Chapter II

THE INTERNATIONAL MONETARY FUND: NATURE, STRUCTURE AND FUNCTIONS

There is now a general view that although the IMF functioned quite well for about 20-25 years\(^1\), it is now in need of major changes. In fact the IMF has been undergoing important changes\(^2\) in the last ten years or so culminating in the birth of international money\(^3\) in 1970. Some critics have gone so far as to say that by and large the IMF has been a failure and its structure and functioning should be radically changed\(^4\), especially keeping view the needs of the developing countries. To have a clear cut idea about IMF and its role in developing countries, and understanding of nature, structure and functions of IMF is very essential.

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2. The important changes here refer to the reforms suggested by various economists to solve the problem of international liquidity.

3. One of the reforms suggested and also finally accepted was the creation of Special Drawing Rights (SDRs) which, alternatively, is also termed as International Money.

Nature of the IMF:

The IMF has a two-fold function. In the first place, it is a club which prescribes a high code of conduct for its members and also ensures that members comply with the code. The second aspect of the IMF is that it is a financial institution standing ready to provide loan assistance to member countries for relatively short periods and under proper safeguards, to assist the countries to tide over their balance of payments difficulties, pending the formulations of appropriate measures for correcting the disequilibrium in balance of payments. There is a close relationship between the two functions. Without its financing role, member countries would not have bothered much to follow the code of conduct prescribed by the IMF. On the other hand without a code the financing operation of the IMF would be arbitrary and haphazard in character, failing to serve the cause of international monetary cooperation.

Objectives of the IMF

The objectives of the fund stated in Article I of the Fund Agreement are as follows:

(1) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.


6 International Monetary Fund, Articles of Agreement of the International Monetary Fund (Washington, D.C.) Dec. 27, 1945, Article I.
(2) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of productive resources of all members as primary objective of economic policy.

(3) To promote exchange stability to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.

(4) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(5) To give confidence to members by making the Funds' resources temporarily available to them under adequate safeguards, thus providing them with opportunity to correct mal-adjustments in their balance of payments, without resorting to measures destructive of national or international prosperity.

(6) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members. The fund is guided in all policies and decisions by the purposes set forth in the above Article.

It will be seen from the above, that international monetary cooperation as conceived by the IMF has two to three fundamental aspects, namely, harmonisation of the national economic interests with those of other members of the international community, provision of financial assistance on a temporary basis to enable the countries to restore balance of payments equilibrium and the promotion of economic growth and high level of employment. The cornerstone of the IMF edifice is a fixed par value system, with provision for exchange rate changes to correct a fundamental disequilibrium, not only in consultation with the IMF but with its prior approval.7 Emphasis is also

7 Articles of Agreement, n.4, Article VIII.
placed on freedom from exchange control on current transactions. In the IMF system there is also a fairly important role of gold.  

**The Structure of IMF:**

Under the Fund structure as adopted at Bretton Woods, there is a Board of Governors, there being a Governor (also an Alternate Governor) for every member country, appointed by

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8 Under the provisions of the Fund the par of the currencies of member-nations is determined either in terms of gold or the US dollars. Gold is thus assigned a key role in the Fund's monetary arrangements, so much so that some economists regarded the plan of the Fund as essentially a gold standard plan. This is so because the par value of each member's currency is expressed in terms of gold. A minimum of the quota (25%) by the member country must be paid in terms of gold. Gold continues to serve as a reserve of international currency in the IMF and the Fund may purchase the currency of any country by making payments in gold. See for example, "Ten Years Off Gold", *The Economist* (London) Sept. 20, 1941, pp.346-47. "Bretton Woods Agreement Act, Hearings on H.R. 3314", in the *Senate Committee on Banking and Currency, 79th Congress, sess. 1st (1945), p.23.

9 The structural composition or Governance of IMF has been discussed in Articles of Agreement of IMF, Article XII and also Joseph Gold, "The Structure of the Fund' Finance and Development (IMF) (Washington, D.C.,No.16, June 1979, pp.11-15.

10 The British and the Americans had rather different views about the appropriate management of the Fund. They came to resolve their differences of view more about the appointments to be made to the Executive Directors positions than over such issues as the composition of the staff or the details of weighted voting.
the Government concerned. The Board of Governors is composed in practice of the Finance Ministers of member countries, who would normally meet only annually and would delegate all but the most important decisions to the Executive Directors. The Managing Director to be selected by but not from among the Executive Directors and, a fortiori, not from the staff, would not have legal powers of decision. The Executive Directors would be appointed by member countries, though only the five countries with the largest voting power would have their own Executive Directors, and other members would be grouped in constituencies (which would each elect an Executive Director) so that their meetings could be limited to a manageable size.

The IMF was to be an international organisation. Unlike many such organisations, decisions were to be made by weighted voting rather than by one country— one vote procedures. Both the U.S. and Britain agreed on this point because weighted voting would assure them jointly a dominating voice in decisions. Voting power on the Board of Governors and the Directorate is pro rata with the size of the member’s quota, each member having 250 votes plus one additional vote for each part of its

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11 Articles of Agreement, n.4, Article XII, Sections 1 and 2.
12 Ibid., Article XII, Section 4.
13 Article XII, n.4, Section 3.
quota equal to $1,000,000 (US).\textsuperscript{14} When voting is required on the waiving of conditions applicable to the granting of an application by a member for use of the Fund's resources, the voting formula is more complex, being designed to give more voting power to surplus countries. This formula can be summarized as follows:

(a) General Formula → Member's Vote = 250 + \frac{X}{100,000}

(b) Voting on Article V,\textsuperscript{15} sec. 4 or 5 →

Member's Vote = 250 + \frac{X}{100,000} + \frac{Y}{400,000} - \frac{Z}{400,000}

Where \( X \) = member's quotas in US $

\( Y \) = net sales of its currency to date

\( Z \) = net purchase of other currencies to date.

