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The Evolution of the International Monetary Fund

by Frank A. Southard, Jr.*

I. Introduction

There appears to be wide agreement that the International Monetary Fund is an effective international institution, standing alongside its sister, the World Bank Group, as a success of the post-World War II era. The Fund devised an organization, assembled a highly professional career staff, and by the end of its first decade had emerged from financial inactivity and seeming somnolence into the self-confidence and performance that have since characterized it. Shaken to its roots by the collapse of the Bretton Woods par-value system in 1971-73, the Fund displayed a capacity for survival and adaptation which gainsaid the funeral orations preached over its casket at that time.

How did this successful evolution come about? This essay is addressed to that question. It is not a systematic chronological account,[1] but rather a description of salient aspects of that evolution written from the vantage point of my years within the Fund from 1949 to 1974, first as Executive Director for the United States and thereafter as Deputy Managing Director. Of the many aspects that could have been included, some major and some minor, I have selected a few that I consider to have been strategic in structuring the Fund's organization, policies, and operations as they are today: (1) relations between Management and staff, Executive Directors, and Governors; (2) relations between the Fund and member countries; (3) the Fund's financial resources, their use and growth; (4) the Fund's exchange-rate policy; (5) the Fund and important but selected international financial crises.

These five aspects lie at the center of the Fund's development as a policy-making, policy-monitoring, and financing institution. To make

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* The author was Deputy Managing Director of the International Monetary Fund from 1962 until his retirement in 1974. This article has been reprinted with the kind permission of the author and the Princeton Essays in International Finance. It originally appeared as No. 135 of that series in December of 1979.

Author's note: To the extent necessary, the IMF has authorized the use of unpublished information known to me by reason of my service as a staff member in the capacity of Deputy Managing Director during the period November 1, 1962 through February 28, 1974. The views expressed are solely my own and not necessarily those of the Fund.

[1] For a thorough chronological account of the International Monetary Fund, *see* 1 K. HORSEFIELD, THE INTERNATIONAL MONETARY FUND, 1945-1965 (1969) and 1 M. DEVRIES, THE INTERNATIONAL MONETARY FUND, 1966-1971 (1976).

that clear, I begin by considering briefly what the Fund was created to do.

II. The Role of the IMF

It is not necessary to recount the complex negotiations that resulted in the adoption of the Articles of Agreement of the IMF at the Bretton Woods Conference in 1944.[2] What is needed is to list the elements in those Articles that set forth the role assigned to the Fund:

1. Monitoring changes in par values or in exchange arrangements under which par values were not effective: The power to approve or disapprove par values was conceptually the most important provision in the Articles; this was the first time that states had agreed to such an invasion of sovereignty. The Second Amendment of the Articles terminated this power unless at some future time a system of par values is reinstated by nearly unanimous agreement. But the "surveillance" mandate in new Article IV does give the Fund substantial authority to evaluate the adequacy of exchange rates.
2. Administering what can be called a "code of fair practice" in the field of foreign-exchange rates and international financial transactions: This important power included approval or disapproval of payments restrictions or discriminatory practices.
3. Providing financial resources to member countries to assist them in dealing with payments imbalances: The framing of the terms on which resources would be made available became one of the most difficult, controversial, but also successful elements in the evolution of the Fund.
4. Developing relations with member countries and providing, or assisting them to provide, information needed by the Fund to carry out its responsibilities: The Fund was given the power to require that certain kinds of information be provided, even if the member regarded it as sensitive and was not publishing it.

In short, the Fund, while not a super-central bank in the full sense of that term, was and is an institution possessing broad powers to guide the international financial conduct of members and to give or withhold financial assistance. To put those powers and duties in the Articles of Agreement was one thing. To make the Fund into an effective operating institution was quite another.

III. The IMF Organization

The first task was to establish a *modus operandi* among the three organs of the Fund: the Governors, the Executive Directors, and the Management (*i.e.*, the Managing Director and Deputy Managing Director) and staff.

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[2] The Articles have been twice amended, in 1969 to provide for Special Drawing Rights (SDR's) and in 1978 to make more basic changes.

The Articles, of course, provided some guidance. The ultimate power resides in the Board of Governors, which could and did delegate all powers to the Executive Board (except a few that could not be delegated, such as admitting new members or increasing quotas). The Executive Board, in turn, is "responsible for conducting the business of the Fund." The Board selects a Managing Director, who serves as its Chairman and conducts the ordinary business of the Fund under the direction of the Board. "Subject to the general control" of the Board, he is responsible for the "organization, appointment, and dismissal" of the staff.

The problem was to make those interrelationships work in practice. What was the Board of Governors to do, and how would the Executive Board and the Management/staff divide the task of developing policy and operating the Fund?

A. The Board of Governors

There has never been any serious issue relating to the Board of Governors. It was evident from the beginning that a Board consisting largely of finance ministers and central-bank governors, who were destined to become very numerous as membership grew, could not meet often and could not be concerned with day-to-day Fund operations. Various devices were tried to give Governors opportunities for participation other than routine approval of the accounts and the passage (at Annual Meetings or by mail or cable) of resolutions on new members and quota increases. Some thought was given, but quickly dropped, to have frequent meetings. In the early years, committees were created at the Annual Meeting to discuss the Annual Report, and on one occasion there was a panel discussion. These efforts were unsuccessful; Governors attended with reluctance or not at all. In the case of the United States, as Executive Director I found myself, in the status of a "Temporary Alternate Governor," representing the United States to discuss an Annual Report with which I had already dealt on the Executive Board. By about 1952-53, it was accepted that Governors came to Annual Meetings to make speeches, perform their minimum legal duties of voting on resolutions prepared in advance by the Management and the Executive Board, talk with each other, and do business with the bankers and others who attended by the scores as invited guests. Indeed, achieving a decent attendance in the meeting hall—especially in the afternoon—has always been a problem; and in latter years the Meetings have been shortened.

Not until the prolonged effort to "reform" the Fund and the monetary system, in the period from 1972 to 1977, was the role of the Governors considered once more, in an effort to find some way they could play a more active part. The result was the provision in the Second Amendment (Schedule D) for a Council of the Governors to "supervise the management and adaptation of the international monetary system." Pending the establishment of the Council, an Interim Committee is func-

tioning. It has met more often than annually, settling down to twice a year, and has demonstrated an ability to reach agreement on policy matters. For example, in Mexico City in April 1978 it considered an increase in quotas and the second issue of SDRs, and it agreed to them in Washington in September. The membership of the Committee (and of the Council when it is established) parallels the constituencies represented on the Executive Board.

B. The Executive Board

The Articles of Agreement provided for a Board of Executive Directors, whose number has increased as the membership has grown and is currently twenty-one. The five members with the largest quotas (at present the United States, the United Kingdom, Germany, France, and Japan) each have the right to appoint an Executive Director who serves at the pleasure of the member. If the first five do not include the one or two members whose currencies have been most used in the preceding year, then that country (or those countries) can appoint an Executive Director for a two-year term. Canada appointed an Executive Director in 1958 and Saudi Arabia did so in 1978. The remaining countries elect Executive Directors for two-year terms by arranging themselves in groups large enough to comprise the number of votes needed to elect. Each Executive Director is entitled to appoint an Alternate who, in the case of elected Directors, is often a national of one of the other members of the group that elected the Executive Director. From a strictly legal point of view, Executive Directors do not "represent" the countries appointing or electing them, are not paid by them, and are not legally subject to their control. For example, it has happened that an elected Executive Director has become *persona non grata* to the country of his nationality, but he may not be removed from office by that country. Nevertheless, in fact, Executive Directors *do* represent the countries that appoint or elect them.

The Executive Board is required to be in "continuous session" at the seat of the Fund. This represented a victory for the view, held especially by the United States, that Executive Directors should devote full time to the Fund and hence be available on short notice to make all necessary decisions. The opposing view was that they should be government officials at the policy level who would be available as needed or periodically.

When the Fund began operations, there were instances—notably Germany, Canada, Mexico, and Italy—of Executive Directors who came to Washington only occasionally, their Alternates being resident in Washington. Louis Rasminsky (an officer and later Governor of the Bank of Canada) was one such absentee Executive Director. He made a determined effort in the early 1950s to persuade leading members that a system of part-time Executive Directors operating at the policy-making level in their own countries would provide an Executive Board more closely in touch with governments. My opposition to this view caused

me some difficulty, since the then Secretary of the Treasury, George M. Humphrey, was more than half persuaded by Rasminsky's arguments.

Two considerations counseled the retention of full-time Executive Directors. One was that in the case of *elected* Directors the idea of an absentee Executive Director who was an official of one country was generally unacceptable to the other countries electing him. The other was the attitude of Per Jacobsson, who became Managing Director in 1956. Before he came to the Fund, Jacobsson had been given the idea that the Executive Board sat rather too heavily on the back of the Managing Director. But he soon concluded that he needed experienced and senior persons as Executive Directors who would be available at Fund headquarters at all times. Major issues could arise without warning, such as the sterling crisis resulting from the Suez venture, which landed in Jacobsson's lap almost as soon as he arrived.[3] The idea of part-time Executive Directors died thereafter and has never been resurrected, although Executive Directors do maintain close contact with the countries appointing or electing them. In some instances—notably the United Kingdom and France—the Executive Director is also attached to the country's Washington embassy as minister or counselor, and in a few instances the same person serves as an Executive Director in both the Fund and the World Bank. But for many years there have been no absentee Executive Directors.

Another problem was how the Executive Board would conduct its activities, whatever the division of responsibility between Board and Management/staff (dealt with in the next section). The question of voting was paramount, but there were other issues.

As is generally known, the Fund operates with weighted voting (that is, voting based mainly on size of quota), and in the early years, with fewer members, the United States had a decisive vote (30 per cent in 1949 and still 25 per cent as late as 1959, though just below 20 per cent in 1978). Was the Board to vote on most of its decisions, even though the Articles *required* a vote on only a very few matters? In the early years, voting was fairly often resorted to and the United States pushed some matters to a vote even though disagreement around the Board table was strong. One instance, in 1952, was the retention by Belgium of discriminatory restrictions aimed chiefly at the dollar area. The United States, with the support of the Chinese, Canadian, Egyptian, and Latin American Directors, proposed a reduction of such restrictions. Over the objections of the U.K., European, and Indian Directors, I called for a vote, and the proposal was adopted by 53,025 votes to 34,610.

Since voting was one way in which the preponderant influence of the United States was made apparent, a practical problem faced by the U.S. Executive Director was how to exercise his power without convincing the rest of the Directors that discussion was futile because the U.S.

[3] E. JACOBSSON, A LIFE FOR SOUND MONEY 299 (1979).

view would prevail. Sometime around 1953-54, the United Kingdom told Secretary Humphrey that it was especially unhappy at matters being pushed to a vote. By that time I was able to explain that voting was becoming rare (except where legally required) and that taking decisions by the "sense of the meeting" was increasingly the rule. As the years passed, decision by consensus became peaceful, although sometimes at the cost of very long debates. Indeed, there have been many instances where, notwithstanding a decisive majority in favor of a given proposal, decision was delayed to permit a search for common ground. An adjunct to the procedure was that Executive Directors often requested that they be shown as opposing or abstaining, even though there was no formal vote on a decision.

C. Relations between Executive Board and Management/Staff

Once it was decided that the Executive Directors were to serve in Washington on a full-time basis, what were they to do? What was to be the division of function between them and the Management/staff? The Managing Director was clearly responsible for the day-to-day operations of the Fund and the direction of the staff, but in the first decade there were areas of activity for which the operating responsibility was not clear.

One issue was leadership in Fund missions to member countries or to represent the Fund in meetings of other international organizations. In early years, Executive Directors headed certain missions—for example, to represent the Fund during the negotiations on an International Trade Organization and on subsequent missions to the GATT. But it became apparent that no single Executive Director could represent the Fund acceptably—something akin to conflicts of interest could arise. Fund missions came ultimately to be composed exclusively of members of the staff (and the Managing Director at some ministerial-level meetings). This was, in fact, the practice almost from the beginning with regard to all missions to member countries. However, the Executive Director elected or appointed by the country concerned had a direct interest in such missions, since they deal with important economic and financial matters, so the practice developed that he or his Alternate would be present at most sessions, although not as a member of the mission.

