SOME ISSUES REGARDING IMF AND THIRD WORLD RELATIONS

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SUMMARY

The aim of this work is to examine the evolving monetary relations and its impact on the developing countries, and to question the validity of any legal theory in this context.

Chapter 1 deals with the management of the monetary relations from the establishment of the Bretton Woods system to the present. It shows that Bretton Woods was the institutionalisation of liberal economic theory fostered by the developed countries. The rules were mainly based along oligarchic principles within the developed capital market countries, consequently such rules were unsuited to the poor underdeveloped countries' economic situation.

Chapter 2 focuses on the decision-making processes of the IMF which excludes any effective participation by developing countries.

Chapter 3 examines the IMF power to adjust payments imbalances and highlights the asymmetrical aspect of its operations with special reference to its conditionality and its economic and legal foundations.

Chapter 4 examines the alternatives for change within the IMF especially regarding its policies and decision-making functions which Third World countries believe operate to their disadvantage.

By way of conclusion it is being strongly argued that only a normative approach can participate to the development of legal theory regarding the international monetary relations. It is inevitable that economic order requires legal order.

INTRODUCTION

The chaos and disorder in monetary relations have questioned the validity and role of the international economic organizations which were set up to ensure smooth and orderly functioning of the economic relations between sovereign states.

The International Monetary Fund is one such organizations where its policies and structure have caused fierce debates.

The aim of this paper is to bring into focus some issues in the troublesome relations between the International Monetary Fund and the Third World.

The first chapter examines the origin and development of the management of the international relations starting from the establishment of Bretton Woods system until the present day in historical perspective. Four points are sought to be comprehended from this historical exposition. First, the Bretton Woods system was a reflection of the economic and political environment after the second World War. It served the liberal economic theory which is based on the belief in free trade as an avenue to prosperity and development. The period of stability in the monetary relations which followed was attributablé to the political consensus on broad objectives of the monetary and economic plans between the western allied powers. Second, the rules which evolved during different stages coincide with oligarchic lines dominated by the developed capital market countries which have formed concrete financial power centres outside and within the IMF management of the monetary relations. Third, an attempt is made to identify the role of the IMF in the different periods of the management of monetary relations and its response to the changes in the international economic environment. The striking aspect is its peripheral role. It is no more than an "echo" of the decisions of the developed countries. Fourth, the role of the developing countries in this process of institutionalization of the international monetary relations provides evidence that there is an absence of any active participation by them in the formulation of the rules simply because at the time when Bretton Woods system was set up they were subject to colonial relations and during the following periods they were de facto excluded. It should be noted that almost all the major decisions are taken by the industrial countries. Developing countries are inappropriately represented in the IMF executive organ and even their demands for changes in the structure and policies of the IMF are not in any precise or rigorous form.

The second chapter deals with the decision making process in the IMF. It shows how the structure and the process of decision making works to the disadvantage of the developing countries. The composition and the appointment of the Executive Directors and the weighted voting system together allow the developed countries to exercise a decisive influence on the IMF decisions. The introduction of the special majority regime by the Second Amendment enhanced the privileged position of the developed countries.

The third chapter analyses the power of the IMF to adjust disequilibrium. Examination of the instruments which are available to the Fund to influence surplus and reserve country currencies reveals their gross deficiency. The scarce currency clause cannot become operative under the present monetary arrangements. Surveillance in effect does not have binding force rather it is merely the summary of the Executive Directors' observations. It was suggested that the Fund, by providing conditional liquidity for deficit countries, can force the surplus countries to adjust their disequilibrium. The limitations and shortcoming of this instrument are too obvious to be of any effective use. By contrast the IMF's flimsy influence over the monetary "system" and the developed countries coincides with tightening up its grasp over deficit countries who ask for the Fund's credit. These countries have no choice but to accept the Fund's prescription in order to gain access not only to the Fund's resources but also to other financial resources. The IMF programmes always result in social unrest. The origin, development, legal and economic foundations of the Fund's conditionality are examined in detail in chapter three.

The fourth chapter deals with Third World demands for changes in the IMF as embodied in several documents and reports. These countries have demanded effective participation in the decision making process of the IMF, reorientation of the IMF programmes toward structural economic concepts, achievement of symmetry in the IMF programmes and increase in its resources. Yet none of these demands provide for a real alternative formula neither did they provide for means to implement them.

It is being argued that unless these demands are based on a coherent set of legal rules they will remain in a stage of rhetoric.

CHAPTER 1

THE MANAGEMENT OF INTERNATIONAL MONETARY RELATIONS SINCE 1945

The purpose of this paper is to analyse the terms under which the developing countries are allowed to participate in the management of international monetary relations through examination of the structure, decision-making process and the policies of the International Monetary Fund.

Special methodological problems are inherent in such research. These are due not only to the nature of the international society but also to the interrelation between economics and politics as well as the role of legal concepts in this interaction.

The process of institutionalization of international economic relationships after the Second World War resulted in the creation of the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD) and the International Trade Organisation (ITO) however the latter never came into existence. The constitutive instruments of these organizations were drawn up at the Betton Woods Conference in 1944. The negotiations of the Articles of Agreement of the International Monetary Fund were dominated by the American and the British and despite the divergence of their views in respect of the intended organization a final agreement[1] was reached. Article I spelt out the purposes of the Fund:

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

ii) To facilitate the expansion and balanced growth of international trade and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objective of economic policy.

