalent of repayments of its loans, will be available to finance a subsidy Account for the Supplementary Financing Facility. After the transfer to the Subsidy Account have been completed; the Trust Fund loan repayments and interest repayments will be accumulated in the special disbursement account. SDR 1.5 billion will be used to provide balance of payments assistance on concessional terms to the developing countries in need of such assistance, under programme broadly similar to those available under the Trust Fund. The Trust Fund Loan disbursement and distribution of profits from Gold sales, by Region 1977-1980 is shown in Table No.42.

**Compensatory Financing Facility** :- This was established in 1963. The Compensatory Financing Facility was liberalised in December 1975. The most important changes were (1)The amount of funds
for compensation of export shortfalls was increased. (ii) The formula\(^2\) for calculating shortfalls was changed to give greater weight to the trend of past growth rates of export earnings. (iii) more flexible procedures for processing applications for assistance were introduced. (iv) Initially, the compensatory financing facility covered shortfalls in earnings from merchandise exports only. However, coverage was widened in August 1979 to permit members to include receipts from travel and workers' remittances as long as data for these are reasonably accurate.

Between February 76 and January 77, the first full years of its operation, no less than 52 drawings totaling some SDR 2.35 billion were made by 48 countries. This is approximately twice the amount drawn during the first thirteen years of its operation. The amount drawn under this facility since 1974 to 1978 (April, 30) is shown in Table No.39-A. The major drawings have been made by the developing countries. The drawings under the compensatory Financing facility was SDRs 620 million, SDRs 1210 million and SDRs 274 million in 1976, 77 and 1978 respectively. The drawings of the developed countries are SDRs 208 million, SDR 543 million and SDRs 48 million in 1976, 77 and 1978 respectively.
The amount drawn under the C.F.F. in 1979 and 1980 was SDR 572 million and SDR 980 million respectively. The developing countries were major users. (See Table No. 39 C) Buffer Stock Financing Facility. The buffer financing facility, was established in June 1969. The buffer stock facility was designed to dampen export price fluctuations. Under this facility, the Fund makes resources available to members to meet contributions to approved arrangements for (1) financing stockbuilding of the commodities, (2) financing operating expenses of buffer stock agencies, and (3) refinancing short-term debts incurred as a result of stockbuilding or operational activities. The Fund does not have the legal authority to make funds available directly to buffer stock organizations but is able to do so indirectly through contributing members. A member can have outstanding purchases under the facility up to 50 per cent of quota. The amount drawn in 1978 and 1979 was SDR 36 million and 38 million respectively. (See Table No. 39-C).

So there is a change in the attitude of the Fund. The Fund has agreed to make its resources for a longer period. The Fund is now giving medium term loans. The Committee of 20 had recommended the establishment of such a facility in its first outline of reforms (para 30). The Fund has increased the Fund quotas from SDR 29.2 billion to SDR 39 billion in the Sixth review of quotas.
Since the implementation of the Sixth Review of quotas was delayed due to various reasons, it was decided to take up the Seventh General Review of quotas within three years instead of usual five years. Accordingly this review was completed by the Interim Committee of the Board of Governors of the Fund on Sept. 24, 1978. As per the resolution adopted by the Board of Governors on December 13, 1978, the quotas of all members will be raised by 50% and additional quotas will be granted to 11 developing countries whose quotas are considered out of line with the calculated quotas. If all members consent to the full increase proposed for them, the aggregate of Fund quotas will be raised from SDR 39,766.5 million to SDR 60,025.6 million. As on June 30, 1981 the total quotas of all the members was SDR 59,605.50 (See Appendix No.8).