The relationship between mission and Executive Director has not been free of awkwardness and, at times, friction. Responsibility for the negotiation rested with the mission chief, and the report to the Executive Board would be prepared by the mission and would not be seen in advance by the Executive Director or the country. Hence the Executive Director had to be considered to be participating by invitation of the member country and, in effect, as a member of its negotiating team. Yet this was not always clear, and conflicting views expressed by the mission

chief and the Executive Director have sometimes caused confusion. For example, when the negotiation concerned a stabilization program and possible use of Fund resources, the mission might press hard for certain lines of action, while the Executive Director might be less demanding. Countries in such circumstances on occasion have been uncertain as to which voice to heed. Moreover, there have been meetings between a mission and officials of the member country to which the Executive Director was not invited. In short, at times participation by the Executive Director has given rise to difficulties, while at others his close relations with local officials have facilitated the mission's work.

A major—indeed the most important—range of issues in the early years of the Fund concerned internal procedures. What sort of oversight, if any, would the Executive Board exercise over the appointment or discharge of staff? How would the papers and reports submitted by the Management be handled by the Board? Would Executive Directors make proposals or would Board consideration generally be based on Management proposals? Would Executive Directors be privy to all information reaching the Fund? Each of these has more recently surfaced for renewed consideration.

It was not easy to answer those questions and thus determine how the Fund would operate. Executive Directors served full time, they were conscious that the Articles of Agreement gave them major powers, and many of them wanted to be activists. Nonetheless, in the end, the result was a strong Management/staff and an Executive Board that acted largely on Management recommendations—which is not to say that the recommendations were invariably approved, especially when matters of policy were involved. But the evolution which led to that outcome was not painless.

The Articles made it explicit that the Executive Board would engage a Managing Director, and the same procedure was followed when the position of Deputy Managing Director was established, except that the Managing Director proposed the candidate. The appointment of an American as President of the World Bank made it inevitable that the Managing Director of the Fund would be a non-American. It was less inevitable that he should be a European, but—given the power structure—that became the unwritten rule, although each time a new appointment has been made there have been challenges behind the scenes. There have been suggestions that a slate of possible appointees should be presented for discussion by the Board, but it has been accepted that no suitable candidate would wish to be the subject of open debate. Accordingly, on each occasion names have been privately considered and a single person has finally been approached. A committee of the Board has then been appointed to negotiate terms of service, and its report has always been accepted. With such an informal hit-and-miss procedure, it is perhaps remarkable that Managing Directors, taken as a whole, have

been able and effective men, like Per Jacobsson, Pierre-Paul Schweitzer, and H. Johannes Witteveen. The latest, Jacques de Larosière, comes to the Fund from a notable career in France.

The Articles explicitly provided that the Managing Director was responsible for the organization, appointment, and dismissal of the staff, subject to the "general control" of the Executive Board. As for nationality, he is enjoined only to pay "due regard" to the importance of recruiting staff on as wide a geographical basis as possible, subject to the paramount criterion of technical competence. The Executive Board recognized early (after a few unhappy episodes) that it should not seek to debate staff appointments. Only two rules were set: First, the Board should be given written notice of the intention to appoint persons to positions above a stated rank or salary. Second, there has been an unwritten tradition that the director of an area department should be a national of one of the countries in the area. This latter understanding has in my view done much to win Fund acceptance in the less-developed countries.

Just as the Board recognized that it should not seek to challenge the Managing Director's appointments to the staff, he in turn has recognized that important ones should be privately reviewed with Executive Directors. For example, a director would not be formally proposed for the African Department without careful consultation with Executive Directors elected by the African countries, and because of linguistic and other aspects of Africa, there have been some intense discussions behind the scenes. But I do not recall any case in which a Managing Director felt obliged to propose the appointment of a particular person solely because of representations by Executive Directors, although that does not mean that such representations are without effect. In one important instance, the Managing Director privately sought suggestions from several countries for persons suitable to be director of an area department. The results were disappointing, so he pressed one country to come up with a first-rate name. He was not satisfied with the response, and, having rejected that name, insisted on a more senior and promising proposal, which he then accepted and submitted to the Executive Board.

Of course, Executive Directors have not been uniformly and invariably enthusiastic about the Managing Director's proposals. But they recognize that their suggestions should be made privately and that there is no practical alternative to accepting his formal appointments. I do not know of a single instance during my twenty-five years in the Fund in which the Managing Director withdrew a proposed staff appointment because of objections by the Board, although this had occurred earlier in at least one important case.

The nationality distribution of the staff has caused remarkably little difficulty. In the first decade, there were objections, usually when the budget was reviewed, to "too many Americans" (not surprisingly, considering that in those years a very high percentage of the professional staff

was American). But time and energetic worldwide recruitment corrected the situation, although an Executive Director might from time to time complain privately to the Management that his country or area was underrepresented. Here, too, the fact that directors of area departments were nationals of the area has been helpful. I recall an instance in 1966 when, as Deputy Managing Director, I was on an official trip in Africa, accompanied by the black African director of the African Department. In one country, the Finance Minister sharply complained about the sparsity of Africans on the staff. I was being placatory and reassuring, promising more diligent recruiting. My colleague, however, did not hesitate to challenge the Minister, arguing that suitably trained Africans were few in number and were in high demand in Africa.

The Executive Board soon came to realize that it would have to depend on Management/staff to prepare papers and reports, either at the request of Executive Directors or, more usually, on the initiative of the Managing Director with the advice of the staff. The important questions were how the Board would treat those papers and whether the Board would act on its own motion without a Management-sponsored paper or recommendation.

One issue was whether the Board would seek to revise staff papers or reports. The answer that gradually emerged was that it depended on the type of paper. Policy papers or the Annual Report could be and usually were discussed in detail—even line by line—by the Board, after which the staff prepared revised drafts. Reports on country consultations, including those recommending use of Fund resources, were not to be revised unless actual errors were found. The Executive Director, speaking on behalf of the country concerned, could and usually did submit his own and the country's comments, which might challenge the staff report. The draft decision for a member subject to Article XIV, which included a summary of the main conclusions stemming from the consultation, was subject to review and change by the Board, even though the staff might not be altogether happy with the alterations. With the advent of the Second Amendment, country consultations fall under new Article IV (which includes the mandate for "firm surveillance"), rather than under Articles VIII and XIV as before. The staff reports no longer include an evaluative draft decision. In its place, the Managing Director sums up the Board discussion, and this constitutes the Board's conclusion of the consultation.

One important and controversial issue in the early years was whether country-consultation reports should be seen in draft by the Executive Director concerned (and, hence, by the country). The Management/staff successfully argued that the whole consultation process would be frustrated if, in effect, the staff had to negotiate the contents of the report. The staff would do its best to record in the report the main elements of the dialogue between the mission and the country. But the time

for the country or Executive Director to dissent or elaborate was when the Board discussed the report. This was another important step in establishing the operational independence of the staff.

Another issue was whether the Board would act in the absence of a Management proposal. So far as policy matters were concerned, there was little difficulty. Executive Directors could and did submit their own ideas. But neither they nor their colleagues on the Board would expect to make a decision without receiving Management/staff views. In most instances, the Board would have before it a paper prepared by the staff.

What was important and for some years controversial was whether the Board would consider requests for use of Fund resources without first receiving a Management/staff analysis and recommendation. Understandably, perhaps, an Executive Director, with a country he represented pressing for action and the Management unwilling to make a favorable recommendation, might be moved to take the matter directly to the Board. In one early instance, when I was U.S. Executive Director, one of my colleagues told me he was planning to do so. My reply was that, unless the Board had received from the Managing Director a report and a favorable recommendation, I would vote no. My colleague did not follow through on his threat, and, so far as I am aware, that was the last time any Executive Director seriously made such a threat. This does not mean, of course, that the Managing Director and staff are left in peace to make their analyses and reach their conclusions. The Fund's mark of approval and use of Fund resources are matters of very great importance to countries, and considerable pressure may be brought to bear to persuade the Managing Director to come to a favorable view. But resisting such pressure is part of the Managing Director's job, and he is in a strong position because the Board has formed a tradition that it will not act in the absence of his recommendation.

A last issue in the evolution of the internal operations of the Fund concerned the confidentiality of information reaching the Managing Director and staff. Obviously, there can be no confidentiality if all such information is available to a Board of twenty-one Executive Directors and twenty-one Alternates who consider that part of their responsibility is to keep member countries informed. This issue was hotly debated in the early years of the Fund, the U.S. authorities taking the lead in insisting that their Executive Director had a right to be kept fully informed. The Board decided that Executive Directors were to be provided with all the information they requested. But, as a practical matter, Executive Directors realized that if *all* information supplied to the Managing Director were made available to the Board, countries would not supply information they regarded as confidential. In the par-value period, for example, the United Kingdom would supply up-to-date reserve data for the eyes only of the Managing Director and three or four of his aides. The practice thus became established over the years that Executive Di-

rectors would not ask for information supplied in confidence to Management and staff.

Not long ago, the issue arose again, as have many of those mentioned here, in a somewhat different form when the staff prepared, at the request of a member and without the knowledge of the Executive Director, a confidential report on an aspect of the country's current economic position. The Executive Director raised the issue of confidentiality, and the subsequent Executive Board review resulted in a reaffirmation of the earlier decision that Executive Directors were to be provided with the information they requested. At the same time, Executive Directors recognized the need for the Management to be able to preserve confidentiality when the member, as in this case, requested it. On his part, the Managing Director agreed to devise informal ways to keep the Executive Board as fully informed as was consistent with that need. This practical solution is important in the evolution of the Fund's ability to operate as a monetary authority.

D. Relations between the Fund and Member Countries

It was evident from the earliest days of the Fund's existence that ways would have to be found to develop close working relations with the member countries. The Fund lacked the explicit power and obligation to "exercise a firm surveillance" over the exchange-rate policies of members that were conferred upon it by the Second Amendment in 1978. But there were in the original Articles numerous obligations imposed on members and on the Fund, and these opened the door to the evolution of a consultation procedure that, by the time the Second Amendment was being drafted, amounted in fact to surveillance.

First, Article XIV permitted countries to maintain restrictions on payments and transfers for current international transactions during a "transitional period," a period which—despite numerous efforts to declare it terminated—is still considered to be continuing even in the amended Articles. But it also required members, starting five years after the Fund began operations, to consult with the Fund annually concerning the further retention of such restrictions. Hence, beginning in 1952 the Fund was able to carry out annual consultations with most members. Moreover, although there was some resistance, the staff was able to win acceptance of its view that the consultation could properly be concerned with a wide range of the member's financial, fiscal, and economic policies, since they were relevant to a judgment concerning retention of the restrictions. As explained above, the staff evolved the procedure of including in the consultation reports a draft decision that the Executive Board was asked to adopt. The decisions briefly summarized the main findings and frequently concluded that it was "feasible" (a favorite Fund word) for the country to reduce or eliminate restrictions.

There was a gap in this consultation process. Some countries (chief-

ly the United States, Canada, Mexico, and the countries of Central America) adhered to Article VIII. If an "Article VIII country" introduced restrictions on payments, it needed prior Fund aproval, and there could be consultations both then and periodically thereafter as long as the restrictions continued. But if it did not, there was no legal basis for a consultation unless it sought use of Fund resources. However, such countries were few in number and, except for the United States, not overly important. As for the United States, with its overwhelming economic power and its exchange system free of restrictions, there was little disposition on the part of the Fund to seek ways to consult.

But by 1959 the situation had changed: on December 28, 1958, ten countries, and later a number of others, formally adhered to Article VIII in consequence of their decisions to introduce external convertibility of their currencies. The Executive Board then decided that, although consultations with countries adhering to Article VIII were not mandatory, there would be "great merit" in periodic discussions between them and the Fund. The debate leading to that decision was strenuous, particularly on the issue of whether such consultations should, like Article XIV consultations, result in a formal "judgmental" conclusion. The controlling view, which as U.S. Executive Director I supported, was negative, and thenceforth Article VIII consultations, while in substance paralleling Article XIV consultations, did not include a decision containing recommendations for policy action like those in reports on Article XIV consultations. Nonetheless, the Fund was able by 1961 to have reasonably intensive consultations with virtually all of its members on the same issues of substance and more or less on an annual basis. (As earlier explained, Fund consultations now take place under the authority of new Article IV.)

