

**Proposals for Changing the Functions
of the International Monetary Fund (IMF)**

by

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Introduction

The fiftieth anniversary of the signing of the Articles of Agreement of the International Monetary Fund (IMF) and the World Bank was celebrated at meetings in Washington, DC; at Bretton Woods, New Hampshire; and at the Annual Meeting of the Boards of Governors of the two institutions held in Madrid.[1] As one of the few survivors who participated in the 1944 Bretton Woods conference, I was privileged to attend the first two commemorations (Mikesell, 1994). The many addresses at the 1994 meetings praising the contributions of the Fund and Bank were overshadowed by the widely-held conviction that both institutions are seriously in need of overhauling. However, there is no consensus on how they should be changed. Some believe that one or both have outlived their usefulness and should be abolished, while others believe the institutions should continue to operate as in the past, but with new responsibilities and enhanced resources.

This Working Paper is mainly concerned with proposals for major changes in the Fund, but because the proposals are also

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related to the operations of the Bank, a brief background on both institutions follows.

The World Financial System After Bretton Woods

The Fund and Bank were designed to avoid the chaotic financial conditions that prevailed during the 1930s by facilitating the transition to a post-World War II economy characterized by stable exchange rates, no exchange restrictions on trade, and the availability of capital for financing postwar reconstruction and the development of poor countries. The IMF was expected to promote a new international monetary order by establishing and enforcing rules governing exchange rates and foreign exchange transactions, and by providing assistance to countries in conforming to these rules. Owing to the magnitude of the financial requirements for reconstruction and to the balance of payments problems of the European countries, neither the Fund nor the Bank played a significant role in the transition period. The Marshall Plan provided most of the financing for European recovery, and the European Payments Union (EPU) established a payments system that permitted multilateral intra-European trade, and paved the way for initiating the IMF par value system in the 1960s.

By the end of the 1960s, the principal threat to the par value system based on the gold-convertible dollar was the weakness of the dollar itself. World recovery brought about a change in trade patterns and capital markets, so that the "dollar shortage" of the 1950s was followed by a dollar surplus in the

late 1960s. The termination of dollar convertibility into gold in 1971 and the 1973 abandonment of efforts to maintain fixed rates by the major countries left the IMF with little influence on the international monetary system. The Bretton Woods monetary system was dead and few expected it to be revived.

The IMF found its niche by providing advice and making loans to developing countries under a variety of programs involving different maturities and interest rates. These loans had little to do with exchange rate stability, and, in fact, the preloan agreements often required devaluation along with trade and exchange liberalization. Although some of the loans assisted countries in periods of crisis resulting from sudden declines in export income, most were designed to induce countries to reform the economic policies that had contributed to their balance of payments equilibrium.

Since it began operations in 1946, the World Bank has been almost completely occupied with assisting developing countries. Although its charter emphasized the Bank's role in promoting the flow of private capital, the bulk of its loans have been made to governments. During the 1950s, the Bank's lending was hampered by a shortage of projects that met the standards of commercial bank loans as interpreted by successive Bank presidents, all of whom (except for Robert McNamara) were from the American banking community. In the beginning, most Bank loans were for specific infrastructure projects such as large dams, power, and transportation. The idea slowly emerged that the Bank should be

a development institution concerned with social welfare and eliminating poverty, as well as with promoting the conditions for economic growth.

The lending capacities of both the Fund and Bank have been increased steadily since their inauguration in 1946. Outstanding credits provided by the Fund as of the end of FY 1994 totalled about \$56 billion and disbursements during FY 1995 were \$17 billion. In addition, the Fund has allocated to its members 21 billion SDRs, which they can use to buy the currencies of other members (as of May 1995, one SDR = \$1.47).[2] The Fund's lending resources have grown with periodic increases in member quotas, which determine both the subscriptions to the Fund's capital and how much members can normally borrow.

World Bank loans outstanding at the end of FY 1995 were \$120 billion, and the Bank made commitments of \$17 billion during FY 1995. In addition, the Bank manages the International Development Association (IDA), which loaned approximately \$5.7 billion in FY 1994. Another associate of the Bank, the International Finance Corporation (IFC), provides equity and debt financing to private enterprise in developing countries. In FY 1995 it committed \$2.9 billion. The fourth and youngest associate, the Multilateral Investment Guarantee Agency (MIGA), promotes foreign direct investment in developing countries by offering political risk investment insurance. The World Bank and IDA operate under the same management, but with different sources

of funding. The IFC and MIGA have separate managements.

Together these institutions make up the World Bank Group (WBG).

Dissatisfaction with the Fund's current functions has arisen from three major sources. First, for more than two decades since the abandonment of the par value system established at Bretton Woods, the Fund has not played a significant role in guiding or influencing the international monetary system. Second, there is considerable dissatisfaction with the present floating exchange rate system on the grounds that there is excessive fluctuation in the exchange values of the major currencies, and these fluctuations have not resulted in satisfactory balance of payments adjustments. Third, the Fund's assistance to developing countries, which has constituted almost the entire use of its resources, has not prevented financial crises, such as that occurring in Mexico in 1994, and much of its assistance and advice duplicates that provided by the World Bank.

Proposals for dealing with the role of the Fund in the international monetary system reflect two opposing positions among international economists and government officials. One is that there should be a new international monetary system characterized by relative exchange rate stability, and that the Fund should play a major role in the creation and management of the new system. The opposing position is that the floating rate system has worked reasonably well for the past two decades and that a new system involving major commitments by the leading financial powers is neither feasible nor desirable. Some of

those holding the latter position propose terminating the Fund as an independent institution.

The proposals for changing the role of the Fund in assisting developing countries also reflect two opposing positions. One position is that the resources of the Fund should be enhanced to enable it to deal with balance of payments and exchange rate crises of developing countries, and that the problem of duplication between the Fund and World Bank should be dealt with by more precise delineation of their functions and improved coordination between the two institutions. The second position, either terminating the Fund or merging its functions with those of the World Bank, reflects the view that the Fund does not provide a unique form of assistance distinguishable from the development assistance provided by the Bank.

At the heart of the debate over the proposals for giving the Fund a role in establishing a new international monetary system is the controversy over whether there should be freely floating exchange rates with no market intervention by central banks, or a system in which governments maintain target exchange rates by monetary and financial measures, including market intervention. Before examining the specific proposals, I want to review the arguments for and against freely floating exchange rates.

