Plumpt
no. 1

336.744
F E I

WEALTH ECONOMIC PAPERS

No. 1

International Monetary Reform

COMMONWEALTH SECRETAI

ARCHIV
Plumpt
no. 1

Reform of the International Monetary System

Some points of special Interest to Developing Countries of the Commonwealth

A STUDY BY
A. F. W. PLUMPTRE

007835

1972
COMMISSIONED BY
THE COMMONWEALTH SECRETARY-GENERAL

© *Copyright 1972*

Published by
THE COMMONWEALTH SECRETARIAT

To be purchased from
THE COMMONWEALTH SECRETARIAT
Publications Section
Marlborough House
London, SW1Y 5HX

I.S.B.N. 0 85092 056 6

Hobbs the Printers Limited, Southampton, SO9 2UZ

FOREWORD

Commonwealth Finance Ministers regularly meet to discuss international monetary questions and other financial matters of common interest during the week preceding the annual meetings of the International Monetary Fund and the World Bank. For the September 1972 meeting, it was apparent that reform of the international monetary system would be a topic of major importance, especially as some Commonwealth countries were expected to become members of the Committee of Twenty. With this in mind, the Commonwealth Secretary-General felt that a study dealing with some points of special interest to developing countries, particularly those of the Commonwealth, would be of value and guidance not only to the Finance Ministers in their discussions but also to Commonwealth Governments represented on the Committee of Twenty.

This study was therefore commissioned by the Commonwealth Secretariat from Mr. A. F. W. Plumptre, who for more than twenty years was in the Canadian Public Service. In 1965 he retired from the post of Assistant Deputy Minister of Finance in Ottawa, where he also served as an Alternate Governor of the Bank of Canada and of its Executive Committee. At the same time, he was an Executive Director of the World Bank and of the International Monetary Fund, and a Canadian representative on the "Group of Ten" at the official level. From 1965 till 1972, Mr. Plumptre was Principal of Scarborough College in the University of Toronto. He was a Member of the High Level Group on Trade and Related Problems set up by the Secretary-General of OECD in the autumn of 1971. He has now joined the International Development Research Centre in Ottawa, of which he has been a Governor since its inception.

The original study has been revised and clarified by Mr. Plumptre at a few points in the light of the discussions at the Commonwealth Finance Officials' and Ministers' meetings held in Lancaster House, London, from 19 to 22 September 1972. The views expressed in it remain his own, and are not necessarily those of the Commonwealth Secretariat or of Commonwealth Governments.

Commonwealth Secretariat
October 1972.

CONTENTS

Page No.

I The Exchange Rate Mechanism 1

II International Reserves and Reserve Currencies 4

III Development and the Link 9

IV Some Constitutional and Organisational Issues .. 12

I. THE EXCHANGE RATE MECHANISM

The present (Smithsonian) exchange rate arrangements are precarious. The necessarily urbane and balanced language of the Executive Directors of the International Monetary Fund in their Report on the Reform of the International Monetary System probably will not convey to many readers their actual precariousness.

The Smithsonian readjustment of parities (and "central rates"), combined with the widening of the margins within which actual rates are to be confined, is providing for some relaxation of tension. But the Bretton Woods system, so excellent and so helpful for so many years, is now deeply cracked: neither of the two reserve-currencies, neither the dollar nor sterling, is able to withstand the strains that have been laid on it; the link between the dollar and gold, which was central to the system has been shattered and neither gold nor the dollar nor (in its present embryonic form) the SDR can serve as an acceptable "neutral" foundation for the system; and, perhaps worst of all, the IMF system of determining par values, at least as between major currencies, has been weighed and found wanting.

The Smithsonian arrangements effectively papered over some of the cracks. But the break-away of sterling within six months made it clear that (to use the phrase employed by the Executive Directors) the system is still "crisis-prone".

The developing countries have as much, perhaps more, to lose from a disintegration of the system, and a breakdown of exchange-arrangements between the major developed countries, as those countries themselves. A breakdown of the post-war regime of expansionist liberal internationalism, with its relative freedom of access to expanding world markets for the staple export products of developing countries and its ability to provide at least a measure of development assistance in a variety of forms, could quite possibly revert towards the sauve-qui-peut nationalist economic warfare of the 1930s in which the weaker countries, with less diversified economies and less sophisticated finances, are almost sure to suffer most.