Second, the more frequent use of the Fund's resources, discussed later, gradually gave the Fund another and more powerful influence on the economic and financial conduct of member countries. Nudging countries in the course of annual consultations to adjust their economic and financial policies so as to reduce or eliminate restrictions was useful and did produce some action. Nevertheless, it was easy for countries to dillydally, expecting that in a subsequent consultation the Fund would do no more than reiterate its pleas. But as the Fund developed the concept of conditionality in the use of its resources, it was able to negotiate undertakings of corrective action in the form of policy declarations and programs. There can be no doubt that this power to withhold approval of use of Fund resources has been an indispensable element in the evolution of the Fund as a "disciplinary" organization; nor can there by any serious question raised concerning its general effectiveness. Countries having serious payments difficulties not only needed to use Fund resources, but they came in many instances to discover that their access to money-market resources depended on obtaining the imprimatur of the

Fund. The most notable recent Fund success in this area of its activities was the long and difficult negotiation at the end of 1975, when the United Kingdom turned to monetary and fiscal restraint as a condition for a standby arrangement for SDR 700 million.

All of this is relevant to the new and explicit obligation contained in Article IV that the Fund "exercise firm surveillance over the exchange rate policies of members." With the combination of consultations on policy and negotiations on the use of resources, the Fund has for many years been carrying on surveillance of the policies and actions or nonactions of members with considerable success. But there have been limitations on the effectiveness of those procedures that may turn out to be limitations on the Fund's new explicit surveillance responsibility:

1. Since the Fund's most powerful leverage arises from its ability to set policy conditions on the use of its resources, it can find itself much less persuasive when it deals with a country that does not need to use the resources or is satisifed to use those drawing rights which lie within the unconditional or virtually unconditional range. This has up to the present time always included the United States and Germany and currently includes Japan.

2. Even when a country reaches agreement with the Fund on the measures it will take as a condition for using Fund resources, failure to perform adequately in the ensuing period may result only in expressions of regret on both sides. Further drawings against any unused portion of the agreed line of credit may not be available and the Fund may quietly let the country know that it should not seek new access to Fund resources unless it can give strengthened evidence of its ability to perform, but even this line of action has to be applied with understanding. Men and countries are fallible, and on very many occasions the Fund has given a country a second or even a third chance if support for a new action program seemed to be worth the gamble.

3. The Fund does have sterner sanctions. If a member is in a strong and persistent position of payments surplus, the Fund can, under Article VII, declare the member's currency to be scarce and authorize other members to impose restrictions against it. But early debate and resulting interpretation made it clear that this sanction was unlikely ever to be useful as a pressure on or a defense against a surplus country—indeed, it was not used even in the time of "dollar shortage." Two other sanctions on their face might look to be promising means of exerting pressure on countries to take the sorts of action desired by the Fund. One is to declare a member ineligible to use the Fund's resources if it is failing to fulfill obligations under the Articles of Agreement. The other is thereafter, in the event of continued deliquency, to terminate the country's membership.

As for the first, formal action to declare a member ineligible is so severe politically as to inhibit the Fund. It has always been the view of

Executive Directors that formal ineligibility should not be declared (and, except in the case of Czechoslovakia, it never has been). Neither would the Board be willing to adopt a decision that a member, because of failure or inability to perform, should be considered as not having access to Fund resources. Nevertheless, an informal and quiet suggestion to a member that it should not expect to use Fund resources may be very persuasive. That such suggestions come from the Managing Director or staff, not from the Board, emphasizes the strong role of the Management in matters relating to the use of resources.

The second sanction, terminating a country's membership, is, of course, even more extreme, and the Executive Board has only twice considered that a sheep was so black that it should not be allowed to run with the flock. One case was Czechoslovakia, and the other was Cuba. Czechoslovakia in 1953 changed the par value of the koruna without obtaining Fund approval, and it also failed to supply required information to the Fund. It said it was withholding information for reasons of national security—an excuse not considered permissible under the Articles. Czechoslovakia could have confessed to the first sin and agreed to supply the missing information, but it did not. In the Cold War atmosphere of that time, I was expected by the U.S. government to press for the application of sanctions in my capacity as Executive Director. I was successful in obtaining a declaration of ineligibility on November 4, 1953, and a recommendation to the Board of Governors, duly approved on September 28, 1954, that Czechoslovakia be required to withdraw unless it had purged itself of charges by December 31, which it failed to do. Czechoslovakia stated that it considered the forced withdrawal to be invalid and withdrew "voluntarily" on May 5, 1955. While no Executive Director voted against the procedure followed by the Board, six abstained, and there is no doubt that the majority felt that it was unwise to force the issue. Only the then powerful U.S. influence, plus Czechoslovakia's obduracy, carried the day. In retrospect, it was an action that the United States should not have pressed to conclusion, since it served only to force from the Fund a country which, because of an apparent U.S.S.R. ban, has been unable to rejoin. The other case, that of Cuba in 1964, was simpler, involving as it did a threat of ineligiblity (and of ultimate forced withdrawal) because of Cuba's failure to repay outstanding drawings within five years and to supply required information. What action the Board would have taken can never be known, because Cuba voluntarily withdrew. Czechoslovakia and Cuba fairly promptly negotiated financial settlements with the Fund.

The Committee of Twenty considered a range of pressures that could be applied to countries in surplus or in deficit,[4] but no additional pressures were included in the Second Amendment of the Articles of

[4] *See* INTERNATIONAL MONETARY FUND, INTERNATIONAL MONETARY REFORM, DOCUMENTS OF THE COMMITTEE OF TWENTY 153-56 (1974).

Agreement. The main point is that in practice the Fund has no formal sanctions that it can use to force members to comply with Fund policy or to take corrective monetary, exchange, or economic action. It can set conditions on the use of its resources only for deficit countries that need the resources. With surplus countries, the Fund must rely on suasion applied during the course of consultations and on the organized opinion of the Executive Board, Management/staff, and—possibly in years to come—the Interim Committee or Council of Governors. Thus an asymmetry in the Fund's panoply of powers that has long existed is likely to condition the effectiveness of its new surveillance duties.

As a concluding comment, it can be said that the Fund has developed close and effective relations with member countries. The Managing Director and senior staff have ready access to high officials, especially in treasuries and central banks, and the Fund's Resident Representatives in many countries become welcome confidential advisors. But it also has to be said that these relations have not been as influential in some large countries—notably the United States—as they should be.

IV. The Fund's Resources

The Fund was designed to perform two principal tasks: to assist members to finance payments deficits, and to monitor their exchange rates and policies. Even in pre-Bretton Woods days, these two had been seen to be closely related. It was intended that the Fund's resources revolve; hence the payments difficulties of members seeking Fund help should appear to be reversible (i.e., the disequilibrium should not be "fundamental"). By implication, the Fund had a proper interest in members' par values and exchange rates even though it could not under its Articles *propose* that these be changed. Yet to work out policies and procedures to govern the use of Fund resources, the subject of this section, and to deal with the complexities of exchange-rate adjustments and payments imbalances, the subjects of the subsequent two sections, have been the most complex and controversial aspects of the Fund's evolution.

Both in the planning stage and during the negotiations at the Bretton Woods Conference, access to Fund resources and subsequent repayments caused the most difficulty. This is not the place to recount the long effort to work out a compromise between the U.S. view that the use of Fund resources should be conditional and that repayment (or, to use the formal term, repurchase) should be at a set time, and the U.K. view that access to resources should be automatic and repayment should follow on the reversing of payments imbalances.[5] All that was agreed was that some sort of quantitative limit should be placed on the use of resources. The rest was the uneasy compromise reached in the drafting of

[5] *See* K. HORSEFIELD, *supra* note 1, at 67-73, 101-02.

Article V, and the whole issue had to be debated again in the early years of the Fund.

Article V said nothing about conditionality except that purchases of currency were to enable members to make payments "consistent with the provision of this Agreement." As to limits, it was more explicit: drawings should not cause the Fund's holding of the purchasing member's currency to increase by more than 25 per cent of quota during the twelve months ending on the date of purchase nor at any time to exceed 200 per cent of quota unless the Fund waived those limits. As to repayments, the Article set forth an "automatic" repurchase provision which (stripped of complex verbiage) required a member to utilize for that purpose half the net increase in its reserves during the Fund's financial year.[6] In addition, in February 1947 the Fund adopted a rule (G-5) by which in any month a drawing not exceeding 5 per cent of quota would be handled by simple written notification to Executive Directors.

There were deep disagreements over the intent and adequacy of the policy on use of Fund resources embodied in those provisions. To begin with, on April 5, 1948, following the advent of the European Recovery Program, the U.S. Executive Director (then Andrew N. Overby) pushed through the Board, after prolonged debate, a decision that in effect barred the beneficiaries of the ERP from using Fund resources. This decision, together with lack of agreement on policy, brought drawings almost to a halt. There were none in 1950 and only $77 million in the two years from October 1949 to September 1951. During that period, I used the strong U.S. position on the Board to block drawings, such as an attempt by the Netherlands, and to prevent the use of Rule G-5 as an opening to automatic drawings.

The debate over policy continued until agreement was finally reached late in 1951 and early in 1952 on the several elements of what became known as the "Rooth Plan" for use of Fund resources.[7] That prolonged debate centered on two major issues: whether the Fund could and should (1) set a limit on the period in which drawings could be outstanding and (2) impose conditions on drawings.

Even during the pre-Bretton Woods period, U.S. planners had emphasized that what they were seeking to establish was some sort of stabilization fund to assist countries in dealing with temporary payments deficits; they had mentioned five years as a suitable time period for drawings. Moreover, the Bretton Woods Agreement Act of 1945 (authorizing U.S. membership) required the U.S. Governor and Executive Director of the Fund to "obtain promptly an official interpretation by the Fund as to whether its authority to use its resources extends beyond . . . operations to afford temporary assistance to members. . . ." The Executive Board,

[6] This provision was greatly simplified in the Amended Article V.

[7] Ivar Rooth of Sweden was the second Managing Director of the Fund, from 1951 to 1956.

on U.S. motion, so decided on September 26, 1946. Accordingly, it should not have occasioned surprise when I proposed in the Executive Board in October 1949 that each member, when drawing, undertake to repurchase within five years. Nevertheless, there were objections from both Executive Directors and staff, partly on legal grounds but chiefly on the argument that the automatic-repurchase arrangement was adequate, based as it was on the idea that payments deficits would give way eventually to surpluses and hence to increases in reserves, which would be used to make repurchases. (It could, of course, be asked what assurance there was that payments positions would be reversed, and this moved the debate into the issue of conditionality.) The controversy over the time of repayment was settled by two decisions. First, agreement was reached on a new schedule of charges that reduced from seven to three years the time at which a member was required to discuss a repayment schedule. Second, Rooth proposed that repayment normally be made within three years and at the outside five years, and his proposal was accepted by the Board.

The question of conditionality was much more difficult, not least because, as indicated above, the Articles of Agreement were almost completely silent on the matter. United States officials were uncompromisingly of the view that a way had to be found for the Fund to require countries to accept performance criteria as a condition to a drawing. By 1951 it had become apparent that the virtual freeze on Fund operations was creating great resentment among members. After all, most of them had paid to the Fund in gold an amount equal to 25 per cent of quota and, if they had no assurance of access to Fund resources, they were worse off than nonmembers. Therefore, I asked U.S. officials to authorize me to propose in the Fund that countries be allowed to draw on virtually automatic terms amounts equal to their gold payments. I was turned down. The officials' opinion, with which I disagreed, was that the whole amount (about $400 million) would be quickly drawn. Within the Fund Board there was little enthusiasm for conditionality, not only on legal grounds but chiefly because Executive Directors did not believe the Fund should give to countries' economic and financial policies the critical scrutiny that conditionality implied.[8] At the same time, Executive Directors, Management, and staff recogized that the stalemate could not be allowed to continue. Members must receive some reasonable assurance of access to Fund sources.