Managed Versus Floating Exchange Rates

Prior to World War I, the gold standard provided a system of fixed exchange rates and automatic balance of payments adjustment

by allowing gold movements to affect the money supply. The gold standard was only partially restored during the 1920s. In the 1930s, exchange rates were neither fixed nor freely floating, but were managed in a way that resulted in restricted and discriminatory trade. The Bretton Woods system of fixed but adjustable parities was a compromise between the gold standard and a managed system. Following the breakdown of the Bretton Woods par value system in the early 1970s, the major currencies were allowed to float with occasional attempts to manage them, and this condition exists today. While there is general agreement that the present system does not perform well, there is strong disagreement on whether and how it should be changed. The ideal system is one in which exchange rates among the major currencies remain fairly stable for relatively long periods of time, changing only when they are incompatible with balance of payments equilibrium. An equilibrium exchange rate is one that can be maintained without substantial intervention in the exchange markets. Equilibrium does not require a current account balance. A country with a current account surplus may be a net investor abroad, while a country with a current account deficit may be a capital importer. A freely floating rate is always an equilibrium rate, but the country may have a current account balance which it finds undesirable, or the exchange value of its currency may fluctuate widely.

There are a large number of variables in the complex system of simultaneous equations for estimating an equilibrium rate, the

most important of which are the macroeconomic variables determined by the economic policies of the country itself and of the countries with which it has economic relations. An equilibrium rate may not be compatible with a country's objectives of maintaining full employment, price stability, and promoting economic growth. Some economists have defined an equilibrium rate as one that can be maintained without intervention and is consistent with internal stability and a high level of employment. Does such a rate exist under all circumstances? More important, is there a pattern of exchange rates that satisfies the equilibrium conditions for each of the major countries? Those who propose a multilateral system of exchange rate stabilization assume it is possible to maintain a pattern of exchange rates that is both consistent with balance of payments equilibrium and with the economic objectives of the countries whose currencies are stabilized. There are certainly advantages to having relatively stable exchange rates, especially for the currencies of the leading financial powers. The current proposals do not call for a return to the par value system, but rather for coordinated central bank intervention in the exchange markets and the collaboration of governments to maintain monetary and fiscal policies that promote stability for an agreed pattern of exchange values. At the time of the Bretton Woods conference there was nearly unanimous agreement on the desirability of managed exchange rates; however, this consensus has waned. Milton Friedman (1950) has argued for a half century that

exchange rates should be determined in free markets, and his position is echoed by many leading economists today. For example, in an address to the January 1995 Annual Meeting of the American Economic Association, George P. Schultz (former Secretary of State and former University of Chicago Professor of Economics), stated that "We should stop worrying about the exchange system. We now have a dirty float. . .the system would work better if it were cleaner, that is with less government intervention. But the system does in fact work reasonably well and has done so over a twenty-year period during which the system has experienced and absorbed some tumultuous economic changes" (Schultz, 1995, p. 3).

The argument for freely floating exchange rates is analogous to that for free markets for commodities, services and capital. Price stabilization does not work because cyclical movements cannot be accurately projected and controlled rates are maintained long after it becomes obvious that they are badly misaligned. The market often makes mistakes, but it soon corrects them; the government tries to cover up its mistakes and misallocation of resources may continue for a long period. Moderate exchange rate fluctuations in free markets are less harmful than the drastic changes in controlled rates that must be made when the controlled rate is recognized as highly improper. Finally, it is argued that free fluctuating rates do not significantly increase the cost of trading since the difference Milton Friedman (1950) has argued for a half century that "

Those favoring managed exchange rates argue that exchange rate fluctuations in response to speculative capital movements and other temporary forces affecting the balance of payments result in misaligned rates and creates a perpetual state of disequilibrium. Even if the government makes a mistake, it is better to establish a target rate believed to be consistent with balance of payments equilibrium and stand ready to change the target whenever it is shown to be incorrect. Allowing exchange rates to float freely without any attempt to manage them is likely to mean that the currency will be continually over- or under-valued.

In appraising the positions for and against managed rates, in contrast to freely floating rates, account must be taken of the complex relationships between the trade and current account balances on the one hand, and changes in the exchange rate on the other. Trade balances are much more sensitive to changes in exchange rates than the services and investment components of the current account, and all elements of the current account are sensitive to changes in business conditions at home and abroad. I begin by examining the effects of exchange rate changes on the trade balance.

A change in the exchange rate will not always improve the trade balance, or it may require a year or more before it does. This is true for the following reasons. First, prices for many internationally traded goods do not immediately adjust to changes in exchange rates. If the U.S. dollar were to depreciate by 10

percent in terms of a composite of all foreign currencies, the dollar prices of imports would not immediately rise by 10 percent because some foreign suppliers in competition with domestic producers would not raise their U.S. prices by that amount. Also, some U.S. exporters would raise their dollar prices to maintain the foreign currency prices of their exports. Second, even when prices are adjusted to reflect a change in the exchange value of a currency, consumers are often sluggish in shifting purchases from foreign to domestic sources. Because of these two factors, the immediate effect of a currency depreciation may be to worsen the trade balance for a few months, following which improvement may take place gradually over a couple of years. This is sometimes called the J-curve effect, which indicates an initial worsening of the trade balance after depreciation (Krugman, 1991, Ch. 2).

A third reason why changing the exchange rate may not improve the trade balance relates to the macroeconomic conditions. If a country's current account balance is to improve, there must be an increase in that country's total output relative to its total expenditures on consumption and investment. The current account balance (B) must always equal the difference between national output (O) and total expenditures. This identity may be expressed as

$$B = O - C - I - G$$

where C is private consumption, I is private domestic investment, and G is government spending. Thus, to improve the current

account balance, currency depreciation must be accompanied by an increase in O , or a decrease in $C+I$ or G . Currency depreciation will not automatically induce the macroeconomic conditions for improving B . While depreciation may stimulate O , it may also stimulate consumption, investment, and government spending. Under these conditions, currency depreciation may fail to improve the current account balance and its most important component, the trade balance. To cite an example of the failure of a nominal exchange rate depreciation to bring about an improvement in the trade balance, the U.S. trade deficit rose from \$74 billion in 1991 to \$133 billion in 1993, and was about \$120 billion in 1994. This occurred despite a more than 40 percent decline in the value of the dollar in terms of yen between 1990 and the end of 1994, and a somewhat smaller depreciation of the dollar in terms of the DM.

To be effective in improving the trade balance, there must be a decrease in the real value of the currency in contrast to a change in the nominal value. Following a nominal depreciation there may be an inflationary rise in domestic prices, which will prevent the prices of internationally tradeable goods from rising relative to nontradeables (e.g., construction and services) so that there is no decline in the real exchange rate (RER). One way of measuring changes in the RER is to multiply the nominal exchange rate by the ratio of the foreign price index to the domestic price index. Another definition of RER is the ratio of the price index of tradeable goods to the price index of

nontradeable goods. If this index rises, the production of tradeable goods for export and for competition with imports will increase relative to the production of nontradeable goods (Edwards 1986). When exchange rate depreciation is accompanied by inflation, foreign competition in tradeables will tend to keep domestic tradeable prices low relative to prices of nontradeables, so that the trade balance will not improve.

