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Recent Developments of the International Monetary Fund

RECENT DEVELOPMENTS OF THE INTERNATIONAL MONETARY FUND

I. NEW CREDIT FACILITY FORMED BY IMF

On August 29, 1977, the IMF's Executive Board adopted a decision creating the Witteveen facility, a supplementary financing facility, named after H. Johannes Witteveen, outgoing Managing Director of the Fund. To date, $10 billion has been pledged from 13 nations — 47 per cent to come from oil exporting countries. The purpose of the new facility is to provide loans to supplement existing IMF sources to nations suffering from serious balance of payment deficits.[1]

The major sources of long term funds available for balance of payments financing are member quotas. These quotas are the total funds which each nation deposits with the IMF. The IMF allows member nations to borrow currency from other member's quotas against their own quotas. In this manner, members can obtain an amount of any type of foreign currency equivalent in value to their own quotas in order to finance trade.

The newly created supplementary financing facility is an extension of the quota system. A member can use the new supplementary financing facility only if it is borrowing against one of its upper credit tranches[2] and needs supplementary funds

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1. IMF Decision No. 5508-(77/127) ¶ 1(a) (Adopted August 29, 1977) (hereinafter cited as IMF Decision). Expected member contributions, expressed in millions of special drawings rights are as follows:

*Abu Dhabi	150	Netherlands	100
Belgium	150	*Qatar	100
Canada	200	*Saudi Arabia	2,150
West Germany	1,050	Swiss National Bank	650
*Iran	685	United States	1,450
Japan	900	*Venezuela	450
*Kuwait	400		

Oil Exporters indicated by asterisk (*).

See IMF SURVEY, September 5, 1977, at 273. Note that 22.9 per cent of the pledges come from Germany and Japan. Until recently these two nations have run large balance of payments surpluses. *See* THE ECONOMIST, September 24, 1977, at 89.

2. For a general discussion of the traditional IMF borrowing mechanism, *see* I. WALTER, INTERNATIONAL ECONOMICS 451–459 (2d ed. 1975). For details of the credit rules on credit tranch borrowing, *see generally,* INT'L MONETARY FUND, BY-LAWS, RULES AND REGULATIONS (July 15, 1975).

to finance a balance of payments deficit. Payments on Witteveen loans commence within three and a half years of acquisition and must be completed within seven. By combining supplementary financing facility borrowing with quota borrowing, a Fund member can receive up to 140 per cent of the value of its quota in foreign currency.[3]

Aside from generally expanding world credit, this facility extends IMF supervision over the lending of surplus funds from nations with balance of payment surpluses, such as the oil exporters, to nations with balance of payments deficits, such as the developing countries.[4] The facility is an attraction to the lenders because it provides a secure repository of their surplus funds as well as relatively high interest rates.[5] It eliminates the need to go through private middlemen. Moreover, the IMF does not compete for loans and will only approve loans with terms favorable to economic adjustment.

When a nation borrows from the new facility it must provide assurances that it is taking economic steps to reverse its balance of payments deficits. Opponents of the facility fear that IMF intervention will so improve the borrowing nation's credit position that the resulting inflow of private capital will be a disincentive for it to actually take the economic steps necessary to maintain a stable balance of payments. The IMF believes, however, that such a reaction is unlikely given the recent experiences of IMF lending to the United Kingdom, Mexico and Italy. Nevertheless, the IMF reserves the power to coerce the borrowing nations into taking corrective measures when they are necessary.

The creation of the facility becomes effective when loan agreements are entered into for a total amount of not less than Special Drawing Rights (SDR) 7.75 billion, including at least six agreements, each of which provides for an amount not less than

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3. IMF Decision, at ¶ 6(a).

4. For general background on the economic basis of the new facility, *see International Debt: Hearings Before the Subcommittee on International Finance of the Committee on Banking, Housing, and Urban Affairs, United States Senate,* 95th Cong., 1st Sess. 58 (1977) (Statement of Richard N. Cooper, Under Secretary of State for Economic Affairs).

5. The Fund will pay 7 per cent interest until June 30, 1978. For each six month period thereafter, the interest rate will be equal to the average yield for that period on U.S. Government securities of at least five year term. *See* IMF Decision at ¶ 2.

SDR 500 million.[6] The Witteveen facility is temporary, and may be abandoned at the next conference to increase member quotas.[7] However, extended balance of payments financing is presently necessary as deficits remain widespread despite the recent switch by world economies to flexible exchange rates. It is anticipated that deficits will continue as the world adjusts to the huge oil price increases of the past several years. After this adjustment, flexible exchange rates should curtail balance of payment deficits.[8] Meanwhile, the Witteveen facility will stand ready to provide supplemental aid to nations with imbalances.