It was hence with a sense of relief that in November 1951 the Execu-

[8] Lord Keynes had similarly argued. In an October 1943 letter to Professor Jacob Viner (who served intermittently as an advisor to the U.S. Secretary of the Treasury), Keynes said it would be very unwise to "try to make an untried institution too grandmotherly." In January 1944, in a report to U.K. ministers, he referred to the American intent that the Fund have wide policing powers and objected that these powers would apply only to countries in need, and hence not to the United States—another instance of Keynes's prescience. *See* K. HORSEFIELD, *supra* note 1, at 72, 74.

tive Board began a discussion of Rooth's proposals. The discussion led to a decision on February 13, 1952, that, with later elaboration, provided the framework within which the Fund's financial operations have since been conducted. First, as mentioned above, the proposals set the three-to-five-year rule for outstanding drawings. Second, the "gold tranche policy" was agreed upon. A country seeking to draw amounts equal to its gold inpayment, ordinarily 25 per cent of quota, which would not increase the Fund's holdings of the country's currency above 100 per cent of quota, would be given the "overwhelming benefit of any doubt." This curious phrasing, devised during a Board discussion, was intended to provide *de facto* automatic access to Fund resources and yet retain the right of the Fund to challenge the drawing, as was legally necessary. (The First Amendment of the Articles eliminated that legal difficulty.) As I had forecast during my earlier fruitless discussions with U.S. officials, there was no rush of countries to use this new assured drawing right, but it had an extremely beneficial effect on Fund relations with members.

The decision concerning drawings in what came to be called the "credit tranches" (each tranche being 25 per cent of quota) went far to establish the principle of conditionality. It said that drawings should not remain outstanding "beyond the period reasonably related to the payments problem" for which they were made. The Managing Director stated in the preamble to the decision that the Fund's attitude would turn on whether the problem to be met was of a temporary nature and "whether the policies the member will pursue will be adequate to overcome the problem within such a period." The decision opened the door for the Fund to use its resources to enable countries to finance payments deficits and at the same time to take the steps considered necessary and feasible to reduce or eliminate the deficits.

There was still work to be done. The next step, taken in August 1952, was to lay out the terms on which countries could negotiate standby arrangements (or lines of credit) with the Fund. These served two purposes: to give the member assured access to larger amounts in consideration of an agreed stabilization program, and to give the Fund the protection arising from its ability to phase the drawings, gearing them to performance. More debate was needed before the Executive Directors were fully reconciled to the conditionality inherent in this procedure. In the following few years, beginning with a standby arrangement with Peru in 1954, the Fund perfected the technique. The most notable step was the devising of the "letter of intent" from the country, setting forth the elements in its proposed stabilization program. This had two uses. It eliminated from the standby arrangement itself any details of the program and could be incorporated by a simple reference to the letter as being the basis for the arrangement. It also was signed by the appropri-

ate government officials,[9] which gave evidence that, whatever may have been the input by the Fund negotiating team, the result was the government's program and not the Fund's program. Moreover, since leaks could be anticipated, it left the government free to publish the letter of intent if it wished to. Needless to say, not every finance minister or central-bank governor has relished the privilege of signing a letter summarizing in some detail a program of action that is highly unlikely to arouse any popular enthusiasm and may even provoke violent public protests.

The final step was to establish gradations of conditionality, with liberal treatment in the first credit tranche and more rigorous expectations for corrective action in the subsequent tranches. The definitive version of this "tranche policy" finally emerged in 1959.

My experience as U.S. Executive Director was that this evolving policy on use of Fund resources ushered in a pragmatic approach by U.S. officials. I recall one case soon after the policy was adopted. I was seeking U.S. approval of a proposed standby arrangement for a substantial amount and was being opposed within the Treasury. Under Secretary W. Randolph Burgess decided in my favor, declaring that, in the light of the new policy, when the Fund Management and staff had negotiated what they considered to be a feasible stabilization plan and had put it to the Executive Board for approval, the United States would give its support.

That is not to say that U.S. officials sat passively waiting for Management proposals to be made. In the 1950s the U.S. voice in the Fund was decisive—indeed a task of the U.S. Executive Director was to keep that voice muted so as not to frustrate Board and Management/staff activity. The practical question in those years, in any prospective large use of Fund resources, was whether the United States would agree—and the answer was obtained by direct inquiry. The most notable example of direct discussion between a country and U.S. officials was the $1.3 billion combined drawing and standby agreement negotiated by the United Kingdom in the aftermath of the Suez incident late in 1956. This dramatic operation put the Fund on the map by demonstrating that it could handle a very large transaction and hence play a strategic role in dealing with an exchange crisis involving a major currency. It also got the Fund's new Managing Director, Per Jacobsson, off to an exciting start.

The decisive negotiation was between Viscount Harcourt (U.K Executive Director) and Secretary of the Treasury Humphrey. Lord Harcourt had not ventured to seek as much as $1.3 billion. He had tentatively suggested something like $750 million, divided between drawing and standby arrangement. In a private meeting with me, Secretary Humphrey (a major figure in the U.S. steel industry and not noted for his interest in world affairs) said he had always believed that if a big job was to be tackled, one should go all out. He then asked me what the

[9] *E.g.*, the minister of finance and governor of the central bank.

U.K. quota was. I replied that it was $1.3 billion. He asked if the Fund could handle a U.K. operation for that full amount. Taken aback, because I, too, would not have proposed so large an amount, I replied that of course it could, if he would authorize me to give support in the Executive Board. Armed with this knowledge of U.S. views, Lord Harcourt completed the negotiation with Jacobsson. The operation was successful, the run on sterling was stopped, and the United Kingdom did not make any drawings against the standby arrangement.

That method of operation fortunately has disappeared with the decline in U.S. dominance and the gain in Management/staff strength and independence. It can be contrasted with the long, difficult, and finally successful negotiation with the United Kingdom almost exactly twenty years later, which was handled by Managing Director H. Johannes Witteveen and L. Alan Whittome, director of the European Department. United States officials most certainly managed to be kept informed about the course of the negotiation, but there is also no doubt that the various judgments and the final decision rested with Management and staff.

Over the years, the Fund's resources have been vastly enlarged by successive quota increases, from $8.9 billion in 1958, prior to the first quota increase, to SDR 39 billion at present, and a further 50 per cent increase has been agreed upon by Governors. To that can be added an initial issue of SDR 9.4 billion and a recent second issue of SDR 14 billion over three years. Moreover, the Fund has from time to time added additional facilities to the standard drawing rights: the compensatory financing facility, the buffer-stock facility, the extended Fund facility, the special oil facilities of 1974 and 1975, and the supplementary financing facility of 1979.

These facilities, together with the automatic reserve (formerly gold) tranche, the very liberal first credit tranche, and the SDRs, have greatly expanded the assured access that Fund members have to unconditional or very lightly conditional resources. Nevertheless, the credit tranches remain important and the Fund's policy on the use of its resources continues to be a mixture of unconditional and conditional access.

That is as it should be. The Fund is intended to be a monetary authority and to impose a degree of discipline—to induce its members to deal with payments imbalances by taking appropriate corrective measures, and to provide financing of deficits while such measures are taking hold. The most effective leverage the Fund has is its power to permit or deny use of its resources. The setting of conditions is difficult, and especially so when the Management and staff conclude in the end that the action a country is prepared to take is inadequate. As Gilbert and Sullivan said so well, "A policeman's lot is not a happy one." But if the Fund is to play an effective role, rather than simply hand out money, its Management and staff must continue the extremely difficult and often lonely task of trying to persuade countries to "put their houses in order." Un-

happily, as stated earlier, the conspicuous weakness is that the Fund has no comparable leverage in dealing with surplus countries that do not need to use Fund resources or with deficit countries, like the United States, that avoid seeking to use the conditional tranches.

V. The Fund's Exchange-Rate Policy

If the Fund's resources are indispensable to its ability to function as an operating institution rather than a debating club, its exchange-rate policy and the administration of that policy give substance to its chief mission. That is why Article IV on Par Values and Article V on Transactions with the Fund were the core of the original Articles of Agreement. They continue to be so in the recently amended Articles, although the titles have changed: the new title of Article IV is "Obligations Regarding Exchange Arrangements," and of Article V is "Operations and Transactions of the Fund." Moreover, the two are closely linked. Use of the Fund's resources is explicitly limited to assisting countries to deal with temporary payments deficits; and, as the preceding section explained, within the range of conditionality the Fund requires that corrective action be taken. Whether or not such action needs to include some adjustment in par values or exchange rates depends, of course, on the circumstances of the case—on whether there appears to be substantial over-valuation of the currency that cannot be corrected by other lines of action such as fiscal and monetary restraint.

Exchange-rate policy was from the earliest stages of pre-Bretton Woods planning a central element in the Fund's purposes and in the obligations of members. It is not difficult to understand why this was so. The chaotic mélange of floating rates, multiple rates, and blocked currencies during the decade before World War II comprised an international monetary anarchy to which no one wanted to return. The desire to protect against that contingency gave the strongest impetus to the negotiation of the IMF Articles. Keynes (who proposed that par values be set in terms of bancor and changed only with the approval of the Clearing Union) and White (who proposed that par values be changed only with IMF approval) were in full agreement. During the long negotiations there was no disagreement with the proposal that the Articles should impose on members the obligation to declare and maintain a par value.[10] That rate was to be changed only to deal with a fundamental disequilibrium and, with minor exceptions, only with the approval of the Fund.

Two aspects of Article IV were to hamper the work of the Fund. One was the inclusion of an explicit provision that a change in a par value could be made only on the proposal of the member. The other was

[10] Maintaining a par value meant that the government would hold exchange rates within one per cent on either side of the par value.

the omission of any power for the Fund to approve, however temporarily, a no-par-value status.

The first provision meant that the Fund, in its evaluation of country situations, could not officially reach a conclusion that there was a need to change a par value. Various indirect approaches had to be resorted to, such as emphasizing the nature and magnitude of the payments imbalance, which made the work of Management and staff more delicate and complicated. Indeed, in the early years, Fund missions felt greatly inhibited about raising the issue of par-value adjustment. However, as time passed and the Management and staff gained experience and confidence, there was no hesitancy in adding the adequacy of the par value to the agenda for private discussion with a member. Notable examples involving the use of Fund resources are included in the next section. When no question of using Fund resources was involved, as when Pierre-Paul Schweitzer discussed continuing U.S. payments difficulties with U.S. Secretary of the Treasury John Connally in May 1971, he touched only very cautiously on the question of the exchange rate.

So the Fund—that is, the Management and staff—found ways to explore privately with a member the need for a change in par value, notwithstanding the fact that a formal proposal for change could be made only by the member. Moreover, the Managing Director could and many times did tell a country (or authorize a mission to do so) that it could not expect to use Fund resources to sustain a par value that overvalued the currency.

More difficult was the lack of any authority for the Fund to permit a country to cease supporting a par value and allow the exchange rate to fluctuate for a period, pending selection of a new par value. At first glance, it seems strange that such authority was not included in the Articles of Agreement. The explanation is that the system was intended to be one in which a country could (and should) change its par value whenever there was judged to be a "fundamental disequilibrium," a term appearing in the original Article IV and retained in Schedule C of the Amended Articles but never defined or interpreted by the Fund. No difficulty was anticipated in moving to a new par value once the decision to change was reached. When in 1968-69 agreement was reached on the First Amendment to the Articles (chiefly concerned with establishing SDRs), the opportunity to correct this gap was not taken. Again, the reason is clear. Despite the fact that storm clouds were gathering, devotion to the par-value system was still so uncompromising that there was objection to any formal recognition of even temporary justification for floating rates.

This led to an anomaly. In the cases of countries with a unified exchange rate, like Canada and Germany, the Fund could not approve a fluctuating exchange rate even for a temporary period. All that could be done was to adopt a decision recognizing the circumstances or, in more

grudging instances, simply taking note of the country's action. At the same time, under other provisions, the Fund could and often did approve multiple rates that involved fluctuating rates; Brazil, Colombia, and Chile are examples. Indeed, as years passed, the Fund on numerous occasions permitted the use of its resources in support of stabilization programs in countries where the par value was not effective and exchange rates fluctuated.

The Fund was thus operating on two fronts in the twenty-five years before the complete breakdown of the par-value system in 1973. Its devotion to the par-value system was undeviating, even though some staff economists were arguing the case for greater flexibility[11] and it pressed countries to establish and maintain effective par values but to change them when need arose. At the same time, many Fund members, chiefly the less-developed countries, did have multiple rates[12] and the Fund was able to recommend and to approve fluctuating rates. For example, the "crawling peg" system adopted by Brazil in 1969 was one that staff missions had long advised.