What exchange rate policy should be followed in dealing with external shocks such as a sudden surge in export income following a substantial increase in world prices of a major export, or a sudden rise in the price of a major import, such as petroleum? A sudden increase in export income exposes a country to the "Dutch disease" (Corden & Neary, 1982). Under floating rates, the appreciation of a currency increases prices for nontradeable commodities relative to those of tradeable commodities, thereby putting tradeables at a disadvantage in competing in world markets. One way to avoid this is to prevent the appreciation of the currency through market intervention. In the case of a sudden doubling of petroleum prices, such as occurred in the 1970s, under a freely floating rate system foreign exchange expenditures by fuel-dependent countries could increase by 20 percent or more, causing a very large depreciation in their currencies. Those favoring managed exchange rates would argue that a sharp rate change should be avoided or at least moderated, especially since there would be no immediate improvement in export income from the depreciation.

The relationship between a country's exchange rate and its current account has important implications for both the freely floating and managed rate arguments. A floating rate will not automatically correct a current account deficit or improve a trade balance. A freely floating rate will assure equality of total payments and total receipts, but the equilibrium rate may not necessarily be the appropriate rate for reducing the current account balance. On the other hand, it is exceedingly difficult to select a managed rate that will both improve the current account and at the same time be an equilibrium rate. Is it better to have an equilibrium rate at all times that may be incompatible for a time with the desired trade and current account balances, or have a managed rate which very likely will be incompatible with equilibrium?

Capital movements present special problems for exchange rate policy. They take place in response to interest rate differentials; to changes in business conditions which affect investments by multilateral firms in foreign markets; and to perceived risk or opportunities for speculative gains. Under a floating rate system, the capital movements cause immediate changes in exchange rates and only over time will they induce adjustments in the trade and current account balances. Those favoring managed exchange rates argue that target rates should be maintained in the face of sharp capital exports or imports, and changed only in response to longer term irreversible movements. An immediate depreciation or appreciation of a currency caused by

speculative capital movements may encourage larger movements without affecting the trade balance. A continuing net inflow or outflow of investment capital must be accompanied by a change in the current account, and such a change may require altering the target exchange rate; but the appropriate rate can only be determined over time.

Those favoring a free exchange market argue that maintaining an exchange rate in the face of capital flight results in a loss of monetary reserves, which itself undermines confidence and causes further capital flight. Moreover, the failure of a country's exchange rate to depreciate with adverse financial developments may lead to a massive capital flight induced by the expectation of a larger currency depreciation. As regards long-term capital movements, supporters of freely floating rates argue that the market is a better judge of the appropriate level for the exchange rate. Gradual movements will do less harm to a country's investment climate than large sudden changes. While the market may overshoot the appropriate exchange rate, market uncertainty with respect to an anticipated change in the target rate may encourage disequilibrating capital movements.

The above conflicting arguments provide little basis for confident conclusions and much more experience with managed rates under a variety of conditions is required. The argument for managed rates is usually based on the assumption that central banks and finance ministers have considerable ability in projecting the future, and taking full account of all the

variables in setting target rates. Doubts as to their ability to identify equilibrium exchange rates, or even to know the direction in which they ought to move, have been expressed by Paul Krugman (1990, Ch. 14) in the following statement:

"Unfortunately, we still do not know enough to give clear and simple advice in all circumstances to central bankers and finance ministers. In particular, the current situation in which an intelligent appreciation of what we know about equilibrium exchange rates leads to a definite 'don't know' response to questions about where to go from here." Supporters of free floating would respond by saying that if the central bankers "don't know," the market will always provide the best answer.

Instruments for Managing Exchange Rates

The principal instruments for managing exchange rates are (1) central bank intervention in the exchange market, (2) changing short-term interest rates, and (3) fiscal policy. The first two are usually under the control of central banks, while fiscal policy, which is controlled by both the government administration and the legislature, is rarely used by governments of major countries to manage exchange rates. Central bank intervention is of two types: sterilized and unsterilized. In the case of unsterilized intervention, purchasing a foreign currency on the exchange markets with domestic currency, or purchasing the domestic currency with foreign exchange, are allowed to have their full impact on the country's bank reserves and, therefore, on interest rates and the quantity of money.

Most intervention is sterilized and its record of success in keeping exchange rates within an agreed range is poor (Humpage (1993, pp. 2-16; Obstfeld, 1990, Ch. 5). A recent review of the literature on central bank intervention (Edison, 1993, p. 55) concludes that "The empirical evidence, although allowing for the possibility of short-lived effects, does not ascribe to intervention a long-lasting effect on the foreign exchange markets."

While intervention serves to signal to the market the official view of the government on exchange rate policy, the volume of intervention tends to be too small in relation to total market forces to substantially affect the rate. An example is provided by the action of the Federal Reserve Board (FED), in collaboration with a number of European central banks, to support the dollar in early March 1995. At this time, the FED purchased \$450 million against the German mark and \$370 million against the Japanese yen. According to a report published by the Federal Reserve Bank of New York (1995), "The dollar met aggressive selling by market participants and proceeded to trade progressively lower. . . ." During the period January-March 1995 when the dollar was under substantial pressure, U.S. monetary authorities intervened in the amount of \$1.42 billion against the yen and the DM. Nevertheless, the exchange value of the dollar continued to decline in terms of these currencies. Small interventions cannot be very effective in a world currency market with daily transactions currently exceeding a trillion dollars.

A truly massive intervention would almost certainly stabilize the dollar for a time, but this could prove very costly if the stabilized rate proved to be untenable.

Short-term interest rates are sometimes altered by central banks in order to support the exchange value of a currency. The German Bundesbank cut its discount rate from 4.5 percent to 4.0 percent on March 30, 1995 to support the dollar (Federal Reserve Bank of New York (1995, p. 9). A similar reduction taken at the same time by the Bank of Japan was probably for the same reason. So far as I have been able to discover, there was only one occasion when the FED deliberately increased domestic interest rates in response to a desire to bolster the foreign exchange value of the dollar. In early November 1987 the FED and the Treasury launched a massive program to reverse the sharp decline in the dollar by a combination of foreign exchange intervention and credit restraint. The discount rate at the Federal Reserve Bank of New York was increased from 8.5 percent to 9.5 percent and a supplementary reserve requirement equal to 2 percent of time deposits was established for commercial bank members of the Federal Reserve System. At the same time, both the FED and the Treasury mobilized foreign exchange from various sources for sale in the exchange markets to raise the value of the dollar (Wall Street Journal, 1978, p. 19). Although there was no intention to peg the exchange rate for the dollar at any specific level, the dollar did rise 7.5 percent against the Swiss franc, 7 percent against the DM, and 5 percent against the yen. It should be

observed, however, that this action was not necessarily at variance with President Carter's anti-inflation program underway at the time. There is little indication that recent FED interest rate policy has been motivated by a desire to support the dollar.