The policy on enlarged access was approved by the Executive Board on March 11, 1981. The policy on enlarged access enables the Fund to provide assistance on an appropriate scale to members that are experiencing payments imbalances that are large relative to quotas. The enlarged assistance is provided under upper credit tranche stand-by and extended arrangements and, accordingly, is subject to the same standards of conditionality that are applied to the use of resources in the upper credit tranches. The guidelines the Fund has
adopted on the level of assistance it generally would be prepared to commit provide for an amount upto 150 per cent of quota under a one year arrangement and 450 percent of quota under a three-year arrangement, excluding transactions under the compensatory and buffer stock financing facilities. A member's cumulative access, net of scheduled repurchases and excluded holdings, would be up to 600 per cent of quota. There is flexibility in application. Under certain circumstances, the member can borrow larger amounts. The Fund intends to borrow 6 to 7 billion in 1981, with additional borrowings in 1982 and 1983 to meet these obligations. With the larger resources at its disposal the Fund will play a greater role.

2) The Article of IMF was amended in April 1978. The role of gold as a common denominator of par values stands abolished. Not only this, gold would not become a common denominator of par values of currencies even at some future date if par values are established. Gold has no official price. Even its link with the SDR has been severed. In future the monetary authorities of the Fund members are free to deal in gold in the market or among themselves at the freely agreed price. Hereafter, IMF will not accept gold in its transactions and operations. Instead it would accept SDRs for repayment or quota subscription or for replacement of scarce
currencies. The Committee of 20 has recommended the reduction of gold and reserve currencies as reserve assets (outline of Reform Para 24). The para reads as follows.

"The SDR will become the principal reserve asset and the role of gold and of reserve currencies will be reduced. The SDR will also be the numeraire in terms of which par values will be expressed."

The elimination of gold from the IMF is a welcome step from the point of view of developing countries. The developing countries had demanded such a measure. It will pave a way for the international control over liquidity and SDRs to become the principal reserve asset. The SDR has been valued in terms of basket of 5 leading currencies. (See Appendix No. 4). The SDR is more stable and balanced than any of the hard currencies now used as monetary assets and reserve currencies. The balanced weightage of SDRs can keep down any erosion in the real value of export earnings or their accumulated holdings due to fluctuations in the external value of international currencies. Considering that the periodic increase in oil prices has been prompted among others by the instability of the dollar, the increased use of SDR as an international monetary asset not only can inject a measure of stability in the international monetary system, but also restrain worldwide price increases that are provoked by a decline in real earnings due to currency's
loss of external value. The recent decision of the IMF to raise the rate of interest on SDRs and to dispense with the rule that member countries should keep its reserves with the Fund 15% of its holdings of SDRs is intended to boost SDR as international monetary asset and reserve currency. The elimination of gold and measures undertaken to increase the role of SDRs will pave the way for the international control of liquidity. The second issue of SDRs amounting to 12 billion SDRs beginning from January 1, 1979 will increase the proportion of SDRs in the world's reserves. The increased role of the SDR will eliminate the defects of the Key Currency System and help the developing countries. If the allocation of SDRs are made to favour the developing countries, the maldistribution of liquidity will be reduced. The elimination of gold and the increased role assigned to SDRs, no doubt, is a welcome step from the point of view of the developing countries.

3) The quota of OPEC countries has been doubled from 5% to 10%. The quotas of the industrialised countries have been reduced. As one of the most creditor members of the IMF, Saudi Arabia has since Nov. 1, 1978 availed itself of its right to appoint its own Executive Director. The OPEC countries' strength is gradually increasing. It will help in removing the hegemonic character of the IMF. The OPEC countries are aligned to the developing
countries because of cultural, religious and historical factors. The increase in the strength of the OPEC will help the developing countries to play a greater role in the decision making process of the IMF.