This is not the occasion to recount at length the long controversy over fixed versus fluctuating rates. In considering the Fund's exchange-rate policy, it suffices to say that there was nothing wrong in theory with the "fixed but adjustable" concept embodied in the par-value system. The difficulty lay in the practice. The Fund discovered very soon that par values were "sticky"—they took on political significance, and to change them could cause finance ministers to resign and governments to fall. Yet on every occasion over the twenty-five years on which the Fund reviewed the system, the conclusion was the same—there was no better alternative. In 1951, for example, the *Annual Report* contained a long discussion of par values and fluctuating rates.[13] It pointed out that the system was "one of stability of rates rather than rigidity" and concluded that a system of fluctuating exchange rates was not a satisfactory altenative to the par-value system. In 1969, the *Annual Report* concluded that the par-value system was as beneficial for the world as when it was written into the Articles twenty-five years earlier.[14] Even more striking was the Fund's most elaborate analysis of the system in 1970—*The Role of Exchange Rates*—which concluded with the assertion by the Executive Directors that "the par value system retains its validity." This time, however, there was a new note. They stated that they had "not come to a final view on the various issues raised by temporary deviations from the par value regime" and that they intended to give them further consideration. Before they had an opportunity to do so, however, the Fund was assaulted by the events of 1971-73.

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11 Some staff economists argued for such changes as wider margins and authority to legalize periods of fluctuating rates.

12 These multiple rates often existed alongside nominal but ineffective par values.

13 INTERNATIONAL MONETARY FUND, ANNUAL REPORT 33-41 (1951).

14 INTERNATIONAL MONETARY FUND, ANNUAL REPORT 32 (1969).

Nevertheless, the Fund managed to operate with a kind of dual system. Most leading countries and many lesser ones had effective par values. While there were numerous instances of reluctance to change them, the Managing Director and staff were successful in pushing some countries into change, and others made changes without such nudging. In other instances, countries were guided into periods of rate fluctuation notwithstanding the legal difficulties. Germany, for example, when faced with a heavy capital inflow, withdrew its support for the par value of the deutsche mark on September 29, 1969, and did not declare a new, slightly appreciated value until October 24. What is notable is that some weeks earlier Schweitzer and some senior staff members, in the course of long discussion with Minister of Economy Karl Schiller, had recommended that, in view of temporary political inhibitions (a pending election), the best course would be to let the deutsche mark float for the time being, and had assured Schiller that the Fund would be "understanding" even though it could not legally approve.

VI. The Fund and Currency Crises

The most useful way to complete the discussion of the Fund's evolution in methods of administering its exchange-rate policy and in the associated use of its resources may be to track through a series of crises involving payments imbalances and major exchange-market pressures to see what role the Fund played and how it did so. Over the years the Fund has been involved in many difficult payments situations in such countries as Brazil, Chile, Turkey, Indonesia, and Australia. The seven cases described in the following pages[15] have been selected because of their importance and the light they throw on Fund evolution.

A. The Par-Value Changes of 1949

In view of the devastation of Europe in 1946, selecting meaningful par values for currencies was a task that might better have been delayed. However, Article XX made it necessary for initial par values to be established before the Fund could begin financial operations. So, despite misgivings, on September 12, 1946, the Fund issued a formal request to members to communicate par values, and during the following three months the proposals were considered and accepted. Almost all of them were the exchange rates existing at that time.

It was not a matter for surprise that Europe's war-torn economies were unable to generate exports in adequate amounts. The huge and undamaged U.S. economy dominated world trade, the "dollar shortage" had emerged, and by 1949 U.S. officials both in the Fund and elsewhere began to question the adequacy of the par-value structure. On April 6,

[15] The seven cases involve the par value changes of 1949, the French franc and the pound in 1956, the Yugoslav dinar in 1963 and the rupee in 1966, sterling in 1967, the franc-deutsche mark crisis of 1968, the Canadian dollar in 1970, and the U.S. dollar in 1971-73.

1949, prodded by me in my capacity as U.S. Executive Director, the Executive Board reluctantly embarked on an examination of that touchy issue. The Managing Director, Camille Gutt, carried on exploratory private talks with some European countries in May and June—with no evident result. In August I proposed that a Committee of Executive Directors be set up to examine the international payments situation. This was done, with the United Kingdom dissenting. After nineteen meetings, the Committee agreed on a report which concluded that member countries "should review their rate structure."

United Kingdom officials privately made it clear that they considered the U.S. authorities to have mounted an assault on the pound sterling (which, in a sense, they had, since the par value of the pound was at the center of the situation). But I nonetheless intended to press for consideration of the report before the Annual Meeting, which was to take place late in September. Suddenly, Secretary of the Treasury John Snyder instructed me to seek a delay. This was acutely disturbing, since I had pressed my allies on the Executive Board (and especially the Chinese Director, who was Chairman of the Committee) for rapid action. When I voiced by concern, Secretary Snyder, first swearing me to secrecy, told me that Chancellor of the Exchequer Sir Stafford Cripps had informed him that the U.K. Government had decided to devalue the pound sterling and had asked him to delay further debate in the Fund. Armed with this information (but unable to give my reason), I proposed on September 8 to postpone consideration until after the Annual Meeting, and the Executive Board agreed.

The scene was thus set for the devaluations of 1949, touched off by the devaluation of sterling on September 17; fifteen other countries followed suit in three days. The Fund was ill-prepared to play an effective role. True, Gutt's private talks in May and June and, under pressure from the United States, the examination in the Committee, counted for something. But there was no prior consultation between any organ of the Fund and the United Kingdom and other devaluing countries, and the selection of the new par value for sterling—the key to the whole exercise—was made within the U.K. Government. When the proposals for new par values reached the Fund, neither the Executive Board nor the Management had any other option than to accept them. Moreover, it would have been damaging if the Board had adopted critical or noncommittal decisions. Following the Annual Meeting, the Board considered and approved the report that had been tabled on September 8, although there was a substantial vote against it.

An adjustment of the exchange rates of major currencies against the dollar was necessary by 1949 if any progress was to be made in reducing payments imbalances and laying a basis for progress—however halting—toward currency convertibility in Europe. From that point of view, U.S. initiative in forcing the issue was justified. But the lesson to be learned

from the whole exercise was that the Executive Board was not the level at which such an initiative should be taken. Besides the legal impediment (the reservation to members of proposals to change par values), it was amply evident that a change in a par value was a sensitive political and financial issue that could not be dealt with by an Executive Board which, however discreet, felt bound to keep many governments fully informed.

Never again did the Executive Board openly discuss the adequacy of individual par values prior to the submission of a formal proposal by the member. It limited itself to more general discussion of the world payments situation, based on staff analysis. If the Fund was to play a role, and everyone realized it should even though not all countries acted as if they did, consultation would have to be entrusted to the Managing Director and staff. Moreover, confidentiality would have to be maintained even though the Executive Board had determined that it had a right to be informed.

B. The Franc and the Pound, 1956

There were two important exchange crises between 1949 and 1966. One was the negotiation with France leading to a standby arrangement for $262 million in October 1956. This amount was fully utilized by June 1957, when the franc came under renewed pressure during the Suez venture. This negotiation was handled very largely in Paris by Managing Director Jacobsson.[16] There was no suggestion of a need to change the par value, and Jacobsson's main task was to work out with the French authorities a stabilization program, which they presented to the Chamber of Deputies.

In contrast was the dramatic U.K. drawing of $561 million and standby arrangement for $738 million. The negotiations were in effect divided between Secretary of the Treasury Humphrey, who, as explained earlier, agreed with Lord Harcourt on the amount the United States would be prepared to support, and the Managing Director, who was concerned with terms. That was the last important occasion, so far as I can recall, when conversations directly between U.S. authorities and another Fund member resulted in bypassing proper IMF channels. Happily, by 1960 the time had passed when countries considered that an approach to U.S. officials to find out whether they would be prepared to support a drawing or standby arrangement was more important than discussions with the Fund Management and staff.

C. Emergencies: Yugoslavia, 1963, and India, 1966

Fund policy on use of resources, as it had evolved in the 1950s, provided for near-automatic access in the gold tranche and easy access in the first credit tranche. Beyond that point, countries were expected to agree

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[16] See E. JACOBSSON, *supra* note 3, at 292-96.

with the Fund on an action program that could in some cases include a change in the par value. The policy did not provide for situations in which a country faced a disaster or a severe decline in export earnings that could have a serious adverse impact on the balance of payments.

To meet problems arising from a shortfall in export receipts, the Fund in 1963 established a compensatory financing facility, revised several times later and widely used by countries suffering from a failure of export crops or a decline in prices of major exports. But on several occasions the Fund was confronted with emergency situations in which the balance-of-payments impact was more widespread, causing increases in imports as well as losses of export income. One of these occurred in Yugoslavia in 1963, and another in India in 1966. In both cases, the Fund found ways of assisting even though the outstanding drawings of each country exceeded the gold tranche and first credit tranche.

Yugoslavia, in July 1963, was struck by an earthquake that virtually leveled Skopje, one of its important industrial cities. Seventy per cent of the buildings and factories were destroyed or heavily damaged, as were public utilities, railroads, and highways.

Fund relations with Yugoslavia had not been notably warm. A Fund mission in March/April 1963 had been politely received, but notwithstanding an obvious need to deal with domestic and external imbalances, the discussions had been inconclusive. Struggling to cope with stresses in its centrist economic system, Yugoslavia was not persuaded that the Fund could assist in finding solutions. The Fund's view of the situation was that Yugoslavia had drawn $75 million in 1961 in support of a program that had not yet been effective. Additional Fund assistance would have to be preceded by a critical overhaul of the program, which did not appear to be feasible.

Confronted by the Skopje disaster, the Yugoslav government sent appeals for help to governments and international institutions, including the Fund. The Fund Management and staff at once decided that a way should be found to assist. On August 22 a senior officer was sent to assess the impact of the destruction on Yugoslavia's payments position both from loss of export production and from the need to import materials for reconstruction. Based on those findings, on September 24 the Management recommended and the Executive Board approved a drawing of $30 million together with a two-year postponement of a $15 million repayment that would have become due in January 1964. Except for a reaffirmation of intention to execute the 1961 program, Yugoslavia gave no new commitments to the Fund.

This prompt response led to greatly improved relations between the Fund and Yugoslavia, to a mission in 1964, and, in June 1965, to a new program that included a major adjustment in the exchange-rate structure and a new standby arrangement.

India, in 1966, was faced with a major drought, which led in Febru-

ary to negotiations in Washington between Managing Director Schweitzer and a team of Indian officials headed by Reserve Bank Governor P.C. Bhattacharyya.

India had faced serious economic and financial difficulties for several years and in March 1965 had entered into a standby arrangement with the Fund for $200 million. But improvement was slow: import restrictions were affecting industrial production; exports failed to increase; the current-account deficit, which had increased from $818 million in 1963 to $1.2 billion in 1964, rose further to $1.4 billion in 1965; and India faced repayments of $125 million to the Fund. At the same time, as in the case of Yugoslavia, early action by India to strengthen its stabilization program was not feasible, although the Indian team assured Schweitzer that the need for action was recognized by the Indian government. The two staff groups agreed that a number of areas would have to be considered in the months ahead—the fiscal position, the level of credit expansion, and the exchange rate. But the Indian team emphasized that, for several compelling reasons, a suitable new program could not be worked out at that time.

The negotiations accordingly turned to the feasibility of providing special emergency assistance based on the impact of the drought. The two groups of technicians calculated that the direct balance-of-payments impact of the drought in 1966 would be in the neighborhood of $180 million, based on the need to import an additional 5 to 6 million tons of wheat and a substantial tonnage of rice at higher-than-normal freight costs. Schweitzer agreed to propose to the Executive Board a drawing of $188 million, with repurchase to be completed by the end of 1967, a much shorter period than the usual three to five years, since the drawing was to be made in April 1966. There would be no policy commitments, but India agreed to reduce its outstanding obligation to the Fund by $75 million before the new drawing, and both sides understood that at some point—not too far ahead—India would need to consider additional corrective measures.

These two cases of financial support for countries faced with emergency payments needs but unable at the time to meet standard criteria governing use of IMF resources are an indication of the Fund's developing maturity and its capacity to devise *ad hoc* ways of dealing with urgent problems.