International Monetary Policy Coordination

Efforts to manage exchange rates are likely to be more successful when a group of countries coordinate their policies than if each country acts alone. Assuming the major economic powers were to reach an agreement on a set of target exchange rates, they could coordinate their monetary and fiscal policies and central bank intervention operations in an effort to stabilize the rates or to maintain them within a specified range. Countries with strong currencies could reduce their short-term interest rates and budget surpluses, while countries with weak currencies could increase their interest rates and eliminate budget deficits. However, these measures may well conflict with the domestic objectives of those countries agreeing to coordination.

A convergence of governmental policies directed toward stabilizing exchange rates is sometimes advocated. This could mean adopting the same objectives, such as full employment and price stability, with the expectation that governments would be using similar monetary and fiscal measures for achieving these objectives. Convergence appears to be the goal of the Maastricht Treaty signed by members of the European Union (EU) in February 1992. Convergence is defined as achieving common economic

integration objectives, such as price stability, budgetary discipline, and maintaining exchange rates within a narrow band (L. Bini-Smaghi et al., 1994). The convergence criteria in the Treaty provide that as a condition for joining the European Monetary Union (EMU), a country's inflation rate cannot exceed the inflation rates of the countries with the three lowest rates by more than 1.5 percentage points; fiscal deficits can be no more than 3 percent of GDP; and the nominal long-term interest rates cannot exceed by more than 2 percentage points the rates in the best performing countries in terms of price stability. A question arises as to whether the convergence criteria for membership in the EMU will guarantee exchange rate stability, since each country will be employing different policies within the limits established by the criteria. Countries experiencing a recession would be inclined to lower interest rates and maintain the highest permitted fiscal deficit, while countries with low unemployment and relatively high inflation would tend to raise their interest rates and cut their deficits. A coordinated effort to stabilize a set of exchange rates would call for the adoption of policies aimed specifically at stabilizing the target rates. For example, if the franc were weak, an increase in the French interest rate would strengthen the franc. But if the French economy was in recession, a rise in the interest rate would be antithetical to French recovery. Each of the G-7 members might agree to pursue the same objectives of price stability, low unemployment and fiscal balance, but if some

countries had low unemployment and rapidly rising prices while others were in a state of recession, the policies each would follow might be just the opposite of those required for maintaining an agreed pattern of exchange rates.

Proposals for an Active Role by the IMF
in the International Monetary System

The most frequently discussed proposals for an active role by the IMF in reforming the international monetary system are (1) those proposed by the Bretton Woods Commission, and (2) the target zone system put forward by economists associated with the Institute for International Economics (Williamson & Miller, 1987; Williamson & Henning, 1994; Bergsten & Williamson, 1994). The Bretton Woods Commission report (1994b, pp. A-4-5) made a three-part proposal for international monetary reform: (1) "The major industrial countries should strengthen their fiscal and monetary policies and achieve greater overall macroeconomic convergence; (2) these countries should establish a more formal system of coordination, involving firm and credible commitments, to support these policy improvements and avoid excessive exchange rate misalignments and volatility; and (3) the IMF should be given a central role in coordinating macroeconomic policies and in developing and implementing monetary reform." The Report suggests that the G-7 should grant operating authority for stabilizing exchange rates to the IMF. However, the Report is vague regarding the nature and implementation of the new international monetary system. It merely recommends that the system should promote exchange rate stability and avoid

misaligned rates. Without formally endorsing the target zone system, the Report appears to favor some flexibility of exchange rates rather than fixing rates at particular levels. The G-7 would need to negotiate agreements among its members regarding their obligations for promoting exchange rate stability, but how such an agreement would be reached on the pattern of rates to be stabilized is not revealed. Presumably, an important function of the IMF would be to prepare a detailed plan of an agreement to be approved by the G-7.

The Target Zone System

According to the Williamson and Henning blueprint for a target zone system, rates would be maintained within a zone of fluctuation, to be based on fundamental equilibrium exchange rates (FEER). The FEER would be consistent with the current account balance of each country and with its domestic objectives of full employment and price stability. The G-7 finance ministers and central bank managers would be "at the center of international monetary management." The IMF would provide both the secretariat and the forum within which the G-7 ministers would make basic policy decisions. The G-7 would set targets for the current account balances of the participants in the target zone regime; identify the FEERs; and establish procedures for realigning target zones in response to developments calling for balance of payments adjustments (Williamson & Henning, 1994, p. 104). The Fund would have the power of surveillance over the exchange policies of its members. However, a council of G-7

finance ministers would establish the target zones for the exchange rates, and determine the changes in monetary and fiscal policies needed to sustain them.

Supporters of the target zone system apparently assume that the band within which exchange rates fluctuate will be wide enough to accommodate pressures arising from speculative capital movements, and that the capital movements will tend to reverse when the exchange rate on either end of the target zone is approached. One problem this poses is the width of the band. If it is very wide, say, 20 percent, the target zone would contribute little to reducing exchange rate fluctuations. Conversely, the narrower the band the more difficult it would be to maintain the rates within the zone. There is also the question of how frequently and under what conditions the band would be changed. If the band is not changed quickly after the market perceives that fundamental conditions are inconsistent with maintaining rates within the band, there would be large capital movements requiring very large offsetting interventions. On the other hand, if the band is changed frequently, the system will lose credibility and there will be little exchange rate stability (Kenen, 1994).

Opposition to a Role for the Fund

Opposition to a substantial role for the Fund in a new international monetary system has been expressed by both academic economists and government officials. Most opposition concerns the desirability or feasibility of managing exchange

rates, either unilaterally or multilaterally. One objection is that exchange rate management is likely to be more harmful than beneficial because governments will tend to support improper exchange rates long after fundamental conditions change. (This is clearly the position of Milton Friedman and George Schultz.) A second objection is that the cost of currency stabilization arising from the loss of freedom to use monetary and fiscal policies for promoting domestic objectives outweighs any possible benefits. Some doubt that currency fluctuations significantly impede trade since the cost of hedging contracts in foreign currencies is relatively small. A third objection is that neither the Fund nor the G-7 will be able to determine FEERs accurately, or to recognize when conditions dictate a change in FEERs. A fourth objection is that central bank intervention cannot maintain exchange rates in the face of large speculative capital movements. Finally, many doubt it will be possible for the major countries to reach agreement on the pattern of exchange rates they would support, either because the rates may not be consistent with their trade objectives or because the monetary and fiscal policies required to support the rates are inconsistent with domestic economic objectives.