It is a common-place to observe that world commodity markets and world commodity prices react adversely to financial crises. It is also necessary to stress the particularly damaging effects on aid programmes and capital exports of the ever-deepening balance of payments crises. When a major country's balance of payments goes into heavy deficit, the external aid programme (for which domestic political support is likely to be chronically insecure) is almost certain to be amongst the early casualties: its growth (under the international 1 per cent target) is interrupted; it may even be cut back; and its quality is impaired by "tying". Nor is there much evidence that countries experiencing heavy surpluses are disposed to apply them promptly and liberally to capital exports and other assistance to the developing

countries. On the contrary, the aid contributions of countries going into surplus are usually poor in both quantity and quality. A steady flow of capital exports and aid from the industrialized countries depends in very large measure on stability of balance-of-payments relationships amongst them. And, in the Bretton Woods system as it has developed over time, such stability is by now conspicuously lacking.

There are unfortunate indications in the present situation of a propensity towards competitive exchange-rate depreciation amongst major industrialized countries. It is true that the IMF Agreement provides a measure of protection against the disruption involved in attempts at competitive depreciation; but it is surely too much to say, as the Executive Directors do, that it still provides "assurance" against such disruption, particularly if major countries are disposed to use the exchange rate in jockeying for position. Another aspect of the unsatisfactory exchange situation is the obvious reluctance of major countries to revalue their currencies upward when, at least to outsiders, the situation would seem to warrant it.

The phrase "at least to outsiders" brings out a point that is frequently mentioned, but perhaps not fully developed, in the Executive Directors' report: the concern of other countries in the exchange rate of any major country. Indeed there is probably no country, however minor, whose exchange rate is not of concern to one or more other countries whose export products are competitive. A greater recognition of the international implications and repercussions of exchange-rate decisions must be built into the new system.

At the time of Bretton Woods there were few who would have challenged the doctrine that a national currency was a matter of national sovereignty and that such sovereignty related as much to the external (exchange-rate) aspect of the currency as to its internal (monetary and central banking) aspect. This doctrine is embodied in Article IV of the IMF Agreement which provides that a change in the par value of a currency may be made "only on the proposal of the member" concerned; further, that provision is entrenched by Article XVII which precludes any change in it unless that change is accepted by **all** members of the Fund! True, under Article IV, a member proposing to change the parity of its currency is obliged to "consult" with the Fund, but in the last analysis sovereignty is clearly national.

The Fund may make, and in recent years has increasingly made, informal proposals to member countries about their exchange rates. But such proposals are informal and obviously carry less weight with countries in a "strong" position that they do with those in a "weak" position.

The political doctrine that each country is naturally and completely sovereign over the external (exchange-rate) value of its currency in

fact makes no economic sense. On the contrary, since each country's exports (whether visible, invisible, or capital) are some other country's imports, the outside world is **equally** concerned, along with the country itself, in movements of "its" exchange rate. The concern of the outsiders is, of course, more diffused than the concern of the people inside the country, but it is economically just as large and just as real.

It is a question for developing and for industrialized countries alike to consider how far to press the interest of the outside world in exchange-rate determination. For each country, any sacrifice of national sovereignty may incur risks. But it may equally involve advantages. For both developing and industrialized countries, economic decisions regarding exchange-rate changes are fraught with political difficulties.

Some developing countries have, as yet, little experience of decision-making in regard to the external (exchange rate) value of their newly-independent currencies. They may do well to take a special interest in the range of proposals in the Executive Directors' Report, relating to "objective indicators" for exchange-rate determination, and also relating to the role of Fund initiative in these matters. No "objective indicators" are likely to yield perfect or uncontroversial results in the determination of par values; but they are surely likely to provide a better basis, a better approximation to what is desirable in a world system, than decisions that are highly political in their nature and unilateral rather than multilateral in their purview.

The Executive Directors' report indicates that developing countries are generally resistant to the various proposals for more flexible exchange rates (parities) amongst the major industrialized countries. The same point emerges in resolutions of UNCTAD and other groupings of developing countries. However this is a point that deserves examination.

Superficially, and prima facie, stable exchange rates as between the major markets for primary products hold out obvious short-run advantages and conveniences for exporters to those markets. Movements of these rates, both actual and anticipated, introduce uncertainties which can be costly, whether in terms of some sort of insurance against them or in actual losses incurred in marketing. The fact that the marketing of many primary products involve contracts, not only externally between national marketing authorities and overseas buyers but also internally between such authorities and producers, accentuates the difficulties and discomforts, political as well as economic, involved in exchange rate instability. Thus, to the simple question whether stability is preferable to instability there can be only one answer.