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

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

v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

vi) In accordance with the above to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members.

The IMF is to achieve its purposes through administration of a code of conduct which outlines the "rights" and the "obligations" of its members. Article IV enumerated the member's obligation regarding exchange arrangement. Article VII deals with the general obligations of members. The Fund can best be described as an institution with a "unique"[3] combination of consultative, regulatory financial and technical assistance functions at intergovernmental level.[4] Viewing these arrangements for the management of the monetary interdependence between sovereign states in a political economic context will provide a better understanding of the nature and the functions of this process of institutionalization of monetary relations. The Bretton Woods institutions and rules were reflections of certain events and ideologies and consequently, the institutions and the rules were designed to validate certain basic principles.

First, it was recognized that exchange rate adjusment was a matter of international concern. In order to avoid the chaos of the competitive devaluation of the interwar period the original Articles of Agreement provided that par value of all member currencies were to be defined in gold terms, exchange dealings must be carried out at a rate which do not vary between maximum and minimum by more than one per cent.[5] A member of the Fund could change the par value of its currency after satisfying the Fund that the proposed change is necessary to correct "fundamental disequilibrium" but the concept of fundamental disequilibrium has never been defined.

It is obvious that this system put the whole burden of adjustment upon the exchange rate since it implies that countries would refrain from policies which aimed at adjustment of their external balances by deflation of their domestic income. The rigidity of this system is demonstrated by the fact that a country might only change the parity to meet fundamental disequilibrium, the disequilibrium is <u>ipso</u> <u>facto</u> in existence by the time action is taken to correct it.[6]

Second, there is an absence of exchange control restrictions. Article VII (2) provides - that no member shall, without the approval of the fund, impose restrictions on the making of payments and transfer for current international transactions. Section (3) requires the avoidance of discriminatory currency practices. Section (4) provides that all currencies are to be freely convertible into one another. The aim of this provision is to encourage free trade. To allow a currency of one member to be sold to pay for foreign currency is only possible for a strong currency. A country needs foreign currency for imports and cannot sell its own currency for the much needed foreign currency therfore it embarks upon policies aimed at restricting socially useless imports through controls in order to help the deficit. This is not only illegal in the terms of the IMF but it also exposes the lack of honest bureaucracy to achieve such a policy.[7]

Third, the most important feature of the Bretton Woods agreement is that it established an organisation to deal and administer these provisions. A brief description of the institutional character of the Fund follows and a detailed study would form the basis of Chapter two.

1. Quota, Resources and Drawing Rights:

The quota system is very essential to the governance of the Fund[8]. It determines the subscription of each member to the capital of the Fund which represents a large size of the Fund's financial resources. It determines the amount which a member can draw from the Fund and finally the voting strength of a member. The Fund is empowered to borrow from its members as well as from other sources.

Each member has the right to purchase from the Fund in exchange for its own currency the currency of another member up to a maximum of 25 per cent of its quota per annum provided that the total holdings of the Fund in that currency does not exceed 200 per cent of its qauota.[9] It should be noted that this drawing is not automatically available but subject to certain conditions. The important one is that the member is to satisfy the Fund that currency required is "presently needed for making payments which are consistent with the provisions of the Agreement". The concept of the conditionality, its development and its implications shall be examined and discussed in the third chapter.

The management of the Fund

The Fund was the first international organization where the decisions were to be taken by weighted voting system, thus departing from the one country one vote rule. The voting strength of each member is determined by the size of its quota which is supposed to reflect the country's position in world trade. The present voting system ensures that no decision can be taken against the wishes of the United States and the EEC.

The Executive Directors control the real decision making power in the Fund. Their appointments, decisions and the voting system in the Fund highlight the political aspect of the management of the Fund and the rule of the international bureaucracy. The mechanism of the decision making process in the Fund will be scrutinized in the second chapter.

There is no doubt that the structure of Bretton Woods institutions serves the liberal economic theory and the privileged positions of the western states through the voting system. The weighted voting system was not to be considered as political at Bretton Woods.[10] The reason for this is intimately connected with the concept of the political democracy in the western states according to which equality is something that belongs to the political realm and has nothing to do with the economy. The IMF is an economic organ thus a country's voting strength reflects its economic power. The liberal theorists[11] rejected the concept of unified political and economic order and replaced it with two separate orders. This position was not challenged by what is now known as the Third World countries, which were at that time politically and economically subordinate and linked with the western world in imperial relations. These states had no choice but to acquiesce to the rules established for them by their former rulers:[12]

The western states shared the belief in a liberal economic system - free trade, market mechanism, minimum barriers to the flow of capital and trade, and private owneship - so the rules were designed to serve this ideology. In Harry White's words:

> "Primarily the Fund is the means for establishing and maintaining stability, order and freedom in exchange transactions. The resources of the Fund are only for the purpose of helping countries to keep such policies."[13]

The concept of international monetary system was very limited since it hinged upon the western concept while supports regulations of the liberal system through removal of barriers to trade and capital flows and the creation of a stable monetary environment to serve these purposes. States rather than the international system bear the responsibility for stability.[14] This concept is embodied in the IMF prescription for balance of payment problems where the emphasis is on national and market solutions to monetary problems and the weakness of the means which are at the disposal of the IMF regarding its regulatory function is a basic feature of the organisation.