On the basis of this formula the normal vote of the five principal members was originally as follows:

US : 27,750 (27.93 percent); UK : 13,250 (13.33 percent);
China : 5,750 (5.79 percent); France : 5,500 (5.54 percent);
and India : 4,250 (4.28 percent). If the Article V formula were applied, the voting power of the US would be still greater.

Subsequent revisions of quotas have altered the absolute


\textsuperscript{15} Articles of Agreement, n.4, Article V, Sections 4 and 5.
number of votes per member but the relative voting strengths of members still favours the large rich countries.16

From all of this it will be evident that the management of the Fund was to be political rather than technical,17 that governors and directors were to regard themselves as a pool of technical knowledge and that the largest contributor to the Fund had secured for itself a dominant role in policy and decision-making. Such a set-up could scarcely fail to undermine the international character of the Fund and help to make it a sounding board for divergencies of political (rather than economic) opinions upon international economic problems.18 Added to this is the location of the Fund's offices in Washington and it will be clear that Keynes' fears for the future of the Fund as an international rallying ground for the best technical option on international monetary matters were well founded.19

The IMF As a Financial Institution:

The IMF is a financial organisation dealing primarily in short-term and now a days medium-term credit to a large number of member-countries owing-allegiance to different types

16 Scammell, n.6, p.121.
17 Keynes opposed political appointments in the management Cadre of the IMF, but US favoured full timers for this purpose.
19 Horsefield, Ibid., pp.131-32.
of economic ideologies. The Fund was established at the end of the Second World War and at that time there were conflicts on the nature of its operations. The UK, represented by Late Lord Keynes, assumed that the post-war situation would require an enlarged liquidity base for stimulating a continuously effective demand to maintain full employment in the UK and elsewhere. It wanted the organisation to be a sort of international money-creating institution. The US, being basically conservative and chary of monetary expansionism, wanted a more modest, rules-bound role for the organisation. Ultimately when the Fund came into existence, a sort of compromise-dollar-based, gold exchange standard came into existence. However, the US gradually started playing the role of a world trustee; its dollar obligations expanded and the slender gold-exchange condition could not be observed. After the sixties, when the Euro-currency markets became very prominent on the market of international liquidity, the Fund has been reduced to the position of a supplier of 'small change'.

The organisation, over a period of more than three decades, has evolved into an expert store house of financial

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20 Keynes proposed the setting up of an International clearing union to meet the enlarged liquidity demand. See Horsefield, IMF (1945-65), n.32, Vol.3, pp.19-36.

21 White's proposal is known as Stabilization Fund. This proposal is discussed in detail in Horsefield, Ibid., pp.85-96.
and monetary information concerning most countries of the world. It's role as a supplier of short-term and medium-term liquidity is not very important for developed countries, for whom it is a potential cushion in times of very great need of foreign exchange. However, for the developing countries, it has emerged as one of the leading sources of exchange lending.22

The financial resources for the Fund are obtained partly from all members, but more particularly from those countries which are prepared to lend to the Fund some of their surplus in the form of their own hard currency23 or of other exchange which they hold. Besides, the fact that most developed countries do not borrow from the fund while they contribute their quotas of subscriptions give to the Fund an opportunity to lend exchange to developing countries.

Operations of the IMF:

As a financial institution, IMF provides 'loan' assistance to the member-countries for relatively short-period. For

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23 These currencies mainly are US dollars and UK pounds which happen to be most important contributors to the Fund’s resources.
this purpose the Fund receives resources from member-countries in the form of 'gold and specified quantities of the currencies of the individual member countries known as 'quotas'. Quotas constitute subscriptions by member-countries to the capital Fund of the IMF. They define the relative importance of the member-countries in the matter of their rights and obligations. For instance, the higher a country's quota, the larger its capacity to borrow from the IMF. Quotas also determine the voting strength of the member-countries and the distribution of international money, i.e. special drawing rights (SDRs), among member-countries is also done exactly in proportion to the quotas of members.

The quotas are fixed on the following basis:

(a) 2 percent of national income;
(b) 5 percent of gold and dollar balances;
(c) 10 percent of average annual imports;
(d) 10 percent of maximum variation in annual exports;
(e) the sum of (a), (b), (c) and (d) increased by the percentage ratios of average annual exports to national income. The years used were 1940 in (a), 1934-38 in (c), (d) and (e) and July 1, 1943 in (b).

24 O.L. Altman, Quotas in the International Monetary Fund, IMF Staff Papers, no. 5, 1956, pp. 129-30, 132, 134. Quotas are determined by negotiations rather than by pre-determined rules.