4) The Development Committee formerly known as the Joint Ministerial Committee of the Board of Governors of the IMF and the Bank on the transfer of real resources to the developing countries was established on October 2, 1974. The Committee of 20 in its outline of reform in June 74, suggested the formation of the Committee to continue to study the broad question of the transfer of resources to developing countries. It is structured along the lines of the C-20. The Development Committee has met number of times. The Committee agreed at its first meeting that the industrialised countries should seek to adopt such adjustment measures considered necessary in their circumstances in such a way as to avoid any reduction in the net flow of real resource to the developing countries; seeking to improve the conditions under which developing countries and international development finance institutions may have access to their capital markets and to improve the real volume and the quality of Official Development Assistance provided to the developing countries and should avoid trade restrictions that would negatively affect developing countries' exports. The Development Committee
besides looking into the present situation of the developing countries also reviewed their medium and long term prospects in the context of analysis prepared by the IMF on the short term balance of payments of developing countries, and a World Bank Study on the capital requirements of the developing countries to the end of 1980. The problems of the developing countries are discussed and suggestions are made. The Development Committee has called for an expansion of the lending programme of the World Bank and regional development banks consistent with their capital structure and availability of funds. It has urged that the capital base of the development finance institutions be reviewed.

An important outcome of the Development Committee's work is the decision to establish 'third window' lending facility by the World Bank. At its third meeting held in June 1975 the Committee agreed to set up a 'Working Group' to make a review of regulatory and other constraints affecting access to capital markets and also to further proposals to developing countries' access to private markets. The Committee's future programme is expected to give special attention to the question of commodity price fluctuations and to their consequences on the export earnings of the developing countries. The Development Committee has done a useful job of studying the problems faced by the developing
countries and in drawing the attention of the developed world. The study is on the continuous basis. The expansion in the lending programme of the development finance institutions, the improved access to the markets of the developed countries of the products of the developing countries and other measures which have been undertaken are mainly due to the suggestions made by the Development Committee.

The recognition of the Fund of the structural nature of the balance of payments, the provision of its resources to meet the structural deficits of a larger amount and for a longer period, the liberalisation in the compensatory Financing facility in 1975, the establishment of the Development Committee, increase in the quotas of the OPEC, dethronement of gold and greater role of SDRs; the establishment of the Trust Fund, the greater participation of the developing countries in the international monetary reforms as revealed by their inclusion in the Committee of Twenty are indicative of the fact that the Fund has changed its attitude towards the problems of the developing countries.

Though there is a change in the attitude of the IMF, the measures undertaken fall short of the expectations. 1) Though the Fund has increased the quotas of its members, the increase in the quotas is not proportional to the increase in the World Trade. "The ratio of Fund quotas to world imports has shown a long declining trend
from about 12% in 1965 to 9% after the quota increase in 1970, less than 5% in 1974, and only about 4% at present even allowing for the full quota increase under the Seventh General Review. The Fund is augmenting its resources from borrowing operations; but it relies mainly on the quota increases for financing. The Managing Director of the Fund, Mr. Jacques de Larosière, observed: "The enlarged role of the Fund will require it to increase its available resources substantially. The Fund continues to place primary reliance on quotas as a source of financing......the Seventh General Review, increasing quotas by 50 per cent, will come into effect....However, the effective addition to our liquidity from this operation will only be of a limited and temporary nature." The quotas are insufficient. Unless the Fund's resources are supplemented by borrowing, the Fund cannot meet the needs of the developing countries' demand for resources.

2) The Fund is making its resources available for a longer period through Extended Fund Facility, oil facility, Supplementary Financing Facility, the Buffer Stock Financing Facility etc. the drawings made by the developing countries is not upto the mark. (See Table No. 39-A). Only the oil facility has been fully used. The IMF Credit facilities have not been well used. Among the special facilities "Buffer Stock Financing " and "Extended Fund Facility" were hardly used; the first with a single drawing from Bolivia, the 2nd with four
drawings by three countries (Kenya, Mexico and Philippines). Commodity Buffer Stock Financing through IMF credit failed because only qualified borrowers are individual member countries participating in an internationally Commodity Agreement itself. Moreover only three Agreements have been concluded to date (end of 1979). The insignificant use of the "Extended Fund Facility" which aroused great expectations because of its stated goals of servicing the developing countries, is due to its high conditionality, corresponding at least to the 'higher Credit Tranches'. Though the compensatory Financing Facility has been well used after its liberalisation in 1975; but the amount falls short of the requirements. Even after its liberalisation the Compensatory Financing Facility has the following drawbacks.

a) It is related to the quotas and not to the shortfalls.

b) Increase in imports are not taken into account.*

c) The repayments are to be made within three to four years and not to the recovery of exports. So there is a basic asymmetry in the criteria of borrowings and those for repayments.

d) Drawing can take place ex-post, even though it is possible in most instances to project shortfalls ex-ante.