The USA, after the war, was the foremost political and economic power. It was willing and able to assume the primary responsibility of the economic leadership. The Europeans and Japanese were in need of the American dollars to reconstruct their industry and finance their trade. The USA acted as the world's central bank by providing international liquidity and managing the imbalances. In performing these functions the USA encouraged protectionism, discrimination against dollar and used the Marshall Plan Aid to encourage devaluation of many European currencies.[15] The American plan worked well and by 1958 the European and Japanese recovery were almost completed. The period from the establishment of the IMF until 1959 can be characterized as the unilateral American management of the intenational monetary system. The American commitments were the centrepiece of the Bretton Woods system and the relative stability of the monetary relations during this period can be imputed to the coincidence of three conditions.

> "The concentration of power in a small number of states - the existence of a cluster of important interests shared by western states - the presence of dominant power willing and able to assume a leadership role."[16]

During this period (1945 to 1959) it can be properly said that the system was in "abeyance".[17] The Fund stood aside awaiting reconstruction of Europe and for the establishment of free convertibility of currencies and multilateral trade - an environment in which the Bretton Woods was designed to operate.

Changes in the configuration of the world economic powers and the shift toward more pluralistic distribution of economic power undermined the American management of the international monetary system.

The system was based on the fact that the American dollar should provide international liquidity once the foreign holdings of the American dollars exceeded the USA gold reserve the whole system would be endangered. In 1960 the USA deficit amounted to 3.7 billion dollars.[18] This was aggravated by the weakness of the sterling pound. The return of convertibility of the major European currencies made possible large speculative international capital flows which could be directed against the pound or the dollar. In 1960 the USA experienced the first run on the dollar. In 1960 also there was a run on the pound. Although the American economy remained healthy, the USA could no longer manage the system alone. Henceforth the USA would join collective management. The USA joined the Basle group and its participation enabled the Basle group to manage important aspects of the international monetary system. A second management which developed at this time was the Group of Ten. This grouping of the ten countries with their developed capitalist economy and with their voting power in the IMF was to assume main responsibilities for key issues in monetary management. They provided a forum for discussion, exchange of information and proposals and negotiation of international monetary relations[19]; the creation of SDR and the General Arrangement to borrow. In Dam's words[20]:

> "the Group of Ten provided the possibility for alternative institutional approach to some key issues of the international monetary policy."

The degree of interdependence was increased by the internationalization of banking and the emergence of international banking consortia, the Eurodollar market, which is beyond the jurisdiction of any state and which is a large uncontrolled international capital market. The availability of huge sums were highly destabilizing. The American deficit affected the economic conditions in Europe and Japan and both became increasingly dissatisfied with the system where international liquidity depends on American deficit but at the same time they assumed no responsibility on their growing surplus. By late summer 1971 there was a decline in the American gold stock to $10 billion versus outstanding foreign dollar holdings estimated at about $80 billion.[21] On 15 August 1971, President Nixon announced his famous decision that the USA would no longer convert dollar into gold and actually put an end to Bretton Woods institution without any consultation with the Fund.

After the United States decision on the 15 August 1971, which was never condemned by the Fund, the Group of Ten engaged in a series of negotiations which ended with an agreement at the Smithsonian Institution in Washington in December 1971.

The Smithsonian Agreement provided for realignment of exchange rates among the Group of Ten.[22] The United States agreed to devalue the dollar in relation to gold by 7.89 per cent, the German Mark was revalued, the Japanese agreed to establish a new yen-dollar parity. The Group decided to allow currencies to float within a plus or minus 2-1/4 per cent of parity instead of 1 per cent which was provided by the Articles of the IMF. However, the dollar remained inconvertible and the new price of $38 per ounce became in the phrase of the time, the price at which the United States did not buy or sell gold.[23]

Dam observed that the minor role of the Fund in these developments is on account of the fact

> "that the United States still did not accept its convertibility obligation under Article VIII (4) thus the entire structure of the Articles was no longer squarely placed on its Bretton Woods foundation. Indeed the Fund was faced with major difficulties even in giving the legal effect to the agreements reached at Smithsonian. One problem was that although the United States had argued to raise the official price of gold, the executive branch had no authority to do so and in the event did not receive congressional approval until March

> 1972. Hence it was in no position to communicate a new par value to the Fund, and the Fund was consequently unable to approve non-existent new par values."[24]

The Fund amazingly referred to Article IV (4)a as the legal basis to legalise the new arrangements!

The Smithsonian Agreement was a form of "crisis control"; it neither resolved the inconvertibility of the dollar nor the adjustment of the problem, although it provided for more flexibility in exchange rates. A year later massive currency flows led to new presure on the Smithsonian rates and by 1973 all major currencies were floating.

In contrast to the Bretton Woods, the international monetary arrangements which evolved after 1972, did not follow any planned or conscientious developments. There is less clear agreement on the "rules of the game", every participant was left to choose its own strategy.[26] The only obvious common element is to place more reliance on the market mechanism. Despite the increase of interdependence in the international financial relations, maximisation of the conflict of objectives of economic policies resulted and no institutional mechanism with power to minimize this conflict was provided. The developing countries' position was worsened not only because of their exclusion from participation in forming the present arrangements and the lack of efficient active market mechanism, but also because of the influence which the developed countries can exercise on market conditions and on the international lending especially interest rate. Another feature of this period is the intensification of balance of payment problems of oil importing countries and the growth of the importance of the commercial lending. The increase in oil prices resulted in creation of huge surpluses which were recycled through international commercial lending rather than international institutions. The oil producing countries were encouraged by the OECD governments to grasp the opportunity for quick profit. There was also a change in the pattern of lending; bank lending shifted from private to public sector borrowers; from long term to short term; from fixed to floating interest rate and from trade-related and project related credit to balance of payments financing.[27] The absence of international machinery to supervise this lending, the votality of exchange rates, increase in interest rates, deterioration in the terms of trade of the developing countries, all combined to result in chaotic monetary relations. Again the "system" is in "abeyance".