But, in a crisis-prone international system, this question is surely not the right one; it is not a simple issue between stability and instability, between certainty and uncertainty. We live in a very

dynamic and hence uncertain economic environment and the question is not **whether** uncertainty should be confronted but rather **how** it should be confronted. In recent weeks the present author has repeatedly posed, to authorities concerned with these matters in developing countries, a question which is probably more nearly the right one: Since it seems that any attempt to maintain virtual fixity of exchange rates amongst major currencies over considerable periods of years nowadays entails the build-up of international financial crises, attended by restrictions of various sorts, internal and external, interruptions to external aid, and ultimate major movements of exchange rates, would not developing countries find preferable a system in which major exchange rates move more frequently but less violently, particularly if such movements can be related in some way to "objective indicators" which are known and understood by all concerned? To this question, whether the smoother adjustment is not preferable to the crisis-prone adjustment, the reply is always in favour of the smoother.

It would be reasonable to assume that more frequent movements of major exchange rates, albeit moderate in extent, are likely to be a feature of the system of the future. Fortunately, the additional difficulties arising for developing countries in such a system, while by no means negligible, are at the same time not entirely insuperable. For example these countries are already fully accustomed to the use, in commodity markets, of hedging against future price movements; they may now be well advised to explore actively and fully various ways of mitigating the difficulties and uncertainties that are likely to be involved in exchange movements. Those developing countries whose financial systems have as yet made little provision for "forward cover" in exchange rates would be well advised to explore this matter forthwith. In view of the very great variety of situations in different international exchange and commodity markets, and the differing financial systems in different countries, what is needed is expert advice and impartial technical assistance adapted to the particular circumstances of each country. In the provision of such advice and assistance the Fund ought to be able to be helpful. The technical assistance facilities recently provided under the auspices of the Commonwealth Secretariat might also be employed.

II. INTERNATIONAL RESERVES AND RESERVE CURRENCIES

There is widespread support for the proposal that the SDR should be developed, as soon as possible, into an accepted, and generally utilized, world reserve asset. Such support seems, naturally enough, to be strong amongst developing countries. The emergence of such a "neutral" asset, under international control, could offer some escape from various objections and uncertainties. Politically, it is preferable to avoid holding a reserve in the national currency of some other country. Economically, insofar as a country holds its reserves in

SDRs rather than in a reserve currency, it avoids the dangers attendant either upon the depreciation of that currency or upon the imposition of restrictions on its use. Unlike gold, which has in the past provided a form of non-national (neutral) reserve asset, SDRs are clearly under international control both in their creation and their disposition. Moreover it is conceivable that, in the future, contracts of various sorts, whether in commodity or financial markets, could be denominated in SDRs.

The issues surrounding the development of the SDR, and its replacement of reserve currencies, have been very fully explored in the Executive Directors' Report, and in other studies. No attempt is made here to enter into the very complex and perhaps controversial issues that will arise if and when the time arrives to convert sterling-reserves into SDRs. There are, however, some points that may deserve emphasis and elaboration.

The reserve-currency system today apparently stands condemned both by those who use reserve currencies extensively in their international reserves (and they include virtually all developing countries) and also by those in London and New York who provide reserve-currency facilities. (In Paris people tend to condemn all reserve currency systems except their own).

It is useful, indeed important, to distinguish between three different lines of criticism of reserve-currency systems. The first criticism is that reserve-currency systems, especially the dollar system, permit and indeed encourage inflationary enlargements of the total of world reserves; these are generated by deficits in the balance of payments of the reserve-currency country and are thus beyond the scope of any control system, whether traditional (gold) or international (IMF). This criticism, it will be noted, relates to the total of world reserves; the other two relate to the movement of reserves between two or more reserve centres and the associated changes, or prospective changes, in the exchange rates between two or more reserve currencies. Thus, most of the users of currencies as reserves have been confronted in recent years by substantial depreciations of "their" reserve currencies in terms of the currencies of such countries as Germany and Japan, from which their imports may be substantial and where they may have financial obligations. The providers of reserve currencies, on the other hand, have been confronted by exchange-crises resulting from massive outward movements of funds, both official and private, and by demands from official holders for guarantees in terms of other currencies. All three groups of critics look longingly to the emergence of SDRs as a means of reducing if not eliminating such problems.

While one cannot quarrel with these attitudes, one may also be warned that the emergence of the SDR into a form in which it can fulfil all the tasks proposed for it will certainly take a number of years (see Section IV of this paper for an explanation of the legal and procedural issues

involved). All concerned will have to live with the reserve currency systems, or some modifications of them, until the new SDR system has been built and put fully into operation.

In other words, the monetary authorities of developing countries are confronted by at least some years in which they will have to make decisions, difficult but by no means impossible, as to how best to deploy their reserves, having regard to the possibilities of depreciation or appreciation of major currencies and the yield and liquidity of the various assets available in reserve centres. For some monetary authorities, these are relatively new issues, but they should be, in practice, quite manageable. Some monetary authorities may wish to obtain expert technical advice or assistance and, here again, help might be forthcoming under the auspices either of the Fund or of the Commonwealth Secretariat.