* In response partly to a suggestion by the F.A.O. and the World Food Council, the Executive Board on May 13, 1981, took a decision integrating compensation for excesses in cost of cereal imports with that for shortfalls in receipts from exports under the Compensatory Facility.
Moreover Compensatory Financing Facility should be availed of within six months of the occurrence of shortfall, where as for many countries statistics are available after a considerably longer time lag.

The Funds are inadequate compared to the requirements. (See Table 41). To quote the Secretarate's submission to UNCTAD IV.

"The CFF of the IMF, on the basis of the revised estimates, has available a maximum of only $5.6 billion, equal to only 16% of the estimated 1974-76 shortfalls, (See Table 41) according to the UNCTAD's estimates. Thus had the revised formula been in effect in 1974, the maximum drawings of $3.7 billion in 1974 would have covered about 80% of the shortfalls in that year as estimated by the alternative (UNCTAD) formula. This would have left some 0.9 billion in 1975 to cover a shortfall of $22.1 billion and nothing in 1976 to cover a projected shortfall of $7.5 billion. Thus, it is clear that the IMF facility does not have the resources to make a significant contribution to the current balance of payments difficulties of the developing countries".5

"According to the calculations attempted by UNCTAD Secretariat, the existing IMF facility for CFF provided on an average cover of only 11% for shortfalls in export earnings experienced by primary producing countries during the period 1966-75 and of only 9% during 1976."
the year of maximum aggregate shortfall in the past 15 years. For non-oil developing countries the corresponding percentage or the cover provided against their short falls was 12.1% and 12.5% respectively as against that of the corresponding percentage for the developed countries which availed themselves of the CFF were 49 and 1017% respectively.6

Though the Fund quotas have been increased, the credit facility offered by the Fund has not been well used because of the high conditionality. The use of Fund's resources beyond the First Credit Tranche is conditional upon a country agreeing to some adjustment policies. The degree of conditionality is different under different facilities and may also vary according to the size of the borrowings. By and large, except for the first Credit Tranche, compensatory financing facility, further drawings under upper credit tranches or Extended Fund Facility or Supplementary Financing Facility require substantial justification and normally made under stand by arrangements. The stabilisation programme is comprehensive and the amount available under stand by arrangements is phased to be available on specified dates during the stand by period subject to the performance of the Key economic indicators described in the stabilisation programme. In the face of the mounting criticism there is a softening of the conditionality. The Fund believes in the market mechanism for the solutions of
the problems. The stabilisation programme suggested by the Fund has an adverse effect upon economic, social and political life of the country. If the performance criteria laid down by the Fund is not fulfilled the Fund does not allow the country to draw further instalments. Bangla Desh for instance could not draw its second instalment of a loan committed by the IMF on account of its inability to fulfil the performance clauses laid down by the Fund.\(^7\)