D. The Sterling Crisis, 1967

The pound sterling struggled through a series of crises that brought the par value of $2.80 per pound under heavy pressure. One crisis was the aftermath of the Suez incident in 1957, which resulted in the dramatic commitment of Fund resources amounting to $1.3 billion referred to earlier. During other crises in 1964 and 1965, the United Kingdom made large use of Fund resources. In 1964 the Federal Reserve Bank of

New York took the lead in assembling a package of aid amounting to $3 billion, all of which was used in 1964-65.[17] The United Kingdom got through 1966 with new assistance from other central banks. But despite budgetary, credit, and other measures, trade results (magnified by shipping strikes) were poor and pressures on sterling were usually strong.

In the spring of 1967, sterling rallied and the United Kingdom made very large repayments of the credits used in 1966. But sterling again came under pressure, incited by worsening trade figures in April-May and again in September. This set the scene for the crisis of 1967, which culminated in November in a par-value change to $2.40 per pound.[18]

During the Annual Meeting of the Fund in Rio de Janeiro in September, Sir Leslie O'Brien, Governor of the Bank of England, had alerted Schweitzer to the developing dangers threatening sterling. October and early November provided no relief from unremitting selling pressure and from the need for large-scale official support. Coombs reports that at the meeting of Governors at the Bank for International Settlements (BIS) on November 11, O'Brien asked if they would support U.K. efforts to raise new medium-term credits (earlier credits had very short maturities). If not, the United Kingdom would have to devalue or let sterling float. All he obtained was their agreement to support a U.K. application to the Fund and the support of "nearly all" Governors for a devaluation. Coombs concludes that by the end of the meeting "the die was now cast for sterling devaluation."[19]

On the same day, a group of senior U.K. officials went to the Fund to initiate discussion of new support. The ensuing meetings, which extended to November 17, were important in several respects. First, sterling was still a reserve and important trading currency, and there was reason to anticipate that a devaluation would bring in its wake a number of other devaluations, as had the sterling devaluation in 1949. Second, as the discussion at the BIS shows, access to Fund resources was bound to be an important factor in any U.K. decision concerning devaluation. Third, the standby arrangement approved by the Executive Board on November 29 contained several elements that provoked subsequent revision of the standard terms for standby arrangements.

The discussions were difficult. The trade figures had been reasonably good during the summer, but the deficit in September was the largest in fifteen months, and the October deficit (fed by a long dock strike) was $300 million—the largest ever. Heavy official support was necessary during October, and an increase of one-half of 1 percent in Bank Rate

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17. See C. COOMBS, THE ARENA OF INTERNATIONAL FINANCE ch. 7 (1976).

18. The official IMF record, on which this account is largely based, is in 1 M. DEVRIES, *supra* note 1, at 338-43 and 431-37. See also C. COOMBS, *supra* note 17, at ch. 8; J. BROOKS, BUSINESS ADVENTURES ch. 11 (1971); and R. SOLOMON, THE INTERNATIONAL MONETARY SYSTEM, 1945-1976 ch. 5 (1977).

19. C. COOMBS, *supra* note 17, at 148.

disappointed the market. Schweitzer made it clear at the outset that he would be much concerned to know what corrective measures the U.K. Government intended to pursue. He also emphasized that the full support of the participants of the General Arrangements to Borrow would be essential, since the Fund would need to borrow in order to finance any large U.K. drawing or standby arrangement.

Over the weekend of November 11-12, the discussions in the BIS and the IMF made it clear that U.K. officials considered that $3 billion would be needed if the par value was to be defended. A standby arrangement of that size would bring U.K. use of Fund resources to 266 per cent of quota, which was not a practical possibility. Schweitzer informed Evan Maude, the U.K. Executive Director, that he would be prepared to recommend to the Executive Board a standby arrangement in the amount of $1.4 billion, to be coupled with a sterling devaluation and an adequate domestic program. The Fund staff's judgment concerning the size of the devaluation coincided with the figure of 14 per cent which, according to Coombs, was mentioned by O'Brien at the BIS meeting. Schweitzer and the staff believed that, while there would be a substantial number of devaluations by other countries, parity changes among Common Market countries could be avoided.

While these discussions continued from Monday through Friday, November 13-17, selling pressure on sterling was intense and the United Kingdom was drawing heavily on swap lines and reserves. The market was clearly expecting a devaluation.

It was the view of Schweitzer and, it became clear as the discussions continued, of U.K. officials that the proposed $1.4 billion standby would be effective only if it was coupled with an adequate program and a devaluation. At the same time, it also became clear that other support to raise the fund to $3 billion was not going to be available.

Finally, at midday on November 17, Maude gave Schweitzer a memorandum from Chancellor of the Exchequer James Callaghan notifying the Fund of a change in the par value from $2.80 to $2.40 per pound sterling, and of the U.K. Government's intention to request a standby arrangement in the amount of $1.4 billion. Schweitzer sent a mission to London on November 18 to discuss the terms of the proposed standby. It was agreed that the Board would be alerted at 8 A.M. on Saturday, November 18, and provided with a staff paper at 9 for a meeting at 10.

During the day on Saturday, Schweitzer and senior staff members conferred by phone with financial officials of a number of countries in an effort to hold down the range of other devaluations. In the event, between November 18 and 27, fourteen countries devalued their currencies, ten of which were closely linked to sterling. No Common Market country devalued, and Australia and Japan in the end decided not to.

The remaining task was to negotiate the standby arrangement, in-

cluding the elements that Schweitzer and the staff wanted to have included in the U.K. program of corrective action. The negotiation was completed in record time and the Executive Board approved the standby arrangement on November 29. The discussion between the U.K. authorities and the mission had focused chiefly on the issue of a reduction in public expenditure and a limit on Treasury borrowing. The standby in the amount of $1.4 billion brought U.K. access to Fund resources close to 200 per cent of quota. No use was made of the standby until June 1968, when the entire amount was drawn.

The U.K. program did not include quantitative limits on public expenditures or credit, nor was there any phasing of drawings: the United Kingdom could draw any amount at any time. As Schweitzer had anticipated, Executive Directors, especially those representing less-developed countries, were quick to point to the less onerous terms imposed on the United Kingdom, although they agreed that a standby arrangement in support of a major convertible currency need not include any phasing of drawings. As a result, there was an extensive review of standard terms for standby agreements later in 1968, with the aim of assuring uniform treatment of all Fund members. The next U.K. standby arrangement, in 1969, conformed to those terms.[20]

This involved and difficult U.K. case was illuminating in several respects. First, it demonstrated that the Managing Director, by setting the terms on which he would be prepared to recommend use of Fund resources, could influence a country to devalue. Of course, if the country's currency was important, he would want to know that the financial officials of other leading countries agreed that continued support of the existing par value was not likely to be successful. Second, it demonstrated that a negotiation could be carried out without a breach of confidence and without Executive Directors' insisting on being kept informed, although the countries in G-10[21] did at least in general know what was going on. Third, it demonstrated that any treatment for one country markedly more lenient than that accorded to others would be quickly called into question; while Executive Directors would approve that case, they would demand a review of policy.

E. The Currency Crisis, November 1968

In 1968, a crisis centering on the French franc and the deutsche mark culminated in an abortive meeting of G-10 in Bonn on November 20-22. The meeting produced no useful results, but it is included here for two reasons. It was the first case of multinational consideration of exchange rates or par values at the ministerial level. And it was an un-

[20] More details regarding the arrangement may be found in M. DEVRIES, *supra* note 1, at 343-48.

[21] The G-10 is the Group of Ten, the major industrialized countries associated with the General Agreements to Borrow.

happy example—to be repeated at the Smithsonian Conference late in 1971—of the complications and frustration arising when the Fund participated in an exercise completely outside its control.

French difficulties had their main roots in the "events" of May 1968, which involved widespread riots and strikes. By November it was evident that the French franc was under heavy pressure. On November 15 the French Executive Director, Georges Plescoff, informed me, in my capacity as Acting Managing Director, that reserve losses had been as much as $100 million per day and could not long be sustained. He also repeated the declaration President de Gaulle had made that devaluation was not being considered. Other measures, even including exchange controls, were possible. Schweitzer was on an official mission in Africa, which in subsequent days was to give rise to frantic efforts to get him to Bonn to participate in the hurriedly convened meeting.

On the same day the German Executive Director, Guenther Schleiminger, reviewed developments with me. Germany was under increasing external pressure to revalue, but there was no support for it in Germany. German officials believed that the surplus in the current account would begin to moderate and that little else could be done with fiscal and monetary policy. We talked briefly in strict confidence about a possible range of revaluation. Schleiminger said anything much beyond 5 per cent was not feasible; I replied that the staff view was that a change of 10 per cent would be more convincing. In the course of the day, something like $1 billion moved into Germany, and sterling was under selling pressure.

On Sunday, November 17, at a BIS meeting of central bankers, the possibility of a revaluation of the deutsche mark and a devaluation of the French franc was discussed. By November 18, Fund officers in Basel and Paris reported that central banking opinion was that parity changes involving the deutsche mark (up) and the French franc (down) were in the offing. During the day I learned that German officials had decided *not* to revalue the deutsche mark, but would change the border taxes. I then communicated to Schleiminger the staff's view that if the French franc were devalued and the deutsche mark remained unchanged, pressure would shift to sterling. At the end of the day, Minister Schiller, who was Chairman of G-10, called a meeting for Wednesday, November 20, in Bonn. Foreign-exchange markets were to be closed in France, Germany, and the United Kingdom for three days. Schweitzer traveled to France and on to Bonn on Wednesday, and other senior Fund officers proceeded to Bonn.

The resulting conference was unplanned and chaotic, with only finance ministers at some sessions, central-bank governors admitted to others, and separate meetings of Common Market ministers.[22] At some of the sessions, no staff members were present, and there were no staff

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22 See C. COOMBS, *supra* note 17, at 182-86.

papers. The consensus (except for the Germans) was that the proposed tax changes would be inadequate. But as to what, if any, parity changes should be made there was wide disagreement. The most positive action was agreement on credit lines of $2.1 billion to be provided by ten or more countries plus the BIS to enable France to support the franc. There was discussion of a possible franc devaluation of 10 to 15 per cent, with Schweitzer recommending 11.11 per cent. Ministers met alone from the evening of November 20 to the early morning hours of November 21; the discussion was reliably reported to be "frantic."

On November 22, Fund officers in Bonn reported to me that Germany's decision not to revalue was firm, and—notwithstanding various rumors—French officials had *not* decided to devalue the franc. I then informed the Executive Board (which, unless individual Directors had private communications, was not aware of developments) that there was as yet no indication that action by the Fund would be needed. Finally, on November 23 President de Gaulle announced that there would be no change in the par value of the French franc.

Following this untidy episode, there were some months of relative calm. But by May 1969 there were heavy movements of funds into Germany and out of France, and these continued during the summer. On August 10, the franc was devalued by 11.11 per cent, the figure calculated by the Fund staff at the time of the Bonn meeting and recommended by Schweitzer. The new rate was consistent with the pledge given by the French Finance Minister at that meeting that any devaluation would not exceed 11 per cent. Shortly thereafter, the Fund approved a standby arrangement for France for the very large amount of $985 million.

It requires no special experience to conclude that the Bonn Conference of 1968 was not the way to arrive at judgments concerning the validity of the exchange rates of individual countries. Finance Ministers were ill-equipped to spend hours arguing very nearly in public about exchange rates. From the Fund's point of view, the whole proceeding was unsatisfactory. There was no opportunity for preparation and there was no confidential discussion with the countries concerned. Moreover, if par-value changes had resulted, they would have been presented to the Fund as *faits accomplis*. The best that could be said was that the Managing Director was a participant and could, with the help of his staff team, give advice.

F. The Canadian Dollar Crisis, 1970

A short-lived crisis confronted the fund in 1970, when, for the second time since joining the Fund, Canada decided to abandon maintenance of the par value of the Canadian dollar after eight years. The background of the decision was the shift to a current-account surplus

early in 1970 and a persistent inflow of capital with which the Bank of Canada was finding it difficult to cope.