Lest, anyone, perhaps under French influence, should cast a nostalgic backward look at gold as a reserve asset it may be desirable to recall that the holders of earning assets in the form of reserve currencies have always come off better over the years than the holders of gold. The very occasional increases in the oficial gold price have never begun to compensate the supposedly shrewd holders of gold for the loss of interest that they suffer. In this regard, developing countries have been wiser and more far-sighted than others.

In considering the general phasing out or phasing down of reserve currency systems it is helpful to distinguish (more clearly than is usually the case) between those that are "organic" and those that are "artificial".

The original reserve currency system emerged organically between reserve-centres such as London, New York and Paris and their overseas dependencies. Each centre provided not merely the main source of development-finance for its overseas political or economic dependencies, but also a market for their staple products: New York for such areas as Latin America and Canada, London for most of the British Commonwealth and Empire, and Paris for the French Colonial Empire. In the "developing countries", local banking facilities were often provided by branches of reserve-centre banks; and the reserves of these banks were held, for central as well as overseas business, in the reserve centre. The currency system of the developing country was, in most cases, an extension of the currency system of the reserve-centre. And, as political and financial independence emerged, it was both convenient and sensible that reserves should still be held in the reserve-centre; not in gold nor in the currency of some other major industrialized country.

The essence of the system was that the reserve-centre provided an important range of marketing and financial facilities to its overseas associates, much of their overseas income accrued in the reserve currency, and it was a convenience for all concerned for them to

retain certain liquid assets in the reserve centre. It is clear that both the D-mark and the yen are emerging, albeit reluctantly, as "organic" reserve currencies. Thus the possibilities of shifting reserves between reserve centres are actually increasing.

Entirely different is the reserve-currency system that has emerged in very recent years as between certain financial centres in industrialized countries. Traditionally, the main European central banks held nothing but gold in their reserves, apart from minimal working balances held in New York and London. In the past decade or so, however, some of these central banks, and latterly the Bank of Japan, have become, unintentionally and often unwillingly, holders of very substantial amounts of U.S. dollars. The American authorities persuaded them to hold these dollars, rather than convert them into gold thus drawing upon the rapidly dwindling gold reserves of the United States.

It will be seen immediately that this latter-day "reserve currency system" is both artificial and unstable. When the Europeans speak feelingly about the need to liquidate the reserve-currency system, and when they demand "convertibility" from the Americans, it is this system that they are usually thinking about. They consider that the ability of the United States to obtain, in effect, massive short-term credit from abroad has not only relieved it of the monetary disciplines that normally force other countries to bring their balances of payments under control but has in addition made it possible for Americans to buy up or buy into large profitable sectors of European industry. To make matters worse, these artifical reserve-dollars constitute a vast inflationary addition to world monetary reserves; if the European central banks could have withdrawn gold freely from the United States there would simply have been a transfer of gold reserves from one owner to another.

European ire is not directed with anything like the same intensity, if at all, towards the traditional "organic" reserve currency arrangements. Obviously, nobody would suggest that the total of world reserves has been inflated, or is in the least likely to be inflated, by the reserve-currency holdings of developing countries. The requirement that the reserves of the franc zone shall be held in Paris does not seem to be actively questioned. The gradual phasing-out of the traditional reserve-currency role of sterling has, however, been tied into the arrangements for the United Kingdom to enter the European Economic Community.

The question of "phasing out" can become a matter of definition: what, in the case of any reserve-currency holder, are properly considered to be "maximum working balances" and what are "reserve balances"? It may transpire that the mutual advantages of the traditional "organic" reserve currency systems (including the French) may be such that they will endure, in fact if not in name, for a longer time and on a larger scale than generally anticipated at this particular moment when anti-reserve currency passions are running particularly high.

Of course arrangements would have to be agreed between reserve-holders and reserve-suppliers as to what limitations could reasonably be placed on the size or use of official reserve (or working) balances. Some restraints on the international movement of official as well as private balances seem likely to be with us for some time to come. It is in nobody's interest that official balances, along with private balances, should rush from centre to centre aggravating exchange instability. However, in so far as a new exchange-rate system can be worked out (along lines suggested in Section I of this paper and elsewhere), the short-term incentives to move reserves from one centre to another should materially diminish. If, indeed, this turns out to be the shape of things to come, any steps taken at the present stage by monetary authorities in developing countries to become more adept and expert in deploying reserve assets, more or less permanently, as between several reserve centres will turn out to yield more lasting advantages than may today be anticipated.