The most interesting part of all this is the Fund's position in these changes. The creation of Special Drawings rights, by the first amendment of the Articles which was negotiated between the Group of Ten, outside the Fund and incorporated into the Articles, did not reduce the American deficit nor enhanced the transfer of resources to the developing countries, nor established an international reserve currency. The reason is that it is based on "undertakings" by the surplus countries to provide "convertible currencies". The limitation of the SDR is quite obvious. It requires an 85 majority vote to create it if a global need arises for liquidity thus not ensuring effective response to the special needs of the developing countries especially when linked to the quotas.[28] It will be noted in the third chapter that the first amendment gives the Fund the authority to examine a member's request for a credit consequently it imposes its conditions on the member who applies for the Fund's credit thus putting the pressure of adjustment on deficit countries seeking the Fund's financial resources, without an attempt to empower the Fund with equivalent instruments to influence surplus and reserve country currencies. In contrast the General Arrangement to Borrow, which was also negotiated among the Group of Ten would permit them to escape the Scarce Currency clause and to avoid any domestic changes in their economic policies.[29] The absolute control of the industrial countries over the financial relations and the IMF is enhanced not only because of their grouping, Group of Five, Seven, Ten, but also by the special majority regime, which was introduced by the Second Amendment of the Articles. This regime gives the USA veto over vital issues for the developing countries; increase and decrease in the number of elective Executive Directors; allocation or cancellation of special drawing rights; overrule of decision of committee on interpretation; adjustment of quotas; all these require 85 per cent of total voting power. It guarantees that nothing can be done against the wishes of USA and the EEC. The growing leverage of the IMF over the developing countries has coincided with diminutive influence over the developed countries and the "reform" of "international" monetary "system". "The Committee of Twenty" - now "the Interim Committee" - ended up with minimal proposals.[30]

It called for the establishment of Interim Commttee of the Board of Governors with advisory role and for a council with decision making power to supervise the management and adoption of the monetary system. Regarding the adjustment process and exchange rates, it called for more effective and symmetrical adjustment process with an exchange rate regime based on stable but adjustable par values. It recommended re-introducing an appropriate form of convertibility and close consultation and surveillance. It also called for promoting SDR as the principal reserve asset and the role of gold and resereve currencies to be reduced.

One writer described these aspects of reforms as "superficial" and purely "cosmetic" and this description of superficiality applies as well to the subsequent decisions of the interim committee and its meeting in Jamaica which apart from acknowledging the reality of floating exchange rates, was principally concerned with enlargement of national quotas in the IMF and disposition of the Fund's own gold holdings.

The reason why the monetary reform has remained an elusive goal is:

> "the absence of some agreed mechanism to ensure compatibility among the external policy objectives of separate national governments. This is the problem of consistency essentially political in nature it underlies and conditions of all the traditional economic issues of reform"[31]

The "rules" which evolved in all these stages are the results of ad hoc negotiations, the debators were largely officials and economists. Consequently they are drafted in such generalised language so the legal content was left vague[32]. Carty noted:

> "The IMF is legally bound to carry out these aims but they are not defined with such precision that one can say in a particular case whether it is observing or is obliged by the terms of its constitution"[33]

The Second Amendment of the Article authorised members to intervene when the market is disorderly or rate movements erratic. It is left to the judgement of each state to consider what the "disorderly" market or "erratic" movements of rates are and to its own corrective action. The American view is that fundamental market forces comprise a much wider range of factors notably capital movements while for the European countries. "Fundamental" refers primarily to the current balance of payments.[34]

Furthermore, this tactic not only precludes systematic approach to the monetary relations but also bring greater political pressure on the negotiations. Therefore it is not surprising that these rules have temporary effects and do not participate in the development of legal theory regarding international monetary relations.

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CHAPTER 2

DECISION MAKING PROCESS IN THE INTERNATIONAL MONETARY FUND

The decision-making proces in the IMF has its own salient significance[1]. This is due to a variety of factors inter alia the IMF as a "task oriented organization" with a capacity to adopt "binding decisions on the organization and on the members", usually deals with matters which are "sensitive aspects" of the sovereignty of states. Consequently, they are of great importance to the "political authorities" of the members. Secondly, the functions of the IMF directly affect "significant values". "Those in control of these values" will generally design "structural and procedural devices to ensure for themselves the means of exerting special influence" and by "specifying doctrines according to which decisions should be taken". Thirdly, the practical consequences of the IMF decisions have their direct impact on the "living conditions of members and their peoples" which are seeking the financial support of the IMF. Fourthly, the "operational decisions" of the IMF are usually taken by a small group, the Executive Directors whose operations constitute a significant aspect in the decision making process of the IMF. In other words, these decisions turn into policies which can be directed towards either reinforcing or transforming not only the international status quo but also the domestic one. The effects of these policies are more evident on the domestic scale than the international scale. No wonder there are pledges in local election campaigns to suspend dealing with the IMF.