26 The subscriptions called as Quotas were the principal source of assets for the Fund. Each member was required to pay the amount of quota partly in gold and partly in its own currency and as a consequence of the subscription formula, the Fund received gold and a 'mixed bag of national currencies' — Articles of Agreement, n. 4, Article III, Section 3(b).
This came to be known as the Bretton Woods Formula. According to this, out of a total of $9,800 million for the 44 nations gathered at Bretton Woods, the quota for the US was $2,750 million. The quota for India was fixed at $400 million, the sixth largest after the USA, UK, USSR, China and France. Quotas of selected member countries of IMF as on 31st December 1972 are given in Table 2.1.

Generally speaking, the members have to pay 25 percent of their quotas in the form of gold and the rest in their own currencies. For the original members, gold subscription were set at either 25% of their quotas or 10 percent of their net official holdings of gold and US dollars as on 12th September, 1946 whichever was less. This formula has usually been followed for later members. But there is a certain amount of bargaining in the matter. In cases, where the gold subscription is below 25 percent the members are under an obligation to reduce their currency subscription, so as to bring it down to 75 percent through payment of gold or other currencies acceptable to the Fund. The quotas are received every few years and adjusted from time to time by the Fund.

27 Altman, n.24, pp.132-144.
28 Sinha, n.1, p.33.
29 Altman, n.24, pp.129-40.
30 Ibid., pp.129-45.
Table 2.1
QUOTAS OF MEMBER COUNTRIES OF IMF
(As on December 31, 1972; Amounts expressed in millions of SDRs)

<table>
<thead>
<tr>
<th>Member</th>
<th>Quota</th>
<th>Gold Subscription</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial Countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>6700</td>
<td>1675</td>
</tr>
<tr>
<td>UK</td>
<td>2800</td>
<td>700</td>
</tr>
<tr>
<td>Industrial Europe</td>
<td>6565</td>
<td>1641</td>
</tr>
<tr>
<td>Denmark</td>
<td>200</td>
<td>65</td>
</tr>
<tr>
<td>France</td>
<td>1500</td>
<td>375</td>
</tr>
<tr>
<td>Germany</td>
<td>1600</td>
<td>400</td>
</tr>
<tr>
<td>Italy</td>
<td>1000</td>
<td>250</td>
</tr>
<tr>
<td>Canada</td>
<td>1100</td>
<td>275</td>
</tr>
<tr>
<td>Japan</td>
<td>1200</td>
<td>320</td>
</tr>
<tr>
<td><strong>Other Developed Areas</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Less Developed Areas</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Latin America</td>
<td>8069</td>
<td>1644</td>
</tr>
<tr>
<td>Brazil</td>
<td>2578</td>
<td>635</td>
</tr>
<tr>
<td>Middle East</td>
<td>1017</td>
<td>250</td>
</tr>
<tr>
<td>Egypt</td>
<td>188</td>
<td>46</td>
</tr>
<tr>
<td>Other Asia</td>
<td>3023</td>
<td>495</td>
</tr>
<tr>
<td>India</td>
<td>940</td>
<td>162</td>
</tr>
<tr>
<td>Indonesia</td>
<td>260</td>
<td>12</td>
</tr>
<tr>
<td>Pakistan</td>
<td>235</td>
<td>35</td>
</tr>
<tr>
<td>Other Africa</td>
<td>1450</td>
<td>$289</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>29169</td>
<td>6937</td>
</tr>
</tbody>
</table>

The significance of the gold subscription is to enable the
IMF to acquire those currencies which are needed by members
but the holdings of which by the Fund have been run down.

The subscriptions (called by quota) were not, however,
the only source of Fund assets. The Fund would derive income
from charges on member drawings. These charges (similar to
interest payments) were to be imposed on drawings and hence
only on deficit countries. In addition to one-time service
charge of 3/4 percent on each transaction the Articles of
Agreement provided for a sliding scale of periodic charges
based on the relation of the amount of drawings to the drawing
country's quota and on the elapsed time from the date of the
drawing. The charges were payable in gold, though members
with monetary reserves less than 1/2 of quotas were permitted
to pay a portion of the charge in local currency.

The Articles of Agreement envisaged two other kinds of
transactions designed to increase Fund's assets: borrowing,
and replenishment by sale of gold. Investment of Fund assets
was a possible third source not specifically provided for in
the Articles of Agreement. A fourth source of assets was

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32 Horsefield, J.K., The International Monetary Fund
1945-65 : Twenty Years of International Monetary
33 Articles of Agreement, n.4, Article V, Sections
8(a) and 8(c).
34 Ibid. Article 8(f).
implicit in the maintenance-of-value provisions. Although the Fund would have large holdings of gold and of member currencies, it was not specifically empowered to increase those holdings by investment. On the other hand, no provision prohibited such investments. Now, to take the maintenance-of-value provisions the Fund was conceived as a revolving Fund of constant gold value and this value was to be maintained. To do this, a member that reduced the value of its currency was required to pay an amount in its own currency equal to the reduction in the gold value of its currency held by the Fund.

Drawings Rights

The purpose of creating a Fund was, of course, to make the resources of the Fund available to members in the balance-of-payment difficulties, though the Fund would also be a source of finance for the staff itself to carrying out its various functions. A fundamental decision was made to specify in considerable details the terms, conditions, and amounts of drawings.