When a reserve-currency system is phased out or phased down in favour of some alternative reserve-asset, the question naturally arises: What rate of interest will the new asset yield? This question is being asked about SDRs, particularly by developing countries which have traditionally regarded their reserve-currency holdings as a significiant source of foreign-exchange earnings. This attitude has been strengthened in recent years because of the relatively high rates of interest paid on short-term liquid assets in both London and New York. The attitude of some developing countries toward the interest to be paid on holdings of SDRs has thus appeared to be "the higher the better".

On this attitude two comments may be made. It is, of course, incontrovertible that interest earned on SDRs should relate in some degree to interest earned on reserve balances in London and New York, but this does not mean that, in order to make SDRs acceptable, the rates ought, broadly speaking, to be equal. On the contrary, relatively high interest rates in New York and London are in some measure a reflection of the weakness of the balances of payments of these two centres, the tendencies towards inflation in the two countries concerned, and the consequent erosion of the value of the dollar and the pound. If the SDR is to serve as a stable standard of value it should, as far as possible, be immunized from the effects of inflation and currency depreciation. The yield that will make it attractive must be related, not only to high yields in U.S.A. and U.K., but also to the low net yields in Germany, Japan and Switzerland. Indeed, the preference for holding it rather than reserve currencies should relate to its stability at least as much as to its yield.

Further, unless the SDR system is to change radically and in directions that seem unlikely, it will have to continue to be self-supporting, rather than subsidized. This means that the revenues to be raised by the IMF on account of the issuance of SDRs must be set against its

payments of interest to holders of SDRs; if the yield is to increase it would seem to involve an increase in the charge. In part these revenues will come, if and when holdings of dollars and sterling come to be converted into SDRs, from New York and London; but in part, and increasingly as the years go by, they will come, as at present, from those countries to which SDRs are originally issued each year. Since there are strong reasons to favour increases in the issuance of SDRs to developing countries (see the next section of this paper), and since these countries are most unlikely to retain all the SDRs that are annually issued to them, it may be questioned how far these countries have a strong interest in high charges related alike to issuance and holdings of SDRs.

III. DEVELOPMENT AND THE LINK

All of the major issues involved in international monetary reform are political as well as economic, and of none of them is this more clearly true than of the proposal to associate, to link, the issuance of SDRs and SDR-like assets with the development needs of the developing countries. To the authorities of these countries the association seems sensible enough; with them the over-riding needs of development make it natural that financial institutions, including in many cases their own central banks, should be involved in provision for development requirements. But this, of course, is just the point which gives rise to profound and sincere worries on the part of authorities in certain other countries who have staunchly defended the integrity of national monetary systems by drawing a firm line between the processes of creation of money and the insatiable demands of political leaders espousing worthy causes.

Quite apart from any special issuance of SDRs based on the Link, there is at present opposition to any issue, or at least any substantial issue, of SDRs in 1973. The reason advanced is that the total of world reserves has, in the recent past, been greatly inflated; several countries have financed the balance-of-payments deficits of the United States by acquiring large amounts of additional "unwanted" dollars. However, as the recently-issued Annual Report of the IMF Executive Directors for 1972 makes abundantly clear, these additional reserves have come into existence under very peculiar circumstances, are held by a very few countries, and can scarcely be considered as a valid argument against continuation of the issuance of SDRs.

Nevertheless, such considerations strengthen the view that if the Link is to gain acceptance (and there are increasing signs that it will), it must be in a form or forms that not only meet the basic requirements of the developing countries but also give reassurance to those countries, those authorities, whose attitudes are more traditional. Indeed, the developing countries themselves have a very clear interest in the

stability of the value of the new reserve asset; they are well aware of the damage to themselves that has arisen from erosion of the value of certain reserve assets in the recent past. Against this background the following suggestions and comments are put forward in the hope that they may prove helpful.

One approach to the Link is for developing countries to press for another general increase in their IMF quotas that would go beyond any simultaneous increase in the quotas of other countries*. This approach has several attractions. It would not only, under the present system of SDR allocation, give to developing countries a larger share of the annual issue, whatever that may be, but it would also increase their access to financing from theFund, both regular and compensatory. Moreover, and this may be a point of some political interest, it would give the developing countries increased voting-power and, formally speaking at least, a stronger voice in IMF management, including the management of the SDR system itself.

On the other hand it must be admitted that, within the framework of the relative quota increases that are likely to be found acceptable by other groups, the gains to be achieved from this approach are unlikely to be very substantial. Other approaches must be considered. And these, for the most part, would require a new rationale.

One rationale for the Link which is to be found, amongst others, in the Executive Directors' Report on Reform of the Monetary System is that, because the developing countries will find the proposed system of more flexible exchange rates amongst major countries less comfortable, less easy to live with, than the relatively fixed parities of the past, they should be given a sort of consolation prize in the form of a Link.