The increase of politicization of international economic relations has fundamentally influenced the outcome of the decision making process in the IMF. This is not due to the weighted voting system only but to other various reasons, for example, the way the Executive Directors are appointed by their governments and their dual loyalty. They regard themselves as political delegates rather than contributors to a pool of technical knowledge, the limited size of the Executive Board, the "rules" which allow members great latitude in interpretation according to their perceived national interests. The projection of the Executive Directors as representatives of the organization consequently as an "independent" body cannot stand any test.

This combination in addition to the concentration of power in the Executive Directors, the question of the finality of IMF decisions, and the external pressure groups, have resulted in the "elite management of the Fund". The power structure and the policies of the IMF are two inseparable issues: the power structure has produced a set of policies and any change in the policies necessitates change in this structure.

The IMF Decision Making System

Decision making in international organization takes place within a context of the functions, the institutional framework and the historical development of the agency.[2] The basis of the IMF decision making model is that the members are legally bound by decisions taken by simple and special majorities reached on the basis of the weighted voting power. The "weighted voting" system was included in the early proposals for establishing the IMF. Keynes's plan[3] provided for a simple voting system, that is, the voting strength of each member would be in proportion to its quota while White's plan[4] proposed a system which is partly based on the traditional one state one vote whereby each member would have given 100 basic votes based partly on quota with an additional vote for each million dollar of quota. The White's system was finally adopted at Bretton Woods. Each member was allocated 250 basic votes plus one additional vote for each $100,000, now 100,000 SDR by the first amendment.[5] The basic vote principle is to serve several purposes, namely:

> "... to pay some homage to the traditional principle of the equality of states, to avoid too close an analogy to the private business corporation, to guard against too great concentration of voting power in the hands of one or two members, and the members who have too small a quota would have virtually no sense of participation in the affairs of the Fund if their voting power depended only on their quota".[6]

Since countries cannot choose their own quotas the amount of each quota allocated to each member became a major political concern. The methods of determining quota went through many deliberations before adoption of "Annex A" of the Articles of the Agreement. Keynes[7] proposed that

> "the initial quota might be fixed by reference to the sum of each country's imports and exports on the average of (say) three years equal or in a determined lesser proportion to this amount, a special assessment being substituted in case where this formula would be for any reason inappropriate".

This formula did not solve the question what is meant by "inappropriate" and what "criteria would be employed in working out special assessment".[8] White suggested[9] in additon to the international trade criterion other indicators such as gold holdings, gold production, national income, population, foreign investment and foreign debts. In the joint statement there was no mention of criteria on which quota would be based but rather a vague provision stating that "the distribution of voting power shall be closely related to the quotas".[10] The explanatory memorandum known as "questions and answers" which accompanied the "joint statement" outlined the formula for determining quotas viz:

- 2 per cent of the national income of 1940
- 5 per cent of the holdings of gold and gold-convertible exchange, as of January 1, 1944
- 10 per cent of average annual imports, 1934-38 inclusive
- 10 per cent of maximum variation in annual exports, 1934-38.

The sum of these four data should be increased by the percentage ratio of a fifty factor to national income in order to augment the quotas of countries particularly dependent on international trade.[11]

Lister commented on this formula as follows:

> "... among other things, the formula had been designed to produce results that would fulfil the following political requirements: (1) a quota of about $2.5 billion for the United States (2) a quota of about half as large for the United Kingdom, and (3) the USSR and China were to have the third and fourth quota".[12]

This system reflected the economic conditions which were prevalent at the time of the establishment of the IMF, but showed little regard for the problems that would arise in the system's future practice. It continued to be used for many years despite the fact that it was a "clumsy instrument"[13] for setting borrowing limits and voting power. The function of quota as a weighter of voting power and limiter of drawings on the Fund's resources was accompanied by certain anomalies. For example, when a country suffers from a shortage of foreign currency, it would need higher borrowing limits to offset this temporary trend. One of the main purposes of the Fund is to provide financial assistance to overcome balance of payment problems without resorting to measures distractive to national and international prosperity, at the same time this fluctuation would cast doubts on the country's capacity to contribute to the financial stability of the Fund and thus to its voting entitlement,

> "... the same sort of anomaly arises in reverse with regard to the national income indicator, which can be justified in terms of the guidelines for establishing voting power but seems somewhat irrelevant in the context of drawing entitlement. Despite the difficulty of meeting complex and sometimes conflicting objectives simultaneously the quota system has continued to form the main basis not only for voting power and borrowing limits but also in connection with the allocation of seats on the Executive Board, in recent years of special drawing rights".[14]

There is a need for objective criteria for adjusting quotas, establishing new quota and to be responsive to the members short term's needs. In 1979 the Executive Board adopted a decision to review the

> "... customary method of calculating quotas after

> completion of the seventh General Review of Quotas. Such a review will examine the quota shares of members in relation to their position in the world economy with a view to adjusting their shares better to reflect member's relative economic positions while having regard to the desirability of an appropriate balance in the composition of the Executive Board".[15]

The adjusted and revised formulas were adopted and the quota calculated for each member on the basis of these revised formulas.[16]

Adjustment of Quotas

Article III (2) provided for adjustment of quotas as follows:

> "The Board of Governors shall at intervals of not more than five years conduct a general review, and if it deems it appropriate propose an adjustment, of the quotas of the members. It may also, if it thinks fit, consider at any other time the adjustment of any particular quota at the request of the member concerned".