On May 27 the Canadian Executive Director, Robert Johnstone, described the developing situation to Schweitzer and informed him that Canadian officials were considering possible lines of action and did not rule out letting the Canadian dollar float. Johnstone was flying to Ottawa the next day and asked for Schweitzer's views. Later that day, after discussion with the staff, Schweitzer reviewed the Canadian situation with Johnstone, arguing that the current-account surplus was of recent origin, that it was premature to conclude that there was a fundamental disequilibrium, and that there were other ways the Canadian authorities could offset the impact of capital inflow if that was the main problem. He strongly advised against allowing the currency to float. The long discussion ranged over a series of alternatives to a floating rate. Johnstone pointed to the difficulties he thought the alternatives presented, emphasizing that the continued inflow of funds threatened Canada's anti-inflationary efforts. He assured Schweitzer that he would report his views in Ottawa.

On Saturday, May 30, Johnstone, just returned from Ottawa, informed Schweitzer that the increase in reserves in May was $600 million, and since the end of 1969 was $1.2 billion. In addition, the Bank of Canada had been buying U.S. dollars forward. The indication when he left Ottawa was that a move to a floating rate was likely, but the decision had not yet been taken. A change in the par value had been rejected, because the situation was fluid—exports were stronger than expected, there was a large speculative element in the capital inflow, and it would not be feasible to select a new par value with any assurance that it could be maintained. Schweitzer and staff members reiterated that there were ways of dealing with the capital inflows without abandoning the par value. In a telephone conversation with Louis Rasminsky, Governor of the Bank of Canada, Schweitzer summarized his reasons for urging that the par value be maintained at least until there was a longer span of experience with the developing payments position. Rasminsky repeated the analysis and arguments that Johnstone had already presented. At the end of these conversations, Schweitzer realized that in all likelihood the Canadian decision would be to let the dollar float, and the staff members proceeded to prepare the papers that would be needed at the Executive Board meeting the following day. At 5 P.M., the Canadian authorities advised Schweitzer that they had decided to withdraw support of the par value.

On Sunday morning, May 31, Canadian officials arrived from Ottawa and met with Schweitzer and his staff team. They informed him that a Canadian communiqué would be available to the Fund at 4 P.M. The position was that the upper margin would not be defended, but there would be no change in the par value. Canada would resume main-

taining the margins as soon as possible and would remain in consultation with the Fund. They again summarized developments, which they argued gave them no choice but to float the dollar. All alternatives had been considered and rejected. On learning that, unlike the Fund decision in the case of Germany, which "recognized the exigencies of the situation" that had led to a floating mark, Schweitzer intended to propose a decision that simply "noted" the Canadian action, the Canadian officials strongly objected. Schweitzer pointed to the differences between the two cases, but after the Canadian officials left, he decided to change the sentence sufficiently to ease Canadian objections.

The Executive Board met on Sunday afternoon, an hour before the Canadian Finance Minister broadcast the announcement.[23] The Executive Directors were critical both of the Canadian action and of the fact that it had already been taken before the matter was presented to the Board. They had no practical choice, however, but to adopt a decision substantially in the form proposed by the Managing Director. The Canadian action was particularly unwelcome, since the Executive Directors were well advanced in considering the 1970 report, *The Role of Exchange Rates in the Adjustment of International Payments*, which would give a ringing endorsement of the par-value system.

For the Managing Director and staff, the whole experience was unsatisfactory. A staff mission had visited Canada in April and was in the process of preparing its report—the possibility of floating the dollar had not then been discussed. There was consultation with the Managing Director, but it was crowded into a few days and was overshadowed by a sense of futility. Over the years, Canada had had difficulty living next door to the U.S. monetary system. For all practical purposes, there was a single capital market in the two countries, with large-scale Canadian borrowing and high sensitivity to interest-rate differentials. While Canada's earlier experience with a floating rate had not been free of costs (for example, the disadvantage to exports during prolonged periods of premia over the U.S. dollar), the conclusion among Canadian financial officials was that floating eased the pressures arising from large and at times erratic capital flows. Subsequent events tended to demonstrate the difficulties that Canadian officials had argued would confront the selection of a new par value. Before the end of 1970, the exchange rate of the Canadian dollar moved from the upper par-value margin of 93.5 U.S. cents to over 99 U.S. cents, and in the following two years it was much of the time above parity with the U.S. dollar.

The experience was notable also because this was another instance of a country that was not seeking to use Fund resources. Otherwise, Schweitzer could and would have refused to agree to their use to support a floating rate for a major currency when the case for floating was—at

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[23] See M. DEVRIES, *supra* note 1, at 478-79.

least in his and the staff's view—so open to question. Lacking that leverage, he was reduced to argument and exhortation.

The two crises just described involved an attempt at ministerial-level exchange-rate negotiation and the floating of a major currency. Both elements were to be present in the events of 1971-73.

G. The Dollar Crisis, 1971-73

The year 1971 was by all odds the most dramatic since the beginning of the Fund. It was marked by the appointment of a new U.S. Secretary of the Treasury, John Connally, who would play a leading role; the abandonment of support of the dollar par value in August; and a series of G-10 ministerial meetings culminating in the agreement reached at the Smithsonian Conference which, in a moment of exuberance, President Nixon labeled the greatest in monetary history.

There is space here to recount only the main events that led to the U.S. decision on August 15, 1971. In 1970 the persisting erosion of the U.S. payments position worsened. Although there was a trade surplus of $2.2 billion, the over-all payments deficit was $10 billion. By the first half of 1971, the payments deficit was running at an annual rate of $20 billion, and the prospect was for an even larger deficit in July and August. With the increase in liquid funds in the international money market, the point had been reached when as much as a billion dollars could cross the exchanges in a single day, and in early August that happened.

Schweitzer and staff economists were watching developments with concern in the spring months. In the first days of May, the flow of funds out of dollars into European countries surged, and on May 5 European exchange markets were closed. Schweitzer guided the Executive Board through two informal reviews. On the basis of Article XVI, he proposed a substantial widening of margins beyond the 1 per cent authorized by Article IV, which would have been an innovation. On May 6 he explored this proposal in private meetings with groups of Executive Directors. For a few days, this effort appeared to be promising. The German Executive Director, Schleiminger, considered that what was happening was in effect the beginning of the devaluation of the dollar and agreed that wider margins would enable countries to retain their par values. But several important countries (notably the United Kingdom and Japan) instructed their Executive Directors to oppose the use of Article XVI, arguing that it would open the door to widespread legalized floating.

That initiative failed. On Sunday, May 9, Germany and the Netherlands notified the Fund that on reopening their exchange markets they would cease to maintain the margins, and Belgium adjusted its dual-market regulations. In contrast, Austria and Switzerland revalued their currencies, setting new par values. This floating of important European currencies was to continue until the actions taken by the United

States in August. The floating of the Canadian dollar the preceding year was passed off as a special case, but there was a growing awareness that these new abandonments of par values were a sign of a deep malaise in the international monetary system. A major eroding of the par-value system was occurring, notwithstanding continuing brave supporting declarations. The Managing Director's effort to speed up the examination of the question of exchange flexibility,[24] though meriting better marks than King Canute's reported efforts to roll back the tide, in the end had no better success.

With the coming into office of Secretary Connally, relations between the Secretary of the Treasury and the Managing Director of the Fund, which had always been close, ceased to be so. Nevertheless, anticipating the international banking conference that was to convene in Munich late in the month, Schweitzer and I, accompanied by Economic Counsellor Jacques Polak, spent an hour and a half with Secretary Connally and Under Secretary Volcker on May 17 to review current developments. It was a wide-ranging discussion, covering various possibilities, including dual rates and capital controls. Secretary Connally emphasized the need for a reduction of trade barriers and insisted that there was no *financial* solution to persistent U.S. payments deficits. He said he would welcome revaluations, especially by Germany, Japan, and Canada, which he felt were the main problem, but these revaluations would have to be more substantial than 5 per cent. At one point, he asserted that the dollar was not overvalued and that the United States was not going to devalue. When Schweitzer argued that broader parity changes would be needed if there was to be an effective adjustment of payments imbalances, the Secretary repeated that such changes would not solve the problem and that the United States would have to review its various overseas commitments and seek reductions in trade barriers, especially in Canada and Japan.

Following that one exchange of views with Secretary Connally, Schweitzer's working contacts with U.S. financial officials were chiefly with Under Secretary Volcker. Secretary Connally made it obvious that he personally did not intend to continue a consultative relationship with the IMF.

As summer approached, Schweitzer and his staff were fully aware that a crisis was in the making. But there was no indication whatever that U.S. authorities were contemplating major action. In a meeting with Schweitzer not long before a secret high-level conclave at Camp David, Volcker, quite plainly deeply worried, said only that various possible domestic measures were being studied.

On August 15, at about 7:30 P.M., U.S. Executive Director Dale telephoned Schweitzer to ask him to come to the Treasury Department at 8:30, thirty minutes before a scheduled television broadcast by Presi-

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[24] *Id.* at 256.

dent Nixon in the White House. Schweitzer and I met Volcker and Dale in Secretary Connally's office; the Secretary was at the White House. In the few minutes remaining before the broadcast, Volcker informed Schweitzer what measures would be announced: cessation of official gold sales, no intervention to maintain exchange-rate margins, the imposition of a temporary 10 per cent surcharge on most dutiable imports, and wage and price controls. United States officials expected a realignment of exchange rates and wanted it to be adequate, but even though he was leaving at once to meet with European financial officials, Volcker would have no proposals to make and would not be negotiating. He also said that no one outside the government except Schweitzer had been given advance notice.

There was a brief discussion of some aspects. Volcker mentioned G-10 or a special committee of IMF Governors as the vehicle for negotiation and made it clear that the Executive Board of the Fund would not in his view be the focus. When Schweitzer said the Fund staff had done some work on relative exchange rates, and that some parities should be appreciated and others left unchanged or depreciated, Volcker interjected that the United States had no intention of changing the gold price. This position was maintained by U.S. officials until the eve of the Smithsonian Conference in December, adding greatly both to the difficulty and to the emotional content of the negotiations. Schweitzer's assertion (which I echoed in a speech at the National Foreign Trade Conference in November) that the United States should expect to participate in the prospective realignment did not improve his and the Fund's relations with Secretaries Connally and Volcker.

At the end of the broadcast, which we watched on television, Schweitzer and Volcker had a brief interchange, the main points being that cessation of gold payments by the United States was essential to allow for negotiation, that any basic reform of the system (which had been mentioned by President Nixon) would take time, and that in the meantime a viable rate structure was needed. Secretary Connally entered the room for a few minutes but did not discuss matters with Schweitzer before he and I left. Thereafter, Schweitzer met until midnight with a staff team to prepare for an Executive Board meeting the following morning and to plan a meeting with the staffs of all area departments of the Fund to get them started on a study of appropriate rate adjustments.

The tortuous and at times acrimonious negotiations culminating in the Conference that took place in the Smithsonian building—the old red-stone castle—on December 17-18, 1971, and including G-10 meetings in London on September 15-16 and in Rome on November 30-December 1, have been described elsewhere.[25] What is relevant here is the role played by the Fund, which, it must be said, was not central. The

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[25] *See id.* at ch. 26.

Executive Board was almost completely on the sidelines; the Managing Director and staff were involved in all G-10 meetings of ministers and deputies, and staff views on parameters of parity adjustment were made known.

On August 18, Under Secretary Volcker, just returned from Europe, reported to Schweitzer that no agreement had been reached as to when and how to conduct the anticipated negotiations. He emphasized, as he and other U.S. officials were to do repeatedly in coming months, that what was needed was a big swing in the U.S. payments position. He said that he distrusted early negotiations, because he was by no means confident that this aim was generally accepted. Schweitzer agreed with the U.S. objective and referred to a table prepared by the IMF staff on relative exchange rates.[26] Even at this first meeting, Volcker and Dale said that U.S. technicians were not satisifed that the rate adjustments suggested by the Fund staff were adequate.

The Executive Board met on August 16, but not until August 20 was it able to agree on a decision. Noting the circumstances that led the United States to take the actions, it stated that the Fund would remain in close consultation with the United States and other Fund members "with a view to the prompt achievement of a viable structure of exchange rates based on parities approved by the Fund." This outcome, sought from the beginning, was achieved in December but was to have a short and dismal life.