This rationale is not entirely satisfactory. If the new exchange rate system works better, is less crisis-prone, more favourable to orderly conditions in world exchange and commodity markets and to the provision of international aid than the system that we have come to know in the last few years, it is a better system for all countries concerned – not better for some and worse for others. All should share, and should want to share, in setting it up and making it work. If, as the Executive Directors rather seem to suggest at one point, the purpose of the Link is not economic development but merely to compensate those developing countries that need to establish facilities for forward dealings in exchange rates for the cost of doing so, the amount of development assistance to be justified on the basis of such a Link will be modest indeed.

---

*At the time of the last quinquennial review of IMF quotas, those of the developing countries were accorded increases that were generally 25 per cent greater than those of other countries.

There are other approaches that can carry more weight. One of these relates to a basic defect in the working of the present exchange mechanism to which reference has been made above. This is the apparent desire of industrialized countries, individually, to develop balance of payments objectives that are at present collectively incompatible. As the Executive Directors point out, industrialized countries are generally anxious to plan for and achieve current-account surpluses; this anxiety is particularly evident in those countries confronted by unemployment. These planned surpluses, in aggregate, substantially exceed the present or probable provision by the countries for capital exports and for assistance to developing countries. Hence, there is a propensity amongst some of them to embark on competitive exchange depreciation and an unwillingness amongst others to revalue their currencies upwards. This situation already constitutes a threat to the stability of the international monetary system. It could be relieved by an enlarged flow of financial assistance to the developing countries from a multinational source, i.e. by the Link in some form.

If this line of approach were to be followed it would be advantageous to all concerned for those reserve assets created for this particular purpose to remain fairly stable in amount from year to year, leaving such annual fluctuations as are to occur in the issuance of reserve assets to be absorbed by those to be distributed on some other basis, such as the present one. In this way the reserve assets created under the Link would provide a continuing and reliable basis both for development planning in developing countries and for the achievement of balance of payments surpluses by industrialized countries. Moreover, if short-term fluctuations are confined to reserves distributed on other bases, the risk that those distributed to finance development under the Link will precipitate world inflation will be lessened.

Another rationale which could be used in support of the same sort of approach to the Link lies in another defect in the present system, i.e. in the chronic deterioration of the terms of trade of the developing countries and their consequently diminishing capacity to finance from abroad their own developmental requirements. This adverse movement of their terms of trade is clearly not the "fault" of the developing countries themselves; indeed it is nobody's fault. But it impairs the capacity of the developing countries to stand on their own feet and purchase their requirements from the industrialized countries. Thus it hurts all types of countries, both developing and developed. A sense of justice can combine with a sense of expediency in a decision to allocate reserve assets to developing countries on this account.

Without embarking on extensive statistical computations (which might well be undertaken by the IMF) it is not possible to suggest whether any quantitative relationship can be established between the amount of reserve assets to be provided on either of the bases outlined above. What is here suggested are two possible approaches, not a pair of yardsticks.

Another range of questions arises in relation to the way in which reserve assets, to be provided on the basis of the Link, are best distributed amongst the developing countries. In this regard, the interests of different developing countries differ considerably. Many would like to receive such assets, as they now receive SDRs, without any strings attached as to their use. Others, which for one reason or another are in a better position to make a case for assistance from development agencies (whether world-wide agencies like IDA or regional agencies) might think that their opportunities for development would be improved if the additional funds were channelled through these agencies. Moreover, it should be added that traditionalist opinion will be more likely to accept such channelling into approved development programmes and projects than to accept what might be considered a simple hand-out.

The Link, and the issues surrounding it, will obviously be very extensively discussed and negotiated in the Committee of 20. It is quite impossible to tell, at an early stage, what form of Link will be most acceptable to others.

It may, however, be of some relevance to recall, by way of conclusion, a point noted by Professor Triffin amongst others. The present method of creating and distributing SDRs has no historical precedent either in the creation of international reserve assets (gold or reserve currencies) or in the creation of national reserve assets (central bank deposits and notes). Historically, reserves have come into existence in connection with investment-financing or deficit-financing. In the particular case of gold, the reserve-asset was created by investment in developing regions of the world, such as California, Australia, South Africa or Canada, but it was not retained in those regions. On the contrary, it was "earned" by the industrialized countries of the world which collectively ran balance-of-payments surpluses to acquire it and added it to their reserves.

IV. CONSTITUTIONAL AND ORGANIZATIONAL ISSUES

The formation of the Committee of Twenty (C20) marks an important achievement and also an important opportunity for developing countries.