The consent of a member is necessary to adjust its quota.[17] An eighty-five per cent majority of the total voting power shall be required for any change in quotas.[18] The recent increase became effective on April 20, 1986. 142 members consented to increase in their quotas.[19]

Majority Voting

The basic rule for taking decisions in both the Board of Governors and the Executive Board is by votes cast. Article XII stipulates:

> "Except otherwise specifically provided all the decisions of the Fund shall be made by a majority of the votes cast".

This rule does not apply if the Articles provide for special majority. Under the original Articles nine provisions required special majorities. By the first amendment the number is increased to 18 and it was raised to 39 by the second amendment.[20] Gold attributed this tendency to increase the number of decisions for which special majorities of the total voting power of members or participants are required to the wish to "moderate the influence of weighted voting power", to "approximate the effect of a rule of unanimity", to give "formal recognition to the informal policy of taking decisions by consensus or by broad consent"; "the result in part of the wider distribution of economic and financial strength among the members of the Fund or groups of them than in the earlier years of the organization", "the increased number of developing countries" and to the "increase in the powers of the Fund and the content of some of the new powers".[20A]

All the IMF special majorities are based on proportions of the total voting power. However Article XXVI 2(b) stipulates in addition the majority of Governors having 85 per cent majority of the participants.

The special majority model represents a compromise between decisions to be taken by a simple majority of votes cast and the unanimity system. While the first maximizes the opportunities for adoption of a decision at the same time it increases the chances that a member's objection to a particular proposal may be overriden.

Devising a system of special majorities requires balancing a number of variables. The negotiator of large countries usually are reluctant to set up a system where decisions can be taken against their government's wishes and at the same time they ensure that their proposals are not to be blocked especially where the issue concerns granting important powers to an organization. The special majority system would allow a "delegation of powers to intergovernmental body or otherwise it would be impossible".[21] Lister notes as follows:

> "A high special majority signifies that the membership as a whole is prepared to accept greater constraints on action in return for a greater security, while a lower one shows that is ready to accept greater risk in order to facilitate the taking of action".[22]

For countries of modest voting power a high special majority enhances their capacity to block a decision and forces them to formation of a vote blocking group.

One predominant characteristic of the decision making process in the Executive Board is the technique of non-voting. Gold endeavoured to explain this phenomenon thus:

> "The origins of the tradition of non-voting are not easy to discover. One reason may be that because members are involved in the decisions taken by the Executive Directors, there is reluctance to employ the brusquerie of voting against states even though they are in a minority. This courtesy is certainly apparent in the collegial relations among executive directors. The wide disparity in

> the voting power of members is probably another reason. Members with great voting power are cautious about employing it and those with small voting power are careful not to oppose insubstantial reasons. The absence of confrontation tactics promotes even further an atmosphere of reciprocal consideration. Experience has shown that decisions can be reached more easily, and more likely to be observed, if they are taken with widespread consent. The patient negotiation of consent is particularly important in connexion with the decisions taken by the Fund in the definition of its regulatory jurisdiction and in the exercise of much of it".[23]

It is a highly contentious question whether the "collegial relation" among sovereign states with conflicts of interests, has any tangible influence on financial matters, especially if the composition of the Executive Board is taken into account. No evidence can demonstrate that consensus enhances the efficiency of decision making process in an international organization. The rule C-10 of the Rules and Regulations adopted by the Executive Directors as early as September 25, 1946, called for the chairman to ascertain the sense of the meeting in lieu of a formal vote. The question is whether the sense of the meeting is in fact the strength of the voting power. Some writers are of the view that consensus is the "invisible weighted voting power".[24]

Adjustment of Voting Power

Article XII Section 5 provided for adjustment of voting power in two cases: 1) A decision under Article V 4 on whether the Fund will waive any of the conditions of Article V 3(a), on which members are entitled to purchase the currencies of other members, 2) A decision to declare a member ineligible under Article V 5, to make further purchase from the Fund or to make further purchases beyond a certain limit because the member is using the resources of the Fund in a manner contrary to the purposes of the Fund. The purpose of this Article is to increase the voting strength of members if the Fund has sold net amounts of their currencies to other members and to decrease the voting strength of members if they have purchased net amounts of the currencies of other members.[25]

The Executive Board

The IMF as an international organization based on weighted voting system and its functions which impinge on the national economic policies highlights the issue of its management. From the very beginning the American and the British had rather different views about this issue. At Bretton Woods they agreed that the structure of the Fund would be composed of the Board of Governors where every member would be represented by its finance ministers. It would meet annually and would delegate all but the most important decisions to the Executive Directors. Five countries with the largest voting power would have their own Executive Directors and other members would be grouped in constituencies which would each elect an Executive Director.[26] The British hoped for

> "... a technical governing body free from political control to develop a sense of corporate responsibility to all members and not the need to guard the interest of a particular country".[27]

Keynes argued for

> "... part-time directors with financial expertise and a high standing ain national treasuries who would bring to the Fund's policy decisions both expert knowledge of national needs and conditions and commitment to the international aims ofthe Fund".[28]

The American preferred

> "... full time directors meeting in continuous session and Washington as a base of the Fund headquarters".[29]

Dam observed, however, that

> "... permanent Executive Directors, especially if located in Washington, would be more likely to be bureaucrats than bankers".[29A]

Eventually, the American view prevailed.