Representatives from the governments of major countries who attended the 1994 Bretton Woods conference in Washington were not enthusiastic about either multilateral coordination or a dominant role for the IMF in creating a new international monetary system. Larry Summers, currently U.S. Deputy Secretary of the Treasury,

expressed doubts regarding the feasibility of policy convergence in the light of the EU experience (Bretton Woods Commission, 1994a, p. 19). The Japanese Vice Minister of Finance for International Affairs, Kosuke Nakahira, also played down a future role for the Fund, stating that "What is important, in my view, is to have frequent and informal contacts among policy makers, Ministers of Finance, and Central Bank Governors or their Deputies, say, through G-7 meetings or other appropriate forums rather than to formalize or institutionalize the coordination process" (Bretton Woods Commission, 1994a, p. 23). The representative of the German Federal Ministry of Finance, Gert Haller, rejected international coordination of monetary and fiscal policies and target zones on both theoretical and policy grounds (Bretton Woods Commission, 1994a, p. 21).

Since the termination of the gold convertibility of the dollar in 1971, the U.S. government has had relatively little interest in stabilizing the foreign exchange value of the dollar, showing concern only when the dollar depreciated sharply. During the first Reagan Administration, the Treasury Department was against intervention in the exchange market and any other action to reduce the value of the dollar, which in 1984 was generally regarded as substantially overvalued. When James Baker became Secretary of the Treasury in January 1985, there was a shift in the Treasury's position on the dollar. At the Plaza Agreement meeting in September 1985, the U.S. Treasury, in cooperation with other G-7 governments, agreed to reduce the external value of the

dollar by intervention, and the dollar depreciated during 1985-1987. At the G-7 Louvre Summit in February 1987, an agreement was reached on collective action to stop the decline of the dollar and stabilize G-7 currencies within reference ranges. There was, however, little willingness on the part of governments to change their monetary and fiscal policies. After rallying in 1988, the dollar resumed its decline in 1989 and continued to fall during the first half of the 1990s. At recent G-7 meetings, the communiqués pay lip service to cooperation, but formal arrangements are not supported.

Economists Views on the Role of the Fund

Aside from those associated with the Institute for International Economics and with the IMF, economists specializing in international finance have not been enthusiastic about either a new international monetary system for stabilizing exchange rates or a major role for the IMF. They find a likely conflict between monetary and fiscal policies that will maintain a set of target rates or zones within which rates may move on the one hand, and policies designed to achieve domestic objectives. This is particularly the case for G-7 countries that have no commitment to a common currency, but this conflict is also impeding realization of the Maastricht Treaty for achieving an EMU by 1999 (Kenen, 1994). Richard Cooper (1994) finds the Williamson et al. target zone proposal unacceptable for two major reasons. First, it would require an agreement on national current account targets among the G-7 countries, which he does

not to be possible. He does not believe the IMF or any other body can be given the authority to determine what Japan's surplus should be or how much of a deficit the U.S. should accept in accommodating a Japanese surplus. A second difficulty is that no outside body could decide whether the U.S. government should have a balanced fiscal budget, especially since agreement on a balanced budget amendment has not been reached within the U.S. government. Cooper also raises the question of whether there would be an adjustment in current account targets following global shocks, and what would be the adjustment in FEERs following such shocks. A sharp rise in oil prices would improve Britain's current account and adversely affect the current accounts of the U.S. and Japan. Britain would undoubtedly oppose an appreciation of the pound following an increase in oil prices since it would be to the disadvantage of her manufacturing industries.

Barry Eichengreen (1995) contends that there is no middle ground between freely floating rates and a unified monetary system with a common currency, such as the EU is seeking to achieve. In his view, stabilizing exchange rates through policy coordination or convergence is not possible. Monetary unification requires a high degree of political integration, which seems very far in the future even for the EU countries. Richard Cooper takes much the same position as Eichengreen in his criticism of the target zone system. He suggests that "in the long run, but not for the next few years, we will desire

irrevocably fixed exchange rates among the major currencies--in effect, a common currency among the industrialized democracies" (Cooper, 1994, p. 116). Thus, we find a fundamental conflict in the positions taken by leading international economists on the possibility of forming an international monetary system in which there is multinational coordination to stabilize exchange rates.

Without a specific commitment by governments to support an exchange rate stabilization program in which the Fund would play a major role, the Fund is left with its present international monetary role of preparing financial analyses, carrying on "formal" annual consultations with individual members, and admonishing the finance ministers of leading countries to take measures these ministers usually find incompatible with domestic objectives. These functions do not constitute a significant role for the Fund in the international monetary system.

One IMF function that should be retained in some way is enforcement of the rules on exchange restrictions on current transactions and on the use of multiple exchange rates set forth in the Articles of Agreement. These rules have their counterpart in GATT rules on trade restrictions and on import subsidies and countervailing duties. Exchange restrictions can be used to accomplish the same purposes as trade restrictions, and the two sets of rules should be made consonant and enforced. If the Fund were to be abolished or merged with the Bank, one way to preserve this function would be to transfer responsibility to the WTO for enforcing the rules on exchange restrictions and multiple exchange rates.

IMF Assistance to Developing Countries

The traditional purpose of the Fund's financial assistance has been to help countries restore balance of payments equilibrium without resorting to trade or exchange restrictions on imports, defaulting on international debt, or reducing investments important for economic growth. Normally, member countries are permitted to draw foreign exchange from the Fund up to the limit determined by the member's quota. Repayment terms are not fixed, as in the case of a loan, but repayments are expected to begin after three years out of a payments surplus generated by either an improvement in external market conditions or by policies designed to improve the balance of payments. Assistance from the Fund has never been an unqualified right, since the Fund has the authority to declare a member ineligible to draw foreign exchange if it finds the member's policies inconsistent with restoring equilibrium. However, in order to assure members that they can obtain assistance from the Fund during a certain period, the Fund adopted the practice of negotiating "standby agreements," according to which the Fund is obligated to provide a certain amount of assistance over a period, say, six months or a year, while the member agrees to follow specific exchange, credit and fiscal policies during that period. Failure of the country to follow these policies may result in a refusal by the Fund to negotiate a new standby arrangement.