It is an important achievement because other approaches to the reform of the world monetary system that were much less palatable to developing countries were being considered. The OECD apparently made an effort to play a central role, if not the central role, stressing the interrelationships between monetary, trade, and development matters all of which fall within the purview of that Organisation. However, this proposal was dropped partly because the OECD is dominated by industrialized countries, to the virtual exclusion of developing countries, and partly because, amongst the industrialized countries, the European group is in a powerful majority position in that Organisation. Another

possibility was that the Group of Ten would play a leading role; but it was found to suffer from the same defects as the OECD, indeed in accentuated form. The UNCTAD resolution of May 21, 1972, gave strong positive support, from developing countries, to the C20 proposal and on July 28, 1972, the IMF was able to announce the approval of its Board of Governors.

It is now important that developing countries should make full and effective use of the opportunities offered by C20.

The first point on which to concentrate is the selection, by each of the several IMF "constituencies", of a member of the Committee of ministerial rank; each member may then appoint one or two "associates" on the Committee; he may also appoint one or two persons to the Committee of Deputies. If developing countries are to make their full and proper contribution to C20, all these choices must be made with care, bearing in mind that the Committee itself, at the ministerial level, will meet infrequently, perhaps two or three times in a year, and that the Deputies will meet much more frequently.

The importance of the selection of committee personnel and the arrangements for their support must be re-emphasized. The discussions, the negotiations, that take place in C20 and its Deputies, will be wide-ranging in character and unpredictable in outcome. To be effective, Committee members will need to be both competent and flexible. While it will be possible for a representative whose constituency consists of a single country (e.g. U.K.) or at most three or four (e.g. Barbados, Canada, Eire and Jamaica) to consult fairly frequently with his authorities "at home" regarding the complex and controversial issues under consideration, this will scarcely be possible for any representative whose constituency is more numerous. Moreover, precisely because of the controversy and complexity involved, the representatives themselves will have to give guidance and leadership to their constituents.

As for staffing arrangements, it is anticipated that C20 and its Deputies will have a small staff of their own backed up, as may be required, by the staff of the Fund. It is not anticipated that Executive Directors of the IMF will generally serve as C20 Deputies; they have their own job to do. If an Executive Director is asked to serve as a C20 Deputy his task will be a heavy one. Similarly it is not expected that the Fund will provide the C20 staff; they, in their turn have their own jobs to do. In short, it is not intended or expected that C20 or its Deputies should be permeated or dominated by the existing Fund "establishment". They should have a life of their own if they are to make recommendations based on an independent as well as penetrating review of the world monetary system and related matters. This appears to be the wish of the developing countries concerned and they will, no doubt, be on the alert to ensure that their wishes are carried out.

It is also known to be the wish of some of the developing countries, perhaps most or all of them, that C20 should, at the outset, engage in a broad discussion of issues and outlook, including the interrelationships between monetary affairs, trade, aid, and development. It should not become immediately immersed in details (e.g. proposals for specific amendments to specific Articles of Agreement of the IMF). Indeed it has been suggested that the first year (1972-73) will probably be occupied in getting a reasonable measure of agreement on the broad outlines of what is to be recommended, and a second year (1973-74) in reducing these outlines to precise proposals.

Amendment of the Articles of Agreement of the IMF requires a three-fifths majority of the member countries having a four-fifths majority of the voting power. Putting these requirements the other way around, any amendment can be blocked by anything more than two-fifths of the membership and one-fifth of the voting power. Whenever contentious amendments come under consideration, the power to obstruct is clearly far greater than the power to progress. This is one important reason why the negotiations in C20 and its Deputies may be expected to extend over a considerable period. No group, such as the group of developing countries, will be willing to forego its power to obstruct until it is reasonably satisfied with the shape and size of the package as a whole including both those changes that require amendments to the Articles of Agreement and also those changes of a substantial nature which do not require such amendments. Moreover legislatures will be particularly concerned to see the whole package before accepting any part of it. A piecemeal settlement (e.g. the settlement of some issues by 1973 leaving others until 1974) would not seem to be at all likely.

After C20 has done its work and made its recommendations, these recommendations not only have to be considered and (hopefully) approved by the Board of Governors of the IMF but, after that again, the legislatures of the member countries have to act in sufficient numbers to fulfil the 3/5 and 4/5 requirements. Altogether, it is not surprising that people are talking in terms of four to five years as the time required for the work of C20 to be put into full effect.

But the world's monetary and financial affairs show no sign of remaining passive and uneventful until 1977! Many things, important things, will happen during that period. This consideration points to two conclusions as far as C20 and its Deputies are concerned.

First, considering that the present system is not only crisis-prone but susceptible to general break-down, the work must be pressed forward as a matter of high priority and with as little delay as possible. The zeal and efficiency of the chairmen, of the committee members, and of the staff, will be of great importance. Second, there should be a "gentlemen's understanding" from the outset that countries – and this refers in particular to the major countries – will refrain from

taking actions, outside the consultative framework of C20 and its Deputies, which would prejudge and prejudice the outcome of its work. This understanding should cover major departures from present arrangements whether or not those departures involve or imply amendments of the IMF Articles of Agreement.