The Executive Board is responsible for conducting the business of the Fund and shall exercise all the powers delegated to it by the Board of Governors,[30] which has made the maximum delegations to the Executive Directors that the Articles of Agreement permit. The Articles reserved to the Board of Governors power over certain matters.[31] This reservation of power does not prevent action by the Executive Board on the subject matter. The Articles of Agreement conferred directly certain powers to the Executive Board, and the exercise of these powers does not depend upon a delegation from the Board.[33] The Executive Board now consists of five Executive Directors appointed by the five members having the largest quotas (USA, UK, France, Federal Republic of Germany, Japan), one appointed by Saudi Arabia[34] and 16 Executive Directors elected by the rest of the membership which is divided into negotiated constituencies; 16 Executive Directors for 145 countries!

The number of votes allocated to each member is the same in the Board of Governors and the Executive Board but there are differences in the way of casting the number of votes allocated to each member which consequently affects the attainment of majorities. In the Executive Board each appointed Executive Director casts the number of votes allotted to the member that appointed him and each elected Executive Director casts as a unit the number of votes that counted toward his election.[35]

Gold argues that when the Executive Directors adopt a decision such decision

> "... is not a decision of members or even of the collectivity of members in some non-institutional sense, but it is a decision of the institution itself".[36]

He referred to the Articles of Agreement and By-laws Section 19 to support his argument. 1. Article XII (8) which differentiates between Governors, Executive Directors, Alternates and a representative appointed under Article XII (3) which authorizes the Board of Governors to adopt regulation under which a member not entitled to appoint an Executive Director sends a representative upon the member's request, if a matter is particularly affecting that member. At the same time he indicates that the dual loyalties which spring from the fact that an Executive Director does not owe his duty entirely to the

Fund might cause "extramural effects".[37] Any international organization is an aspect of international relations. Changes in the distribution of the economic and political relations would be reflected in the executive organ of any organization. It is quite unwise to project the Executive Board as an independent body free from the politics of its members where decisions represent the interest of the international community as a whole and consensus reached through "free" negotiations among independent Executive Directors whereby facts are examined and rational techniques applied to them. These conditions are not present especially when there are major conflicts of interests. The rational techniques are less likely to be determined and the whole process depends on the bargaining power of the parties involved. The relation between an Executive Director and his government is a crucial one. Some governments seek to control the position of their directors within the Fund, for example, in the United States the appointment for the post of Executive Director is a presidental choice subject to the advice and consent of the Senate. Once an Executive Director is appointed he is under the instructions of "Special National Advisory Council".[38] The resignation of a senior IMF counsellor "in protest at the increasing political use made of the organization by the United States"[39] is a clear example. The influence which is the ability to modify the behaviour of others plays a central role in an organization with limited function, based on weighted voting system and managed by a small group and consequently becomes a major constraint upon the determinants of decisions.[40]

Killick noted that:

> "... the stringency of policy conditions will in practice often depend upon whether the government

> which has applied for a credit has powerful allies within the Executive Board. If a country is thought to be of key political or strategic importance the Executive Directors of the more powerful countries may lobby the Managing Director, the result often being a softening of the terms. Vietnam has been prevented from obtaining credit altogether because of a de facto US veto".[41]

The U.S. attitude which prevented Vietnam from obtaining a credit forced the Executive Board to approve $36 million for El Salvador in 1983 despite the opposition of other Executive Directors who refused at the beginning to approve the El Salvador application on technical ground.[42]

The IMF decision making model does not allow any effective participation by the developing countries which are most affected by its decisions despite the fact that the developing countries, as a group, enjoy a veto over the decisions of the IMF. It was estimated that the developing countries have nearly 32 per cent majority of the total voting power.[43] This increase in their voting power has never been matched with a capacity to influence the Fund's decision for they can block a decision if a formal vote takes place but they cannot force the Fund to adopt a decision simply because they cannot achieve the required majority. It was noted earlier that the increase of the special majorities, introduced by the Second Amendment of the Articles, give the U.S. veto power over key issues and ensures that no decision can be taken without the concurrence of the EEC. Other consequences which follow from the system and which go beyond the objection to the weighted voting system as inroads on the sovereign equality of states, are for example, the fact that the IMF decision making system has fragmented the interactions between its members forcing them into groups instead of harmonizing their views and promoting a kind of collective view within its framework; the French lobby on behalf of the countries of Francophone Africa; Britian on behalf of other Commonwealth countries,[44] consequently, enhancing the role of the developed countries while and undermining the developing countries' position as a whole. If the IMF is to oversee the function of the "international monetary system" a basic fact must be realised and that is, a system cannot be dependent on the will of few states. The weighted voting system must be understood to mean "power must go with responsibility".[45]

One of the arguments against transforming the decision making process of the Fund into a democractic one is based on the "efficiency". Haberler argues that

> "... any reforms that would make the IMF democractic and universal and its support automatic would make it inefficient and ineffective and would lead to its eventual demise as a useful instrument of world economic development. It should not be turned into a satellite or replica of the United Nations".

The efficiency of any international organization is measured by its impact upon its environment as well as its capacity to realign its environment according to its purposes. One may wonder about the efficiency of the IMF rule to promote exchange stability and to maintain orderly exchange arrangements.