The sources of balance of payments disequilibria for which

the Fund has normally provided assistance include short-falls in export earnings resulting from supply shortages or sharp decreases in prices of export commodities; emergencies such as natural disasters; and improper monetary and fiscal policies. While the Fund continues to provide assistance in response to problems arising from the above sources, it found that many of its members have structural problems that keep them in a condition of perpetual disequilibrium and low growth, in contrast to temporary conditions that are cyclical or can be dealt with by monetary and fiscal restraint. Over the past decade, the Fund has introduced new loan facilities that differ from traditional assistance provided in response to balance of payments disequilibria. One is the Structural Adjustment Facility (SAF), which provides loans on very liberal terms--an interest rate of only 0.5 percent and repayments over five-and-one-half to ten years--in support of macroeconomic reforms and structural adjustments. SAF loans are accompanied by detailed agreements on programs that may deal with the curtailment of bank credits, privatization of state enterprises, or the elimination of price controls and trade restrictions. Periodic releases of the credits depend on the borrower's performance under the agreement. Not all of the SAFs have succeeded in achieving balance of payments improvement and satisfactory economic growth. There have been several outright failures, especially in the African countries of Zambia and Zaire. In some of these countries economic progress has been impaired by civil war and

irresponsible dictators. As of FY 1994, Fund obligations in arrears totaled 2.9 billion SDRs (\$4.3 billion). Many countries would probably default on their repurchase obligations to the Fund if they could not continue to receive new loans. Hence, repayments are not being made from improvements in the balance of payments. To quote Peter Kenen (1994, p. 34), "It is time to concede that the Fund and the Bank have been involved in the de facto rescheduling of their claims on a number of developing countries that cannot possibly repay them." Assistance from the Fund has undoubtedly helped some countries liberalize their economies and achieve reasonable growth rates. On the other hand, it is argued that the absence of financial assistance from the Fund might force countries to institute economic reforms more rapidly and avoid accumulating external indebtedness.

Another facility, called the "systemic transformation facility," was created by the Fund in 1993 to assist former Soviet countries in the process of transforming to private enterprise and free markets. Such assistance involves problems quite different from those dealt with in developing countries, most of which have largely private economies with markets, credit institutions, and reasonably functioning systems of monetary and fiscal control. The Fund's staff has formulated national plans for new financial institutions in the former Soviet countries to mobilize and allocate credit, and for creating capital markets required for transferring ownership from the state to the private sector. The Fund's functions in these countries are not only far

removed from those for which it was designed, but there is little to distinguish them from the functions of the World Bank operating in the same countries.

The Fund's programs in Russia and several other former Soviet countries have not been very successful in either promoting the transition to capitalism or improving the balance of payments. Privatization has been slow and trade has fallen sharply, partly as a result of the collapse of ruble-based trade and the shortage of foreign exchange for financing trade with convertible currencies (Black, 1994, pp. 265-272). In June 1993, Russia obtained from the Fund a loan of 1.1 billion SDRs (\$1.6 billion), but the government was prevented from drawing more than the first 25 percent, because of its inability to achieve the required degree of monetary and fiscal control. Strong political pressure has been put on the Fund to release the loan funds. Chaotic political and social conditions are perhaps the major barriers to economic reconstruction and internal stability in Russia. Should the Fund attempt to operate in such an environment?

Why Two Development Institutions?

Just as the Fund discovered that countries with chronic balance of payments deficits could not improve their payments position without structural changes in institutions, markets and government operations, so also the World Bank found that many of its members could not have sustained growth in per capita output without structural change. The required structural changes cover

the whole gamut of deficiencies in institutional arrangements and government policies in developing countries that economists have found to obstruct economic progress during the past few decades. Balance of payments equilibrium and growth are closely related; there cannot be sustained growth without the conditions for long-term balance of payments equilibrium. During the past decade and a half, the Bank has made an increasing number of structural adjustment loans (SALs), which currently constitute more than one third of the Bank's lending. SALs provide a means for the Bank to influence a country's broad development policies and evolving institutional structure in a way that it cannot do through project and program loans. The Bank releases portions of an SAL, according to the degree to which the borrowing country is carrying out conditions set forth in the loan agreement.

The IMF tends to emphasize monetary, fiscal and exchange rate policies in its SAFs, while the Bank's SALs give greater emphasis to allocating capital among economic sectors. Both institutions seek to promote a combination of governmental policies and institutional changes that are closely inter-related. Not only is there considerable overlap between the Fund and Bank in these operations, in a few cases there is actual conflict in the agreements with individual countries negotiated by the institutions. Therefore, some critics have argued that the Fund and Bank should not be engaged in providing development assistance. As stated by Gustav Ranis, "the Bank used to concentrate on projects, leaving balance of payments issues and

related macro advice to the IMF. . .it has lately become increasingly difficult to tell the difference between the two institutions" (Ranis, 1994, p. C75). George Schultz (1995, pp. 5-6) states that "the overlapping activities of the Bank and Fund, a change in the traditional mission of the IMF, and the need to use scarce resources carefully all argue for a merger of these institutions." Schultz would put the functions of the Fund into the Bank.

Fund officials insist its SAFs are not development aid because the financing promotes balance of payments adjustment rather than development. This is largely semantics because of the close relationship between a healthy balance of payments and sustainable development. The argument might have been more credible when the Fund's assistance took the form of supplementing international reserves in order to deal with short-term or cyclical short-falls in foreign exchange income. The SAFs are designed to correct basic structural defaults in a country's economy.

The Bretton Woods Commission Report opposed merging the institutions on the grounds that the Fund can provide unique services to developing countries (Polak, 1994). Nevertheless, the Report recognizes the need for a more clearly defined division of labor. The Report recommends that the Fund "focus squarely on short-term macroeconomic stabilization" and "the Bank should not duplicate the Fund's macroeconomic analysis, but should rely on it in its program planning and project design.

The Fund, in turn, should depend on the WBG to provide financial and technical assistance to recipient countries, to mitigate the impact of macroeconomic adjustment on the poor and the environment." The Commission was concerned that duplication of effort could become a serious problem "when a country's financial imbalance is structural and, therefore, longer term in nature." In these cases, the Fund "should not pursue independent programs, but its macroeconomic advice should become part of a longer-term adjustment strategy led by the World Bank Group" (Bretton Woods Commission, 1994b, p. B-19). In stating that the Fund should focus on "short-term macroeconomic stabilization" the Commission report appears to be saying that the Fund should not make SAFs, since, by definition, they are structural in nature and not limited to short-term financial stability. Another question is whether the Fund's short-term stabilization assistance is sufficiently unique to justify the existence of such a large specialized institution.