In conclusion, it should be pointed out that, if C20 together with its Deputies works effectively and successfully, its establishment may set an important precedent. Ever since the Fund was established there have been those who saw the weaknesses, as well as the strengths, of having the Executive Directors serving full time and resident in Washington. While this arrangement made it possible for the Executive Directors to immerse themselves in the work of the Fund, it also made it impossible for them to participate in the day-to-day affairs and decisions of countries that they represented.

The influential role in recent world affairs which has been played by "The Group of Ten" and by "Working Party 3 of OECD" with which it is closely associated has depended, not only upon the fact that the number of persons involved was sufficiently small to allow for frank and effective discussion, but more particularly because the persons involved, both at the ministerial and official level, were continuously engaged in the decision-making processes of their capitals. It is clear, of course, that some of the IMF "constituencies" involve a considerable number of countries, and countries which cannot always speak with a single voice on issues of importance. Nevertheless, the establishment of C20 may be seen as offering an opportunity to bring important elements of planning and decision-making in world economic affairs back into the IMF where they would seem to belong, and to give developing countries the voice in these matters that they desire and deserve. These countries have a strong interest in ensuring that decision-making is kept in those international institutions like the Fund where they have an opportunity to be effectively represented rather than in institutions which do not include them. Thus, despite the difficulties which the developing countries (because they are numerous and diverse) will always face in obtaining effective representation in effective international bodies, it may well turn out that C20 will come close, perhaps as close as practicable, to meeting their real requirements.

Commonwealth Economic Papers

This publication is the first in a new series of papers on economic subjects of concern to Commonwealth Governments to be published from time to time by the Commonwealth Secretariat.

COMMONWEALTH SECRETARIAT PUBLICATIONS

ECONOMIC

Commodity Publications provide comprehensive and continuous information on all aspects of the market situation for agricultural commodities. Although the emphasis is on Commonwealth countries, the coverage is world wide.

Commodity Series (current issues of annual publications)
Fruit No. 19
Vegetable Oils and Oilseeds No. 20
Dairy Produce No. 20
Meat No. 18
Grain Crops No. 14
Industrial Fibres No. 19
Plantation Crops No. 13

Intelligence Bulletins (published quarterly/monthly)
Tropical Products Quarterly
Hides and Skins Quarterly
Fruit Intelligence
Grain Bulletin
Rice Bulletin
Meat and Dairy Produce Bulletin
Wool Intelligence
Tobacco Intelligence

Other Economic Titles

Flow of Intra-Commonwealth Aid 1970

Organisation of the Tourist Industry in Commonwealth Countries (as at December 1971)

Commonwealth Trade 1970

Reform of the International Monetary System

MEDICAL

Report on the Second Commonwealth Medical Conference, Vols I, II, III

Continued over

EDUCATIONAL

As part of its clearing house function the Education Division has published the following titles, which deal with a variety of issues in education and related fields at both regional and Commonwealth levels:

Education in Commonwealth

Education in the Developing Countries of the Commonwealth: Research Register 1970-71.

School Building and Design in the Commonwealth.

Special Education in the Developing Countries of the Commonwealth.

Youth and Development in the Commonwealth

Youth and Development in Asia and the Pacific.

Youth and Development in Malta.

Youth and Development in Cyprus

Forthcoming publications include:

Selected Education Research.

Approaches to the Employment Problems of Youth in Developing Countries of the Commonwealth.

Commonwealth Periodicals Directory.

Directory of Training and Social Development Programmes

Mathematics Teaching in Schools.

The Education and Training of Technicians.

COMMONWEALTH INFORMATION PROGRAMME

Publications prepared by the Information Division:–

Commonwealth Diary, a listing of coming events (quarterly)
Commonwealth Record, summaries of recent events (quarterly)
Notes on the Commonwealth, reference papers on:–

Members of the Commonwealth
Heads of State and Heads of Government
The Commonwealth Declaration
The Commonwealth Secretariat
The Commonwealth Foundation
The Commonwealth Scientific Committee

Particulars of prices and subscription rates and any further information required may be had from the Commonwealth Secretariat Publications Section, Marlborough House, London SW1Y 5HX.

© *Copyright 1972*

Published by
THE COMMONWEALTH SECRETARIAT

To be purchased from
THE COMMONWEALTH SECRETARIAT
Publications Section
Marlborough House
London, SW1Y 5HX

I.S.B.N. 0 85092 056 6

Price 50p Net