II. THE STATUS OF THE PROPOSED AMENDMENT TO THE IMF'S ARTICLES OF AGREEMENT

The Second Amendment[9] to the Articles of Agreement proposed in January of 1976 in Jamaica (the Jamaican Agreement) took effect on April 1, 1978.[10] The Amendment represents the culmination of nearly five years of negotiations[11] started in response to the international financial crisis of 1971 and the subsequent abandonment of the Bretton Woods agreement and fixed exchange rates.[12] Article 4 of the Second Amendment includes provisions to sanction the existing floating exchange rate system, and to reduce the importance of gold as the basis of international reserves.[13]

The most significant aspect of the Amendment is the creation of rules of conduct for nations regarding their international

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6. *Id.*, at ¶ 13.

7. The results of the last conference are still pending ratification by the membership. The plan would increase total membership quotas from SDR 29.2 billion to SDR 39 billion, in proportion to existing quotas. The plan has been approved by only 44.11 per cent of the required 75 per cent of the votes.

8. For an explanation of the balance of payments adjustment process under flexible exchange rates, *see, e.g.*, I. WALTER, INTERNATIONAL ECONOMICS Ch. 22 (2d ed. 1975), *cf.*, Ch. 21 (on fixed exchange rates).

9. International Monetary Fund, Proposed Second Amendment to the Articles of Agreement, Articles of Agreement, April 29, 1976, 15 INT'L LEGAL MATS. 499.

10. Wall Street Journal, March 31, 1978, p. 5, col. 1.

11. For a general discussion of the particulars of the Jamaican Agreement, *see* NATIONAL ADVISORY COUNCIL, INTERNATIONAL FINANCE 23-24 (House Document No. 95-67).

12. For a discussion of proposed monetary alternatives and the Bretton Woods system, *see* I. WALTER, INTERNATIONAL ECONOMICS 460-480 (2d ed. 1975).

13. *See* 2 INT'L. TRADE L. J. 252 (1977).

monetary policies, with the IMF monitoring these rules. The IMF has developed three principles to guide implementation of exchange rate policies:

> (1) A member shall avoid manipulating exchange rates in order to prevent effective balance of payments adjustments or to gain unfair competitive advantages over other members;
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> (2) A member should intervene when necessary to counter disorderly conditions;
>
> (3) Members should take into account in their intervention policies the interests of other members, including those countries whose currency is the object of the intervention.[14]

Exchange rate manipulation consists of intervention by a nation's central bank in the foreign exchange market in order to significantly affect the supply and demand for that nation's currency. Such interference can be used for protectionist purposes by raising the price of imports entering the country and lowering the price of exports. Experience with flexible exchange rates has shown that manipulation can be advantageous to a country, but in ways which subvert the goal of international cooperation and orderly balance of payments adjustments. One nation's gain is another's loss and ultimately through retaliation comparative advantage is lost and underlying economic conditions distorted.

The first guideline is drafted in an effort to avoid such manipulation by IMF members. The second guideline approves of intervention to counter disorderly conditions. These conditions are short-term fluctuations which have no relation to underlying long-term economic conditions and are largely the result of chance happenings. Flexible exchange rate theory ignores the possibility of disorderly conditions because of the simplicity of the model. In the real world, however, such conditions occur and nations need sufficient flexibility to allow intervention and stabilization of short-term fluctuations.

Nevertheless, intervention under disorderly conditions should not be taken lightly. Manipulation of exchange rates can have adverse effects on the nation whose currency is intervened. From

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14. International Monetary Fund, *supra* note 9, at Art. IV, Sec. 3, 15 INT'L LEGAL MATS. 549. *See* IMF Executive Board, *Surveillance over Exchange Policies* (Guidelines in Implementing the Second Amendment).

a world perspective it would be futile for a nation which is attempting to lower exchange rates and to ward off a balance of payments deficit to intervene in a currency of a nation with the same problem. The third guideline tells nations to give due consideration to the effects of intervention on other countries.

In summary, the IMF would like its members to float their currencies to achieve long-term economic adjustments. At the same time, however, intervention to counter short-term fluctuations is encouraged. With the adoption of the Second Amendment, the IMF becomes the monitor of what will hopefully be a more stable system of flexible exchange rates.[15]

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15. For a discussion of the limitations and possibilities of the IMF after the Jamaican Agreement, *see* G. Halm, *Jamaica and the Par-Value System,* in PRINCETON ESSAYS IN INTERNATIONAL FINANCE No. 120 at 19–20 (March 1977).