A complete merger of the Fund with the WBG would require either redrafting the charters of both institutions, or terminating the Fund and restructuring the Bank. U.S. Legislative approval would be extremely difficult to obtain. The easiest way to accomplish a merger of their current activities would be to bring the Fund into the WBG as a separate entity, similar to the IFC. Integrating the Fund and WBG could be accomplished by having a single set of executive directors for the two organizations, with each director serving both

institutions. (This is, in fact, the case with the Boards of Governors of the Fund and the Bank since they are the ministers of finance of the member countries. The task of integrating research staffs and administrative bureaucracies would be left to the joint executive board and the president of the Bank (who might also be the Managing Director of the Fund), but the funding for the two institutions could remain as presently provided in their charters. This could be done through a simple amendment to the charters.

The Fund's New Role in Crisis Prevention

The Halifax Summit of the G-7 countries (June 15-17, 1995) proposed a new role for the Fund in dealing with financial crisis prevention and emergency assistance. The proposal provides for (1) "an early warning system," including the publication of key economic and financial data; (2) increased surveillance and policy advice to governments; and (3) an emergency financing mechanism which would provide "faster access to Fund arrangements with strong conditionality and large up-front disbursements in crisis situations" (IMF, 1995). To enhance the Fund's resources for emergency financing, the Halifax Summit communique requested that wealthier nations double the \$28 billion now available to the Fund under the General Agreement to Borrow (GAB), and, in addition, suggested that consideration be given to increasing IMF quotas.

The Halifax proposal was initiated by the U.S. government as a response to the Mexican financial crisis of December 1994,

which led to the mobilization of some \$50 billion in credits for the Mexican government. Of this amount, about \$20 billion was made available from the U.S. Treasury Stabilization Fund, \$18 billion from the IMF, and the remainder from other countries. Because NAFTA had recently been negotiated and its success was very important to the Clinton Administration, the Administration had a strong incentive to assist the Mexican economy and moderate the decline in the peso. If such a crisis had occurred in Argentina or Venezuela, would the U.S. government have provided such a large aid package and urged the Fund to provide a similar amount?

The Fund has responded to financial crises before, but never in such large amounts for an emergency created by massive private capital withdrawals. The Fund's Articles of Agreement specifically prohibit members from making use of Fund resources "to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such uses of the resources of the Fund" (IMF, Art. VI, Sect. 1). However, in recent years many developing countries have freed their capital markets from controls, thereby exposing them to sudden capital outflows, with a consequent draining of the country's foreign exchange reserves and threatening the country's ability to meet both private and official debt obligations. The country's official reserves may also be depleted if the central bank attempted to support the currency in a period of capital outflow.

The Halifax Summit proposal does not affect the system of international payments represented by the major currencies, but it does address the risk inherent in the global capital market, which now include many developing countries. In appraising this role for the Fund, it is necessary to consider whether increased Fund surveillance and the requirement that countries make public all the relevant information on their current financial condition will reduce the incidence of crisis, and whether a large aid package following a crisis is the most beneficial use of public international capital. Mexico received economic assistance from and scrutiny by the Fund before the December 1994 crisis, a factor which raises the question of whether the Fund can provide an effective early warning system. In fact, in 1994 the Fund held consultations with Mexico shortly before the crisis, and there is no evidence that the Fund advised depreciation of the peso or other changes in Mexico's financial policies (IMF, 1994, p. 81). Will foreign investors become less cautious if they rely on the Fund to warn them of risky conditions and bail them out if the country in which they are investing is faced with default? Will countries be willing to borrow more on international capital markets if they know the Fund provides a safety net to avoid default? Private capital imports do not necessarily finance productive investment that will strengthen a country's balance of payments position. Should the Fund's resources be used to encourage and, in effect, guarantee external debts incurred by loans which may not have been used for productive purposes?

Clearly, countries receiving assistance should make available to the public all relevant information on their financial condition. Given this information, should not external creditors be able to evaluate their risks and not count on emergency aid from the Fund to avoid losses from defaults?

There is a question as to how the "early warning system" would work. Who would be warned and when? As soon as the world financial community receives a warning that a country is facing financial difficulty, a massive capital outflow is likely to occur, in which case crisis prevention would be out of the question. What would the emergency assistance be used for? If it is used to enable the country to meet its external debts, there is no decrease in total indebtedness and no new productive capital. Only if the capital outflow were reversed could the Fund be repaid within a short period, but this is by no means assured. If the external creditors were not immediately repaid, what would be the affect of a large additional obligation on the credit standing of the country? How could emergency credits improve the current account balance given the additional debt service obligations? These questions were not satisfactorily answered in the G-7 proposal.

Proposal for a New Allocation of SDRs

Included in the multilateral sources of financial assistance under the jurisdiction of the IMF is the allocation of SDRs. There is strong support by the Managing Director of the IMF for creating more SDRs. One argument is that new IMF members that

missed the earlier allotments should be provided with SDRs. This suggests that somehow SDRs are an entitlement, which should be made available to the former Soviet Bloc countries recently joining the Fund. The original argument for SDRs was that a shortage of international reserves would limit world trade. Those opposing point out that there is no evidence of any relationship between world aggregate reserves and the volume of world trade. The idea that global reserves may at times be inadequate originated during the early post-war period when dollars and gold were the bulk of the international reserves. The so-called "dollar shortage" disappeared in the 1960s. Currently, there are several major currencies serving this function and there is certainly no shortage of convertible currencies held by central banks of the world. In addition, central banks have negotiated agreements for borrowing large sums from one another. Shortage of reserves is an individual country problem, not a world problem. A general expansion of SDRs is a poor form of foreign aid. It is neither targeted to specific purposes nor countries in need. Expanding the total volume of international liquidity serves no global function and might contribute to world inflation.

Problems Created by Liquidating the IMF

If the IMF were liquidated, a number of problems would arise. First, all 179 members of the Fund count as a part of their international monetary reserves their reserve positions in the Fund (totalling \$52.9 billion as of FY 1995) and their holdings of SDRs (totalling \$31.6 billion). Although these amounts are small compared to total reserve assets in excess of a trillion-and-a-half dollars, they represent \$13.5 billion in reserves for developing countries. Liquidating the Fund would eliminate these reserves. Such a liquidation would involve repayment of gold and current subscriptions made by member countries. In order to repay these subscriptions, countries would need to repay obligations to the Fund totalling \$58 billion as of FY 1995. Many developing countries are dependent on new IMF credits to meet their repayments on old credits. In addition, the Fund has made commitments under standby and SAF agreements, which would probably be honored, but could not be renewed. Liquidating the Fund would also mean that members would no longer be obligated to accept SDRs in payment of debts. However, there would need to be some way of compensating countries holding SDRs in excess of their initial allotments. Such compensation would need to come from those countries (mainly developing) that spent all or a portion of their SDR allotments. The net use of SDRs by members totalled nearly \$13 billion as of FY 1995. Countries would need to pay this amount to buy back the

SDRs they used over and above their initial allotments.