No doubt, the new guidelines reflect an awareness of the Fund. Among other provisions, the new guidelines, contain the provision which runs as follows, "The Fund will pay due regard to the domestic, social and political objectives, the domestic priorities and the circumstances of members including the causes of their balance of payments problems". The guidelines also recognize that assistance from the Fund should be provided at an early stage of balance of payments' difficulties and the adjustment period may be extended up to three years. There are also provisions which are intended to discourage the fund from attempting to increase the degree of conditionality during the life of a stand by agreement. Even after softening the conditionality there is no increase in the drawings under the upper credit tranches because these guidelines leave substantial scope for the exercise of discretion by the Fund's Management in the interpretation and application of
guidelines. The developing countries are doubtful how conditionality is interpreted in their case. That is why the major drawings are made by the industrial countries who are familiar for many years with Fund's practices and which are basically "good clients" find themselves in a different position from most developing countries in the controversy about how conditionality is interpreted in their special case. Though IMF has larger resources and has made provisions to supply resources for a longer period to meet structural deficits in the balance of payments; even then the Fund's officials are guided by the philosophy outlined in the Articles of Agreement for the purpose of Fund's operations. The Article of Agreement is "to give confidence to the members of making the Fund's resources available temporarily to them under sufficient safeguards thus providing them with opportunity to correct adjustments in their balance of payments without resorting to measures destructive of national and international prosperity". In the context of developing countries this criteria makes little sense. The balance of payments deficits of these countries are beyond the control and require fundamental structural changes, much larger than permitted by the Funds existing tranche facilities. That is why the contribution made by the IMF towards meeting the deficits in the balance
of payments of the non-oil developing countries is insignificant. "In 1979, according to IMF data, the total trade deficit of the non-oil developing countries increased to $74 billion from an already high figure of $57 billion in 1978. The bulk of these deficits, about $43 billion in both years, was financed by private commercial flows. The recourse to IMF was small—only $840 million or a little over 1% of the total trade deficit of non-oil developing countries. In 1978, the IMF actually made a "negative contribution" to financing deficits with repayments by developing countries exceeding total drawings on the Fund by about $72 million." 8

Besides these the allocation of SDRs done in 1979, 80 and 81 are based upon IMF quotas. The mal-distribution of international reserves continues (See Table No. A, B, C.) In September 1975, the industrial countries had 53.1 per cent of total international reserves whereas less developed areas had 38.0 per cent of total reserves. The non-oil less developed countries had 13.6 percent of total international reserves. (See Table 4-A). In 1978 the less developed countries had SDR 52.8 billion reserves out of SDR 279.4 billion reserves. (See Table No. 4-B)). At the end of 1981 the developing countries had $75.2 billion reserves (Non-gold total) out of $396.3 billion. (See Table No. 4-C). The voting
rights are still based upon IMF quotas (See Appendix No.8). The creation of liquidity has not been made more development-oriented. Though the role of gold is reduced, the creation of liquidity still depends upon the deficits in the balance of payments of the Key Currency Countries. This is obvious from the share of the foreign exchange component in the total world reserves. The foreign exchange component in world reserves was SDR 293 billion out of SDR 354.4 billion. The SDR amounted to only SDR 11.8 billion, (See Table No.6-A) in 1980. The role of SDR has not increased as a reserve asset. At the end of April 1981 (the accounting year for transactions in SDRs is May-April), the total holdings of SDRs was 21,433 million, equivalent to $24,540 million, against the total quote of $60.7 billion. "IMF's recent analysis of SDR transactions shows that between 1977 and 1981, * seven industrialised countries, one oil exporting country and 61 non-oil developing countries used their holdings of special drawing rights to obtain foreign exchange through transactions with designation and by agreement. However non-oil developing countries were almost the only users of SDRs in transactions with designations, with the industrialised countries, the oil exporting countries and a few non-oil developing countries being required to provide the

* See Table No.47-A & 47-B.
currency. On the contrary, the industrialised countries were virtually the only users of SDRs in transactions by agreement, which were arranged mostly through the Fund. Generally, the major oil exporting countries were only marginal users of SDRs. The generation of liquidity continues to be inequitable. The main demand of the developing countries that is SDR aid link has not been accepted.


9. **Financial Express** (Monday August 9, 1982) - SDRs yet to make mark as reserve currency - from K.S.Ramchandran
THE IMF LOAN TO INDIA

In a near unanimous decision, the IMF approved a loan of 5 billion SDRs- computed between 5.6 billions and 5.7 billions dollars at the current SDR value-to India in Nov, 1981 to enable her to meet her current balance of payment problem created by higher import costs of oil and other items. In the 22 nation Board of Executive Directors of the IMF, the solitary opposition to the Indian request came from the USA which abstained from voting for it. The loan is the largest ever single credit to be issued by the IMF.