Exchange Transactions of the IMF

When a member-country acquires currencies from the Fund, it is called an exchange operation, that is to say, the member

36 Ibid., p.153.
37 Bretton Woods Hearings, n.22, p.63.
38 Articles of Agreement, n.4, Article IV, Section 8(b).
gives its currency to the IMF in exchange for other currencies it requires. When a member acquires currencies in this manner, it is said to be a 'drawing' from the Fund and when it returns to the Fund the currencies, it had acquired earlier, it is said to be making a 'Repurchase' of its currency.

The statutes of the IMF prescribe broad limits to the quantity of credit which a member-country can receive from the IMF. Ordinarily a member should not borrow more than 25 percent of its quota in any 12-month period. Borrowing in excess of this limit requires a specific waiver of the Executive Board. Such waivers have been given rather freely for many years now. Besides, there is also a broad limit to the overall credit which a member can receive from the Fund. This limit is 125 percent of a member's quota. Actually the way the Article runs, a member's borrowings from the IMF should not go beyond a point when the IMF's holdings of the members currency reaches 200 percent of the quota. If a member has paid 25 percent of the quota in gold, the IMF is holding 75 percent of the member's currency. If the IMF's holding of the member country's currency is to reach 200 percent this means that the member can borrow up to 125 percent of its quota, by giving the equivalent of its currency in exchange for other currencies. If a member's gold

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41 Ibid., pp. and also Articles of Agreement, n.4, Article V, Section 3(iii).
subscription is below 25 percent of the quota, to that extent the limit of aggregate borrowing from the IMF is reduced. Thus if a country has paid 10 percent of its quota in the form of gold, which means that the IMF is already holding 90 percent of the member's currency, then the aggregate borrowing of the member from the IMF is limited to 110 percent of its quota. In that event, the IMF's holding of the member's currency will be 200 percent, namely 90 percent of the original subscription plus 110 percent of subsequent payment for the exchange transactions. 43

Thus the Fund has developed a number of outlets for lending. These are known as 'Facilities' and are the following:

(1) Gold Tranche (because it corresponds to the country's subscription in gold);
(2) First Credit Tranche;
(3) Second Credit Tranche;
(4) Third Credit Tranche;
(5) Fourth Credit Tranche;
(6) Stand-by Arrangements;
(7) Compensatory Financing Facility;
(8) Buffer Stock-facility;
(9) Oil Facility;
(10) Extended facility; and
(11) Trust Fund Loan Facility.

43 Simha, n.1, p.39.
Some of these outlets have become possible because of the resources placed at the disposal of the Fund by some of the oil-exporting countries and others.

The gold tranche is the total of a member's gold subscription and the credit, if any, which the member has extended through the Fund, to other members.44 For example, if a member has paid 25 percent of the quota in gold, then the gold tranche for the member is 25 percent of the quota. If a member, besides paying 25 percent gold subscription has a creditor position in the Fund to the extent of 25 percent, then its gold tranche is 50 percent of its quota45 while if a member has paid 18 percent gold subscription and 82 percent in terms of its own currency, then the gold tranche is 18 percent for the member-country. As regards drawings under the Credit Tranches,46 the IMF's policy is to treat the drawing in the first credit tranche of 25 percent of the quota on a liberal basis, almost automatically. However, the requests for drawings beyond the first credit tranche 'require substantial justification'47 i.e., while approaching the Fund for a

46 The credit tranches are not unconditional. The conditions for credit tranches are discussed in Articles of Agreement, n.4, Article IV, Section 3.
47 Ibid, Article V, Section 3. The Fund could look behind a representation to verify whether, in view of the member's policies, the assistance provided could be expected to be temporary.
drawing in the higher amounts, the member would have to give a programme of actions, in the fiscal, monetary and exchange fields, which would have the effect of correcting the disequilibrium in the member's balance of payments; on the effective implementation of such a programme the member would be in a position to repay, in relatively short period, the credit which it receives from the IMF. "The Fund's attitude to requests for transactions within the first credit tranche—that is, transactions which bring the Fund's holdings of a member's currency above 100 percent but not above 125 percent of its quotas—is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require a substantial justification. They are likely to be favourably received when the drawings on stand-by arrangements are included to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."48

Thus it shows that the assistance provided by IMF is a mixture of unconditionality and conditionality. The chief source of conditionality is found in stand-by arrangements and

it is because of its conduciveness to conditionality that the Fund made little or no use of its waiver authority to impose conditions.

The stand-by arrangements were initiated in 1952 and they involve the advance arrangements of future needs with the IMF for such credit facility. Under stand-by arrangement, a member of the IMF is given an assurance that, following a review of the member country's financial and economic policies and its balance of payments position, the member can purchase from the Fund the currencies of other members, up to an agreed amount and during a stated period. To quote Joseph Gold, the Fund's general Counsel:

One of the purposes of stand-by arrangements is to make resources available should the need for them arise in the future, and practice shows that it is essential that a need for them should exist at the time when the stand-by arrangement is requested or approved. Although there may be no need for resources at the date of the request for an approval of a stand-by arrangement, normally the objective of a stand-by arrangement is to assist a member to deal with particular problems that could arise during the period of the stand-by arrangement.

49 As with the change from de facto to de jure unconditionality of gold tranche drawings, the Fund's conditionality practices were endorsed in the First Amendment. These changes are described in Article V, Section 3(c) of the Bretton Woods Articles of Agreement, also Joseph Gold, "The Reform of the Fund", The IMF Pamphlet Series, no. 12, 1969, pp. 27-30.