On August 19, Schweitzer called on Canadian Finance Minister Edgar Benson, Chairman of G-10, who had met with Secretary Connally. Benson reported that the Secretary was willing to see a beginning of negotiation but wanted it to start at the level of G-10 Deputies (the officials just below the level of minister or central-bank governor). Accordingly, Benson was asking Rinaldo Ossola, Deputy Governor of the Banca d'Italia and Chairman of the Deputies, to convene a meeting as soon as possible. Schweitzer said he agreed that G-10 was the only immediately effective channel for negotiation. He did not object to a beginning at the level of Deputies, but negotiation at the ministerial level would be essential at an early date. He wanted a meeting on August 20, but the G-10 Deputies did not meet until September 3-4 in Paris. When Benson emphasized the need for preparation before the ministers met, Schweitzer pointed to the Fund staff calculations as a basis. To make some effort to inform all Fund members, Schweitzer sent a cable to all Governors pointing to the need for "prompt, collective and collaborative" action.

It was thus evident that G-10 would be the focal point for the negotiations, as it was during the negotiations leading to the creation of

[26] This table, presented to the Executive Board on August 16, posited an improvement of $8 billion in the U.S. trade position. It was confidential, but was leaked to the press during the following week, angering U.S. officials, who developed their own calculations calling for an improvement of $13 billion. In retrospect, it would have been wiser for the Fund staff to delay distributing any table until negotiations were started and gave rise to a call for technical advice.

SDRs. But during the SDR negotiations, there were joint meetings between G-10 and all Executive Directors, while this time Executive Directors were unable to obtain a repetition of that procedure except for one meeting, mentioned below. It was this experience that later prompted Schweitzer successfully to propose that negotiations for the reform of the international monetary system be conducted by a Committee of Twenty representing all constituencies on the IMF Executive Board. This structure was carried into the amended Articles of Agreement in Schedule D, providing for a Council of Governors. As explained earlier, pending the establishment of the Council the Interim Committee of Governors is operating with the same composition.

On August 20, Yusuke Kashiwagi, a senior official of the Bank of Japan and Japanese Deputy of G-10, talked to Schweitzer. He reflected Japanese anxieties and frustrations, and complained about the lack of notice for U.S. actions. Japan had felt obliged to keep its exchange market open and as a result had taken in $2.5 billion during the week. He had told Volcker that Japan would not revalue the yen. Schweitzer replied, as he continued to do on various occasions, that there would have to be a range of adjustments; the dollar should be devalued, some parities should remain unchanged, and others, including the yen, should be revalued.

In three sessions on August 22-23, Schweitzer and his staff team had a wide-ranging discussion with Ossola, during which it was agreed that the Fund staff would prepare the papers needed for G-10 discussion.

On September 7, following the meeting of the G-10 Deputies, Volcker reviewed developments at length with Schweitzer and staff members. This meeting revealed more clearly than before that the U.S. officials had two major concerns: (1) They continued to argue that the Fund staff calculations pointed to an inadequate rate adjustment. (2) They doubted if the other leading countries would revalue enough even if the United States were to agree to devalue the dollar. Volcker also spoke with greater concern than before of the need to reexamine the international monetary system.

It was to take a year for Schweitzer and the Executive Directors to formulate, and the Governors to agree on, a procedure to study the reform of the system. But after the Annual Meeting of the Board of Governors at the end of September, negotiations for a new structure of parities gained momentum and became increasingly frenetic. The Fund's participation continued to be limited to Schweitzer's attendance at the ministerial meetings of G-10, staff participation in meetings of the Deputies, and staff preparation of papers.

On November 30 and December 1, G-10 met in Rome and, after discussing percentages and figures, agreed to meet in Washington on December 17 and 18. On December 14, President Nixon and French President Pompidou met in the Azores with senior advisors and agreed on a

devaluation of the dollar.[27] Meanwhile, Executive Directors representing the less-developed countries repeatedly urged Schweitzer to find a way for them to express their views. At last, on December 16, the day before the Smithsonian Conference, this was accomplished by convening a joint meeting between the Deputies of G-10 and the Executive Directors of the IMF, although it cannot be said that this one meeting had any noticeable impact on the outcome.

The Smithsonian Conference has been described many times.[28] The Fund's participation was confined to Schweitzer. I waited at Fund headquarters for word that agreement had been reached, so that the Executive Board could immediately be convened to approve any parity changes and to authorize central rates if countries preferred them to par values and wider margins (2 ¼ per cent either side of par in place of 1 per cent). The Board and staff had been working on those two matters during the weeks when G-10 was wrangling about rate realignment.

The new parity/central-rate structure agreed upon at the Smithsonian Conference had a short life, notwithstanding initial official enthusiasm. In March 1972, when I discussed with Volcker the evident lack of support for the dollar parity, he replied that it was fundamental to the Smithsonian Agreement that maintenance of the new parity structure was up to the other leading countries. This had been the system during the years when the United States had exercised its option under the original Article IV to acquit itself of its obligation by freely buying and selling gold, but the United States was no longer doing so. Volcker did tell a group of reporters at that time that the new structure was in everybody's interest and that he fully expected it to stand. But U.S. officials made no secret of their dissatisfaction with the adjustments agreed to at the Smithsonian, and statements made in Europe were not calculated to breed confidence.[29] There was some U.S. intervention in the first days of February 1973, but by that time Treasury officials had decided on a second dollar devaluation. With the abandonment of U.S. support of the new dollar parity on February 12, 1973, international collaboration based on par values came to an end.

VII. Concluding Comments

The events of 1971-73—the collapse of the par-value system and the resort to floating rates by all major industrial countries—led to a general belief that the Fund could no longer be an effective institution. There was much reason for this. The Fund had no legal basis for approving fluctuating rates. It was thought that its financial operations would be crippled by the exchange-risk uncertainties inherent in drawings and the

27 *See* M. DEVRIES, *supra* note 1, at 26.

28 *See e.g. id.* at 553-56; R. SOLOMON, *supra* note 18, at 204-08.

29 Coombs cites grudging U.S. Treasury approval on July 18, 1972, for small market intervention, which was revoked two days later. *See* C. COOMBS, *supra* note 17, at 226-27.

use of SDRs. It was also thought that with fluctuating rates there would be little need for official intervention in exchange markets and hence little occasion to use Fund resources.

For a number of reasons, the prediction of collapse in Fund usefulness was not borne out by events: (1) The long exercise on the reform of the international monetary system was carried out under the auspices of the Fund and soon centered on finding ways to recast the system within the framework of an amended Articles of Agreement. (2) Notwithstanding the floating of important currencies, most countries continued to peg their currencies to the dollar or some other major currency and had the same need for Fund technical and financial assistance as before. (3) The huge increase in oil prices at the end of 1973 confronted even the floaters with a need for Fund resources, and the Fund's prompt action to establish the oil facility made a good impression. (4) Probably most important was a renewed realization that international financial collaboration was essential, that the floating-rate system needed management (as time passed, large-scale intervention reemerged), and that there was no alternative to the IMF as a global authority. This was emphasized by the amended Article IV. However permissive it is in allowing countries to choose any exchange system they wish, it requires them to collaborate, and it gives the Fund a mandate to oversee the international monetary system and the compliance of each member with its obligations, and to exercise "firm surveillance" over the exchange-rate policies of members.

A. The Evolution Summarized

It has been the intent of this essay to trace the evolution of the Fund from a paper charter to an effective policy-making and operating institution with a demonstrated ability to adapt to changing circumstances and to devise new facilities to meet the needs of its members.

1. The Managing Director and staff gradually—and not without difficulty—emerged as an effective organ, highly professional, able to operate with a satisfactory degree of independence from heavy supervision by the Executive Board, and successful in establishing close working relations with member countries.

2. The Executive Board, with its 21 Executive Directors and 21 Alternate Executive Directors appointed or elected by 138 members (in 1979), is admittedly unwieldy. But contrary to critical opinion, it has been an effective policy-making body and has given to members—especially to the large number of less-important ones—a feeling of "representation" that staff members cannot and should not provide.

3. The Board of Governors is almost by definition incapable of doing more than it has—approve certain actions of the Executive Board and meet annually as a forum for expression of official views. But with the emergence of the Interim Committee and, prospectively, the Council, there has been rather surprising success in creating a ministerial-level

group capable of reaching important agreement—for example, on another increase in quotas and a second issue of SDRs.

4. Effective techniques of staff consultations with members have been developed to assist in analyzing their financial and economic situations and formulating lines of policy. True, these consultations have been most effective when countries seek to use Fund resources, providing the Fund with leverage. But there have been many instances where countries not so placed nevertheless welcomed Fund consultation missions as an occasion for a review of developments, and many where they asked the Fund to continue maintaining a Resident Representative even though no new use of Fund resources was envisaged. Since 1974, the Fund has also developed world economic surveys, which at least twice a year enable the Executive Board and staff to collaborate in an intensive review of developments in world payments and to identify and analyze trouble spots.

5. Finally, the Fund's resources have been increased and various facilities elaborated, so that they have become—as was the original intention—important additions to the potential reserves of members. Maintaining and adapting an appropriate mix of automatic or quasi-automatic and conditional access to resources is a continuing problem for the Fund, especially since the setting of conditions—the requirement of corrective action—often gives rise to political and financial stresses. But the principle of conditionality was not seriously challenged for years, although it is a subject of current debate. Potentially important in the longer-range evolution of the Fund is the SDR, which, in the language of the Second Amendment, is to be made the "principal reserve asset in the international monetary system." It is beyond the scope of this essay to forecast when and how this can be accomplished. But it can be suggested that if the amount of dollar or other reserve-currency holdings becomes a potential threat to the international monetary system, the setting up of SDR substitution accounts in the Fund may turn out to be a useful defense. During 1979, earlier negative attitudes abated at least to the extent that Managing Director de Larosière's new suggestions for a type of voluntary substitution account were examined by the Executive Board and subsequently reviewed by the Interim Committee in Belgrade in September. Following further work by the Executive Board, the Committee will have the matter on its agenda at its next meeting in April 1980.

B. Remaining Problems and Questions

1. It must be recognized that there is asymmetry in the Fund's ability to influence country actions. When a country needs financial assistance that will fall within the conditional zone of its access to resources, it has perforce to listen to the Fund and work out a corrective program that the Managing Director will be prepared to recommend as justifying use

of resources. In many cases the negotiations have foundered, while in many others, a notable one being the United Kingdom in 1976, after long and difficult discussion an effective program has at last been agreed upon. But—and this is significant in relation to the Fund's task of surveillance—where a country has no need to use resources, the Fund may find its voice muted. Germany and Japan, as major creditor countries, and the United States, with its huge payments deficits, are current cases providing little evidence that the Fund has been able to exercise its influence.

2. In a system where leading currencies are floating, as at present, the task of surveillance is much more difficult than in a par-value system (or any other where there are agreed official exchange rates). In a par-value system there are basing points, which provide clearer evidence of overvaluation or undervaluation, and there is intervention to keep exchange rates close to these points. During the Committee of Twenty reform exercise, efforts to find some objective indicator such as reserve movements were fruitless. Now, to carry out its surveillance mandate the Fund is proceeding case by case, with what outcome will be seen only over time. It has had substantial success in dealing with the exchange-rate and payments problems of individual countries; surveillance on that basis follows well-charted paths. But problems in the future may increasingly call for multilateral analysis and negotiation, especially if currency blocs (European Monetary System, dollar, possibly yen) become the prevailing pattern. The Fund may well find that surveillance in an international monetary system with such complex relationships will call for new initiatives and techniques. Preserving the global character and authority of the Fund will be a continuing task. On several occasions in the past there have been proposals that would have undercut the Fund. The U.S. and French proposal that the General Arrangements to Borrow be organized outside the Fund had to be beaten down by Jacobsson in angry sessions.[30] Some years later, Schweitzer had to struggle to ensure that the reform exercise would be conducted by an organ of the Fund, the Committee of Twenty, rather than by an outside group. The establishment of separate funds—the Arab Monetary Fund and the prospective European Monetary Fund are examples—raises the specter of groups of countries meeting among themselves to make decisions on exchange rates and other matters and coming to the IMF, if at all, only as a formality. It was not easy to create the IMF and it has not been easy to develop it into a world monetary authority. It *would* be easy for the leading members to reduce it to ineffectiveness or to an institution concerned chiefly with meeting the financial needs of less-developed countries.

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[30] *See* E. JACOBSSON, *supra* note 3, at 376-77.