The current loan is well within the limits of its quota. (India's quota as on June 30, 1981 was SDR 1717.50 million. A member has annual access to Fund resources upto 150% of its quota or upto 450% over a three year period excluding Compensatory Financing Facility and Buffer Stock Financing Facility). The loan is made on the basis of a new facility introduced in 1974 by the Fund known as Especially Extended Facility. The Specially Extended Facility is designed to assist those members whose economies suffer from serious balance of payments difficulties resulting from structural imbalances in production, trade and prices and an inherently weak balance of payments position. Drawings under the SEF can be phased over three years. The disbursement of the 5 billion SDR loan to India is as follows.
Before June 1982 - 900 million SDRs.
Between June 82- June 83 - 1.8 billion SDRs
Between June 83- June 84 - 2.3 billion SDRs.

The purchases are phased and subject to performance clauses relating to the implementation of key policy variables. The purchases will be made from ordinary and borrowed resources in the ratio of 1:1 until the purchases under the agreement reach the equivalent of SDR 4809 billion, and then from borrowed resources, provided that any modification by the Fund of the proportion of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modifications. The borrowed resources have become available because of the borrowings by the IMF from the industrial and oil exporting countries. The repayment schedule can be spread over a period of 7 to 10 years. Thus more time is available for adjustment. The rate of interest on the loan borrowed from (ordinary resources), for about 50%, will be at about 6.25% and the other 50%, (the portion of loan made available from borrowed resources) will be governed by other market yields on short and medium term securities. The repayment will be as follows.
the actual results may differ from those presented in the table if the pattern of drawals in the year 1981-82 to 1984-85 is different from that assumed. If the drawing is heavier in earlier years, the burden of repayment and interest will also become relatively heavier in earlier years than has been shown.

The standard of conditionality is the same as that applicable to stand by arrangements in the upper Credit Tranches—such as reduction in budgetary deficits, expansion of exports, liberalisation of imports, control of inflation, restrictions on borrowings from international market and injunctions against multiple currency practices, fresh bilateral agreements with members and other macro-economic performance criteria.

In the case of India the performance criteria (which is included in the letter of Sanction which is a binding document) is (1) Credit ceiling on net credit to Government and total domestic credit. The following table shows the credit ceilings on net credit to Government and total domestic credit.

<table>
<thead>
<tr>
<th>Amount outstanding on March 27, 1981</th>
<th>Ceiling (In billions of Rupees)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net credit to Government</td>
<td>258.06</td>
</tr>
<tr>
<td>Total domestic credit</td>
<td>621.26</td>
</tr>
</tbody>
</table>

The total domestic credit expansion is to be limited to Rs. 741.81 billion by March 26, 1982. The net credit to the Govt. is to be limited to Rs. 309.81 billion by March 26, 1982.

2) The second performance clause relates to the limit placed on the contracting or guaranteeing of medium term loans of maturity of less than 12 years in the Euro-currency market to 1.4 billion SDR. This restriction for the first year and may continue every year.

The resort to IMF loan has led to a good deal of criticism. It has become a focus of controversy among journalists, feature writers, economists and political leaders. It has roused public curiosity. A mention may be made of the criticism levelled against it by the West Bengal Govt. The West Bengal Govt. in its White paper titled The IMF Loan - facts and issues, which contained an Introduction by Dr. Ashok Mitra, West Bengal's Finance Minister, who appealed to the people and the Parliament to annul the Loan Agreement.