50 The stand-by arrangements was the chief legal vehicle for conditionality. For a detailed discussion see Gold, n. 45.
The member's policies must be designed to overcome these problems within a reasonable period if they should arise. In this way, the member can demonstrate that the Fund will have adequate safeguards when making its resources available to the member. (51)

According to some (52) the facility of stand-by arrangements is wholly unnecessary and inconsistent with the IMF policy of liberal credit to member-countries up to the limits prescribed in the Articles of Agreement. The IMF itself is a source of stand-by credit and a formal stand-by arrangement does not appear to be necessary. Besides, undertakings are given (by the member country) all too freely about the pursuit of fiscal and monetary policies at the time of stand-by arrangements without careful regard to their practicability and the result is that the undertakings are not honoured and requests for relaxation are often made. Besides there is a certain amount of inherent discrimination among the member countries. (53) In addition, the repayment of stand-by assistance will have to be made within a period of three years.

To meet the growing needs of developmental financing of the less developed countries the IMF adhered to compensatory financing facility (54) with special rules for countries

51 Gold, Ibid., p.27.
52 Simba, n.1, p.45.
53 Ibid., p.45.
suffering from a short-fall in export proceeds from primary commodities. This facility was available to all members suffering from this particular balance of payments problem. Specifically they would be able to draw up to 25 percent of their quota (increased in 1966 to 50 percent) and, if necessary, the Fund would waive the normal limit of Fund holdings of a member's currency to 200 percent of quota. The effect of the decision was thus to permit the drawing country to avoid the performance commitments involved in a stand-by arrangement and to permit members to draw even though they had already exhausted their credit trenches by conventional drawings. Moreover, as a result of a floating feature introduced in 1966 liberalization a drawing under the compensatory financing facility did not affect a member’s tranche position. Thus, a member not having drawn previously could draw under the facility while leaving its gold tranche intact and fully available for future drawings.

Besides, the Fund has developed a number of other outlets for lending e.g., buffer stock facility, oil facility,


56 Joseph Gold, "Conditionality", IMF Pamphlet Series, no.31, 1979, pp.6-7. The provision for repurchases apply to drawings under the compensatory financing facility are generally the same as those applying to drawings under credit tranche policies.
extended facility and trust fund loan facility. Some of these outlets have become possible because of the resources placed at the disposal of the Fund by some of the oil-exporting countries and others; for example, the Fund coffers have recently been enriched by a loan from the Saudi-Arabian monetary authority ($8 billion - $4 billion a year for two years; interest payable on the basis of weighted average rate of 5-year government securities in the five component currencies of SDR, which is currently between 14 to 15 percent). Since some of these loans are repayable over a longer term, the Fund has the opportunity to extend the time length of its lending operations. The Trust Fund loans are made by the Fund out of the profits it has made by its gold-sale operations. The purpose of Buffer Stock Financing Facility is to assist in the financing of members' contributions to international buffer stocks of primary products when members having balance of payments difficulties participate in such arrangements under commodity agreements that meet appropriate criteria, such as the principles laid down by the United Nations in regard to international commodity agreements. This facility was introduced in 1969.

58 Ibid., p.3.
59 Brahmanand, n.57, p.3.
The drawings for buffer stock financing may be made up to 50 percent of quota. The Fund has so far authorized the use of Fund resources for tin, cocoa, and sugar buffer stocks, but drawings have been made only for tin and sugar. The repurchase provisions are roughly the same as for purchases in the credit tranche.

Besides, the Fund has the Supplementary Financing Facility\(^\text{61}\) (which is financed by resources borrowed by the Fund), the purpose of which is to enable the Fund to provide supplementary financing in conjunction with the use of the Fund's ordinary resources to all the members of the Fund facing serious payments imbalances that are large in relation to their quotas.

Under the Extended Fund Facility,\(^\text{62}\) the Fund assists those members whose economies suffer from serious balance of payments difficulties resulting from structural imbalances in production, trade, prices, and an inherently weak balance of payments position. The funds under this scheme are made available in large amounts, sequentially for longer periods and the repayment schedule can be spread over 7 to 10 years. The drawings under this can be phased over three years and are

\(^{61}\) Introduced in 1973, \textit{Ibid.}

\(^{62}\) This facility was introduced in 1974, \textit{IMF Survey}, n.60.
subject to performance clauses relating to the implementation of key policy measures. The purchases outstanding under this scheme may not exceed 140 percent of the member’s quota (reduced by any tranche drawing beyond the first credit tranche). Between 1974 to 1981 only 7.7 billion SDRs had been allotted under this scheme and it has mainly been utilized by non-oil rich developing economies for overcoming their balance of payments crises.

In 1980, the Fund adopted a policy called Enlarged Access. The maximum total amount available to a member from Credit Tranches, the extended facility and the supplementary financing facility (or successor borrowing arrangements) has now been set at 150 percent of quota per annum or 450 percent of quota over three years. A member’s cumulative drawings under these arrangements is not to exceed 600 percent of quota. These limits are subject to review in the light of the availability of borrowed resources to the Fund.

The tables (2.2 and 2.3) given below summarize the use of Fund’s resources under various tranche policies.