The IMF could not be rapidly liquidated without creating financial crises for a number of developing countries, especially those with debt servicing problems. It would require at least a decade and probably longer during which time some loans would need to be made to avoid crises. One approach to phasing out the Fund would be a gradual reduction in the number of countries eligible to draw on its resources. This has been occurring as members, such as Korea, approach the economic status of developed countries. Eligibility to use the resources of the Fund might be limited to those countries that are poorest and most in need. Alternatively, eligibility might be limited to those countries that are most likely to make the best use of the Fund's resources for achieving growth and long-term balance of payments equilibrium. If the Fund made eligibility for credits depend on the first criterion, it would be less able to repay its subscribers than under the second criterion. In either case, the Fund's unpaid obligations are likely to be substantial. However, so long as the Fund is not terminated, there would be no losses by member countries holding SDRs and reserve positions in the Fund.[3] This might dampen enthusiasm for liquidating the Fund!

Conclusions

1. I do not favor the establishment of an international monetary order based on an agreement among the major financial powers to maintain a set of target exchange rates or ranges within which the rates would move through coordinated exchange market intervention and monetary and fiscal policies. I have reached this conclusion for three reasons. First, I do not believe it is possible for the G-7 countries to reach agreement on a set of target rates and current account balances they would be willing to support. Second, I do not believe that the United States or most of the other G-7 countries would be willing to subordinate domestic objectives to the stabilization of exchange rates in situations where these objectives are in conflict. Third, I have serious doubts whether G-7 countries with the support of the IMF can be successful in selecting a set of target exchange rates that would be compatible with both the current account balances they could agree on balance of payments equilibrium for each country. The macroeconomic conditions for maintaining any set of exchange rates that would satisfy these goals are continually changing, and stabilization efforts would continuously be thwarted by developments that would render the rates inappropriate. Except for emergency situations brought on by global shocks or crises in individual countries where temporary financial coordination for influencing exchange rates might be beneficial, exchange rates should be determined by free markets without multilateral management.

2. I reject the proposal for a substantial increase in the resources of the Fund for emergency assistance in dealing with financial crises. The Fund should provide stricter and more comprehensive surveillance for those countries making use of its resources, and should insist that all information relevant for an analysis of a country's financial outlook be made public with a minimum of delay. However, funds for public international assistance are scarce and should be used mainly for reducing world poverty and promoting broadly-based development. Large amounts of financial assistance for preventing defaults and stabilizing capital markets is unlikely to promote these objectives.

3. The Fund's very limited contributions to the international monetary system do not warrant continuing an institution of this size. For more than two decades the Fund has functioned almost solely to assistance and advise developing countries, and much of these activities duplicate those of the WBG. I believe the Fund should be merged with the WBG, and its personnel, policies and administration closely integrated with those of the World Bank. I do not believe the current functions of the Fund are sufficiently unique to warrant its continuation as an independent institution. However, an immediate liquidation of the Fund would create serious financial problems for many developing countries, and its liquidation should require a period of at least a decade and possibly longer, while operating within the framework of the WBG. Because of the problems in renegotiating the Fund's Articles of Agreement, I suggest that

the capital structure and sources of funds for the Fund remain as presently constituted, but that its policies be determined by a joint board of executive directors in which each director would serve as the executive directors of both the Bank and the Fund. Both institutions should be under the general management of the president of the Bank. Since the Fund's Articles call for the appointment of a managing director, this position could be held as a joint appointment by the president of the Bank. The Boards of Governors of the Fund and Bank appoint both the President of the Bank and the Managing Director of the Fund. The two Boards are already integrated; in almost all cases, the Governors are Ministers of Finance of the member countries.

4. The Fund's responsibility for administering the provisions of the Articles of Agreement on exchange restrictions and multiple exchange rates should be transferred to the WTO, since these rules are the financial counterpart of the GATT rules on trade restrictions and subsidies. This function would be taken over by the WTO since it is generally related to the GATT trade rules.

Although all 179 members of the Fund hold reserve positions in the Fund in SDRs as part of their assets, these assets represent only 5 percent of their total reserves. Since the Fund's very limited contributions to the international monetary system scarcely warrants continuing an institution with a \$200 billion budget and a first-rate research staff, (including many of the world's most prominent economists), the question of whether the Fund should be maintained indefinitely as an independent institution depends almost entirely upon an evaluation of its contributions to developing countries, and those former Soviet bloc nations in the process of transition to free economies.

The issue of whether the Fund's current activities in assisting developing countries and Eastern European countries in transition, depends upon whether these activities justify the existence of such a large institution and whether the Fund's assistance could be provided more efficiently if merged with the WBG. I question whether the Fund's assistance to developing countries is unique enough to be handled by the Fund as an independent institution, especially since a substantial portion of the assistance provided is quite similar and closely related to that provided by the WBG. I have argued that balance of payments assistance, which now goes well beyond temporary supplements to member country reserves, is indistinguishable from development aid and should, therefore, be provided by a single institution. However, the new proposed role for the Fund,

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Footnotes

1. The Washington, DC conference was sponsored by the Bretton Woods Commission and held at the U.S. Department of State on July 20-22, 1994. The conference on October 15-17, 1994 was held at the Mt. Washington Hotel, Bretton Woods, New Hampshire and sponsored by the Institute for Agriculture and Trade Policy.

2. SDRs have been allocated to the members of the Fund in accordance with an amendment to the Articles of Agreement in May 1968, with the first allocation of 9.5 billion SDRs over a three-year period starting January 1, 1970. A member wanting to acquire the currency of another member may transfer SDRs to that member in exchange for that member's currency. Each member has an obligation to accept SDRs up to an amount equal to twice its own SDR allocation. Normally, only developing countries use SDRs to obtain convertible currencies.

3. So long as the Fund is not terminated, countries holding reserves in the form of SDRs and reserve positions in the Fund would continue to hold them as a part of their reserve assets, and they would continue to be transferrable to other countries in payment of debts as long as all countries abided by the agreement to accept them. It would be analogous to a situation in which all members of a community held deposits in a bankrupt bank and all payments were made within the community by drafts on deposits and there were no cash withdrawals.

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