The resort to IMF loan has become necessary because of the growing deficits. The trade deficits during 1980-81 (p) was -5626 Crores. (See Table No. 8-A). The balance of payment on current account during 1980-81 was Rs. -3300 Crores (See Table No. 8-B). The foreign exchange net of outstanding IMF borrowings have gone down from Rs. 5219.9 Crores to Rs. 2844.5 crores in Oct. 81. (See Table No. 8-C).
"The current account balance which had earlier been in surplus, moved into sharp deficit in 1980-81, reaching the equivalent of 2.0 per cent of GDP. Projections for 1981-82 indicate that the deterioration in the current account will be arrested in that year, reflecting a return to normal levels of domestic crude oil production and a consequent moderation in the growth of total imports...... The current account deficit as a proportion of GDP would peak in 1983-84, at 2.2 per cent of GDP, it would decline markedly to 1.8 per cent in 1984-85 and gradually thereafter during the remainder of the decade. Taking into account official capital receipts, increased recourse to commercial credits and the possibility of private capital inflows, the balance of payments financing gap is projected to be SDR 6.4 billion during the 1981-82--1983-84 period.\(^1\) The deficit of this magnitude has compelled the Govt. to resort to IMF loan. The loan of this size is necessary. Had India borrowed under the normal Credit Tranche facilities, the amount that would have been available would not have been more than Rs.760 crores.\(^2\) Moreover had India borrowed under the Credit Tranche facilities, the repayment period is 3 to 5 years. The borrowing under the Specially Extended Facility gives more time for adjustment because the repayment period is longer. Only disadvantage is that the rate of interest is high only on that portion of the loan which
is made available from borrowed resources.

The standard of conditionality is not severe. "Most of the statements contained in our letter of intent to the IMF can be found in Chapter 7 - the policy framework of the Sixth Plan." The emphasis on sound monetary & fiscal policy, control of money supply, increased investment in infrastructure and promotion of exports - all these are contained in the Chapter on policy framework." As for India is concerned, as the conditions laid down by the IMF are consistent with the accepted tenets of current economic policy laid down in the Sixth Plan. There is no question of surrender of sovereignty. The nations have become more economically interdependent and such interdependence is accepted as a normal part of the working of an economy. The exchange rates, interest rates and even budgets are closely interrelated. According to P.R. Brahmananda, "the term sovereignty does not seem to have any operational relevance in the current day international world. Every country is dependent on others for its inputs and even consumption goods and for an outlet for its exports." It should be noted that IMF is not a charitable institution. The conditions are laid down because IMF believes that adjustment and financing should go together. It is true that conditionality bordering on ideology and policy matters are eroding IMF's credibility. IMF
which deals with sovereign nations and not with individual loanees should design better modalities for assistance to members to suit their aspirations. Most of the leaders of the developing countries have criticised the IMF conditionality. The conditions laid down by the IMF stand in the way of economic and social policy of the countries. The conditions such as liberalisation of imports and credit ceilings are harmful to the countries. But as far as India is concerned, the credit ceilings laid down by the IMF are liberal enough. The indications are that the ceilings will not be exceeded. The loan does not prevent us from borrowing in the Euro-currency market for loans of maturity more than 12 years. It does not prevent us from Bilateral Agreements with Socialist Countries and resort to IDA credit.

In the present circumstances loan is welcome one. Much depends upon the measures undertaken to reduce the deficits. Especially by reducing the consumption of oil and intensifying the exploration of oil production in the domestic field is urgently needed. The domestic production of crude oil in 1984-85 is expected to be 27 Million Tonnes, above the target laid down. The demand for petroleum products may be about 42-43 million Tonnes as
against 45 million Tonnes projected in the Sixth Plan document. The balance of payments deficits on Current Account was 2.4% of GNP in 1981-82. There is need to reduce this size in the deficit. It should be brought to 1% of GNP in four to five years. "This order of deficit may be unavoidable in the short run but it is unsustainable in the long run". The IMF loan will be utilized for the development and strengthening of the public sector. No doubt the IMF Loan gives a necessary breather for overcoming the hurdles in the path of higher growth, self reliance, poverty eradication and expansion of employment. Much depends upon how the loan is utilized. The loan, it should be remembered is largely in the nature of reprieve that merely postpones the problem instead of meeting it.

NOTES AND REFERENCES:


5. President Nyerere's views on IMF conditionality (See Appendix No. 10).


7. Ibid.