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63 Ibid.
64 Brahmanand, n.57, pp.4-5.
66 These tables and analysis are based on IMF Survey, n.60, 1980.
Table 2.2
POSSIBLE DRAWINGS FROM THE IMF

<table>
<thead>
<tr>
<th>Facility</th>
<th>Use of Ordinary Resources</th>
<th>Use of Borrowed Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserve Tranche</td>
<td>Whatever % of quotas</td>
<td>None</td>
</tr>
<tr>
<td></td>
<td>brings Fund holding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of member's currency</td>
<td></td>
</tr>
<tr>
<td></td>
<td>upto 100% of quota</td>
<td></td>
</tr>
<tr>
<td>Credit Tranches</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>25%</td>
<td>100%</td>
</tr>
<tr>
<td>3</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>Extended Facility</td>
<td>140%, reduced by any</td>
<td>-do-</td>
</tr>
<tr>
<td></td>
<td>drawings in trenches</td>
<td></td>
</tr>
<tr>
<td></td>
<td>2, 3 &amp; 4</td>
<td></td>
</tr>
<tr>
<td>Compensatory</td>
<td>100%</td>
<td>None</td>
</tr>
<tr>
<td>financing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buffer-Stock</td>
<td>50%</td>
<td>None</td>
</tr>
<tr>
<td>financing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2.3
USE OF FUND RESOURCES (in million SDRs)

<table>
<thead>
<tr>
<th>Fiscal Year of the Fund end April 30</th>
<th>Within Reserve Tranche</th>
<th>Within Credit Tranche</th>
<th>Compensation Financing Facility</th>
<th>Buffer Stock Facility</th>
<th>Extended Facility</th>
<th>Oil Facility</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>602.6</td>
<td>2203.4</td>
<td>11.3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2817.3</td>
</tr>
<tr>
<td>1967</td>
<td>677.0</td>
<td>322.0</td>
<td>62.3</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1061.3</td>
</tr>
<tr>
<td>1968</td>
<td>639.0</td>
<td>489.6</td>
<td>219.7</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1348.3</td>
</tr>
<tr>
<td>1969</td>
<td>902.8</td>
<td>1924.0</td>
<td>12.1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2838.9</td>
</tr>
<tr>
<td>1970</td>
<td>689.4</td>
<td>2297.2</td>
<td>9.0</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>2995.7</td>
</tr>
<tr>
<td>1971</td>
<td>810.5</td>
<td>354.5</td>
<td>2.5</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1167.4</td>
</tr>
<tr>
<td>1972</td>
<td>1576.5</td>
<td>264.9</td>
<td>167.0</td>
<td>20.1</td>
<td>-</td>
<td>-</td>
<td>2028.5</td>
</tr>
<tr>
<td>1973</td>
<td>641.0</td>
<td>322.8</td>
<td>206.4</td>
<td>5.3</td>
<td>-</td>
<td>-</td>
<td>1175.4</td>
</tr>
<tr>
<td>1974</td>
<td>607.5</td>
<td>238.8</td>
<td>211.5</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1057.7</td>
</tr>
<tr>
<td>1975</td>
<td>981.5</td>
<td>1603.8</td>
<td>18.0</td>
<td>-</td>
<td>2499.3</td>
<td>-</td>
<td>5102.5</td>
</tr>
<tr>
<td>1976</td>
<td>1324.1</td>
<td>461.0</td>
<td>827.8</td>
<td>4.7</td>
<td>7.7</td>
<td>3966.2</td>
<td>6591.4</td>
</tr>
<tr>
<td>1977</td>
<td>160.6</td>
<td>2370.0</td>
<td>1752.8</td>
<td>-</td>
<td>90.0</td>
<td>436.9</td>
<td>4910.3</td>
</tr>
<tr>
<td>1978</td>
<td>135.7</td>
<td>1936.8</td>
<td>321.8</td>
<td>-</td>
<td>108.0</td>
<td>-</td>
<td>2503.0</td>
</tr>
<tr>
<td>1979</td>
<td>2480.4</td>
<td>485.0</td>
<td>464.7</td>
<td>47.6</td>
<td>242.0</td>
<td>-</td>
<td>3719.6</td>
</tr>
<tr>
<td>1980</td>
<td>225.5</td>
<td>1105.8*</td>
<td>862.9</td>
<td>26.1</td>
<td>216.0**</td>
<td>-</td>
<td>2433.3</td>
</tr>
</tbody>
</table>

* including 383.5 under supplementary financing facility.
** including 119.0 under supplementary financing facility.

To understand the table, it is necessary to point out that when a member draws on the Fund, it uses its own currency to purchase the currencies of other member countries or special drawing rights (SDRs) held by the General Resource Account. Thus a drawing results in an increase in the Fund's holdings of the purchasing member's currency and a corresponding decrease in the Fund's holdings of other currencies or SDRs that are sold.

A member incurs an eventual obligation to repurchase its currencies from the Fund to the extent that the Fund's holdings of the member's currency are in excess of 100 percent of the member-quote.

Usually, repurchases are required to be made within three to five years after the date of purchase; but under the extended facility, the period of repurchases is within 4-10 years, under the oil facility within 3-7 years, and under the supplementary financing facility within 3½ to 7 years.

If the Fund's holdings of a member's currency are less than 100 percent of the members quote, the difference is called the reserve tranche. Purchases in the reserve tranche are not subject to prior challenge, to economic policy conditions, or to repurchase requirement. This all is summarized in the following table:
### Table 2.4
**USE OF SDRs 1970-80**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>To participants and other holders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In designation</td>
<td>884</td>
<td>661</td>
<td>220</td>
<td>267</td>
<td>852</td>
<td>1317</td>
<td>1316</td>
</tr>
<tr>
<td>By agreement</td>
<td>989</td>
<td>1275</td>
<td>353</td>
<td>699</td>
<td>1827</td>
<td>318</td>
<td>347</td>
</tr>
<tr>
<td><strong>To the Fund:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repurchasers</td>
<td>1088</td>
<td>101</td>
<td>446</td>
<td>837</td>
<td>347</td>
<td>492</td>
<td>1275</td>
</tr>
<tr>
<td>Charges</td>
<td>149</td>
<td>356</td>
<td>628</td>
<td>807</td>
<td>747</td>
<td>584</td>
<td>519</td>
</tr>
<tr>
<td>Quota payments</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>220</td>
<td>1</td>
<td>5068</td>
</tr>
<tr>
<td>Other</td>
<td>15</td>
<td>42</td>
<td>22</td>
<td>24</td>
<td>41</td>
<td>59</td>
<td>88</td>
</tr>
<tr>
<td><strong>Transfers by the Fund:</strong></td>
<td>623</td>
<td>576</td>
<td>989</td>
<td>1145</td>
<td>1332</td>
<td>1472</td>
<td>2262</td>
</tr>
<tr>
<td><strong>To participants &amp; other holders:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchasers</td>
<td>292</td>
<td>46</td>
<td>430</td>
<td>428</td>
<td>1025</td>
<td>1266</td>
<td>1556</td>
</tr>
<tr>
<td>Reconstitutions</td>
<td>104</td>
<td>438</td>
<td>531</td>
<td>583</td>
<td>120</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td>Remuneration</td>
<td>35</td>
<td>37</td>
<td>24</td>
<td>122</td>
<td>136</td>
<td>140</td>
<td>220</td>
</tr>
<tr>
<td>Other</td>
<td>192</td>
<td>5</td>
<td>3</td>
<td>13</td>
<td>50</td>
<td>67</td>
<td>480</td>
</tr>
</tbody>
</table>

(Table continues....)
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Transfers</strong></td>
<td>3747</td>
<td>3031</td>
<td>2659</td>
<td>3779</td>
<td>5365</td>
<td>42381</td>
<td>10891</td>
</tr>
<tr>
<td><strong>SDRs holdings at the end of period (total of net cumulative allocations)</strong></td>
<td>9317</td>
<td>9315</td>
<td>9315</td>
<td>9315</td>
<td>13348</td>
<td>17381</td>
<td></td>
</tr>
<tr>
<td>Participants</td>
<td>8686</td>
<td>8764</td>
<td>8655</td>
<td>8133</td>
<td>8110</td>
<td>12479</td>
<td>11503</td>
</tr>
<tr>
<td>Other holders</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td>Fund's General Resource Accounts</td>
<td>629</td>
<td>551</td>
<td>659</td>
<td>1182</td>
<td>1205</td>
<td>869</td>
<td>567</td>
</tr>
</tbody>
</table>

Special Drawing Rights (SDRs) 67

The preceding discussion has been frequently using the

67 The solution to the Fund liquidity problem (before adopting SDRs scheme) arrived at in the General Arrangements to Borrow (also known as GAB) from the industrialized convertible-currency countries other than US and UK. Though the idea came from the Fund staff, however, the negotiations occurred largely outside the Fund among the major industrialized countries (also called Group of Ten) namely, US, Britain, Germany, France, Italy, Netherlands, Belgium, Sweden, Japan and Canada. The form of agreement was such that it could be subsequently incorporated in a decision of the Executive Board approving the GAB under provisions of Article VII, Section 2, involving replenishment of scarce currencies. The decisions were somewhat deceptive, GAB created a special fund facility available only to certain members and, above all, controlled by those particular members. Joseph Gold also questioned the legal propriety of GAB on the Fund and the negotiators to make amendments. The GAB Fund was $6.0 billion (of which $2.0 billion US and $1.0 billion UK) and was not used till UK drew under a $1.0 billion & stand-by arrangements.

term 'Special Drawing Rights'\(^6\) (SDRs). Now it is a time to explore this term in detail.

Prior to World War II, gold constituted over 90 percent of international liquidity. The balance consisted of foreign exchange holdings, principally in the form of Pound Sterling and US dollars. These two currencies were known as 'Reserve Currencies' and London and New York came to be known as 'reserve centres'. In the post-war years too, until a few years ago, gold constituted the largest component of international liquidity but its relative importance had diminished considerably. Over the years the importance of Pound Sterling has steadily declined and the role of dollars has increased a great deal.

And added to this, a new component of international liquidity, namely, 'Reserve Position' of member countries in the IMF, known as 'Gold Tranche' position plus any lending to the IMF by a member country outside the quota.\(^6\) With the fast increasing volume of world trade and payments, it was felt that a shortage

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69 de Vries, n. 31, vol. 2, pp. 3-29.
international liquidity (both in its quantitative as well as qualitative aspects) is likely to arise because of the slow growth of gold reserves and the present international monetary system would not automatically provide the increased liquidity. Perhaps, in the absence of additional gold coming forth, the needs of growing reserves could be met by increasing the supply of key currencies, namely, the Pound Sterling and the dollars. Since the Pound Sterling recorded a marked decline in the past, so the only effective reserve currency available to the world was the US dollars. In order rest of the world to increase dollar holdings, US must have continuous deficits in its balance of payments and the inability of USA to provide convertibility to the continuous accumulation of dollars, would create imbalance in the composition of international reserves and would also create the risk of devaluation for the US currency. While if USA tries to eliminate deficits in its balance of payments, then, the growth of reserves is halted. A need was, therefore, felt for a new type of reserve and the solution of this problem was provided by Special Drawing Rights (also known as SDRs) which was created in 1969 as a supplement to gold and dollars.

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The SDRs is defined variously as a legal tender or paper gold in international payments — almost like creation of paper currency in the national economies substituting regular coins in gold and silver. SDRs supplement the traditional reserve assets, namely, gold and foreign exchange. The scheme of SDRs was approved in principle in 1967 but came into operation only since January 1970.

With the establishment of the facility of SDRs, the accounts of the IMF are divided into two categories, namely, the General Account and the Special Drawing Account. The ordinary transaction of the IMF relating to subscription towards quota, drawings, repurchases and payment of charges are all conducted through the General Account. The transactions relating to the SDRs are conducted through the Special Drawing Account.

Every member of the IMF has a right to be a participant in the SDR facility. But a member of the IMF is not compelled to join the SDR scheme. However, most of the IMF members have become members of the SDR scheme. The allocation of SDRs may

72 Articles of Agreement, n.4, Article XXI, Section 24.
74 Gold, SDRs (1970), n.68, pp.54-56, 81-83.
be made only to participants but the holding of such rights is not restricted to participants. The Fund can accept and hold SDRs in and use them through the General Account. The Fund, by a special majority (85 percent of voting power) will be able to permit non-members and members that are not participants to engage in operations and transactions involving SDRs. 75

The SDRs themselves are not international money; they are like coupons which can be exchanged for currencies required by the holder of SDRs, for making international payments. The SDRs transactions are carried out through entries in the books of the IMF. 76 When member-countries are allocated SDRs they are given credits in the IMF books and when a member-country parts with SDRs to acquire other currencies; its SDRs account is debited. Similarly, a country accepting SDRs is given credit in the Special Drawing Account. When SDRs are converted into other currencies, the charges and interest rate has to be paid at the rate of \( \frac{1}{15} \) percent per annum. The SDRs are not the liability of the IMF. There is no pool of currencies to back the issue of SDRs. The real backing of the SDRs is the undertaking given by the member-countries to honour the provision of

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75 Articles of Agreement, n.4, Article XXIV, Section 4. Also Gold, Special Drawing Rights, 1970, n.68, pp.19-23.

76 The rules are spelled out in Articles of Agreement, Ibid., Article XXX and XXXI and International Monetary Fund "Articles of Agreement" First Amendment (Washington D.C.), 1968, Schedules H and I.
the Articles of Agreement and, particularly, the undertaking to give convertible currencies in exchange of SDRs. 77

Allocation of SDRs:

The allocation of SDRs is made on the basis of the quotas of IMF of the individual member-countries. 78 If a country's quota in the IMF is 25 percent, then it will receive 25 percent of the allocations of SDRs. Since the developing countries do not have the major share of the quotas, they also do not have the major share of allocation of SDRs.

The decisions to allocate or cancel SDRs may be made only by the Board of Governors on the basis of the proposals from the Administration of the Fund and only by a special majority. 79

The first allocation of SDRs 80 was made by the IMF on

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80 Simha, n.1, p. 109.
1st January, 1970. A total of SDRs 3,414 million was distributed among 104 participants each member being entitled to an allocation for 16.8% of its quota. Out of the 115 members of the IMF, 105 had agreed to participate in the SDR scheme. China exercised the option not to accept any allocation.

The second allocation\(^{81}\) was made on 1st January 1971, for an amount of 2,949 million, each participant getting 10.7 percent of its quota. Out of 117 members, 110 had participated and China again decided not to accept any allocation.

The third allocation\(^{82}\) of 2,952 million units was made on 1st January 1972 to 112 participants. China did not accept any allocation and 113 out of 129 members had participated.\(^{83}\)

The SDRs can be used by members in three alternative ways:

1. to obtain US dollars, French Franc or Pound Sterling from other designated participants to obtain currency in exchange;
2. to use SDRs for obtaining balances of its own currency held by another participant by agreement with that participant; and
3. to use SDRs to effect repurchases and to pay charges in the Fund's general account. Thus the IMF can hold and use SDRs though no allocations are made to it.

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81 Ibid., p.109.
82 Simha, n.1, p.109.
83 By April 1980 all 140 Fund members had become participants. IMF Annual Report, 1980, p.90.
Two important observations are noticeable with regard
to SDRs. The SDRs do not solve or cure the basic problems
of international monetary relations such as international
movements of funds arising out of the disturbance in intern-
tional monetary equilibrium. The scheme lacks the prevention
of currency-gold switches and SDR-gold switches. Secondly,
the distribution of SDRs on the basis of IMF quotas also
fails to satisfy the canons of equity because according to
the scheme a major part of SDRs has been allocated to the
rich nations already having enough liquidity. This kind of
arrangements may aggravate financial disequilibrium in the
world. The table 2.4 (at pp.54-55 of this chapter) shows
the use of Fund's SDRs scheme.

84 The criticisms are made by Simha who was on the