Proposals for changes are discussed in the fourth chapter.

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16. (1) $Q_1 = (0.01Y + 0.025R + 0.05M + 0.2276V)\ (1 + X/Y)$

(2) $Q_2 = (0.0065Y + 0.078M + 0.5065V)\ (1 + X/Y)$

(3) $Q_3 = (0.0045Y + 0.070M + 0.9622V)\ (1 + X/Y)$

(4) $Q_4 = 0.005Y + 0.044M + 0.044X + 1.044V$

(5) $Q_5 = 0.0045Y + 0.039M + 0.039X + 1.304V$

Q = quota, Y = national income, R = gold + foreign exchange reserve, X = average annual exports (Five Year average), M = average annual imports (Five Year average), V = variability of exports.

17. Article III (3) b,c

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CHAPTER 3

ADJUSTMENT OF DISEQUILIBRIUM:

THE POWER OF THE FUND

One of the criteria by which the efficiency of any system is judged is its capacity to influence its subjects equally. While the Fund has developed the concept of conditionality and invented the technique of stand-by arrangement to impose its concept of adjustment on deficit countries seeking its financial resources, any analysis of the means which are available to the Fund to influence the policies of surplus countries exhibits their limitation and the need to review the Fund mechanism in this respect. The first part of this chapter examines the Fund's instruments to influence the surplus and reserve currency countries. The second part deals with conditionality.

Scarce Currency Clause

The clause was first suggested by White.[1] White anticipated that a currency of a surplus membere - US dollar - might be under too much demand from deficit country members. Therefore the Fund's holdings of this currency would be depleted, the Fund in such a case is to take a decision declaring that the currency is scarce, consequently authorising the members to discriminate against the issuer of the currency by limiting exchange transactions in the currency. This authorization is recommendatory in character and the members cannot be compelled to discriminate.[2] The declaration does not require any finding that the issuer has violated the Articles of Agreement. Gold explained:

> "The policies of a member in persistent surplus in its balance of payments that create a scarcity of its currency are not treated by the Articles as a breach of obligation notwithstanding the economic undesirability of the member's policies".[3]

This clause recognises the joint responsibility of both surplus and deficit countries. Although it was first proposed by the American plan, its inclusion in the Articles came as a result of the insistence of the United Kingdom which feared that a large and persistent surplus by the United States would be responsible for large and persistent deficits of many other countries. The question which arises here is why this clause has never been implemented especially in recent years where the balance of payments of the USA is in persistent deficit, while there are surpluses in the balance of payments of the Federal Republic of Germany and Japan. To answer this question one has to examine the conditions which must be satisfied before activating this clause. Roessler[4] argues that Article V provided that members can only purchase a currency that is presently needed for making in "that currency" payments which are consistent with the provisions of the Agreements. The requirement "that currency" is meant to limit drawing to the currency with which the drawing member has a bilateral deficit, as the American negotiators explained that[4A]

> "the Fund could not use the currency of one country to help maintain stability of the exchange of another country if the deficit giving rise to the pressure on the exchange is with a third country".

As a result of the setting up of a multilateral system of payments in the late 1950's the need to finance the settlement of official currency holdings in specific surplus countries currenciees has not arisen.[5] In 1962 the Executive Board adopted a decision which dealt with the problems of selecting currencies for drawings.[6] It laid down three criteria governing the selection of currencies. First the balance of payments position of the country whose currency is considered for drawing. Second, the country's reserve position. Thirdly, the Fund's holdings of the country's currency. These arrangements ensure that there is always a minimum supply of all currencies. There are other reasons which explain the reason why the scarce currency clause cannot become operative under the present system. For one thing, the Fund is empowered to replenish its holdings of the currency by asking the member to sell its currency to the Fund for gold, the Fund now may compel replenishment for SDRs instead of gold. The Fund may also replenish its holdings by borrowing the currency by agrement with the lender and with the concurrence of the issuer if it is not itself the lender. However, it must be noted that Article VII (1)i which empowered the Fund to borrow from a member also provided that no members would be obliged to lend to the Fund. To overcome this obstacle a new arrangement - the General Arrangement to Borrow - was signed and subsequently incorporated in the Articles of Agreement. Another reason is the Fund's reluctance to employ remedies and its "distaste" for discrimination.[7]

Exposure to Inflationary or Expansionary Pressures

It was suggested in the IMF Annual Report 1969[8] that the Fund by providing substantial amounts of financial assistance to deficit countries, can exert expansionary or inflationary pressure on surplus countries, consequently forcing them to contribute to the adjustment process. The Report states as follows:

> "Conditional liquidity can make a major contribution to the adjustment process while the behaviour of countries in payments surplus is not directly affected by these facilities, the fact that Fund assistance permits the deficit country

> to finance its deficit rather than to suppress it has an expansionary effects on the surplus countries and thus puts them under pressure to play their part in correcting the situation".[8A]

The manipulation of inflationary or expansionary pressure has its limitation. The Fund's financial assistance is too insignificant to produce this effect. It is very doubtful that the conditions which are attached to Fund's financial assistance would help to produce this end. Roessler explained that this pressure is too indiscriminate to be of practical use:

> "This pressure cannot normally be directed against individual surplus countries; it will be felt by all countries, whether they are in surplus, deficit, or equilibrium. In most situations, this instrument of exercising influence will therefore be much too indiscriminate to be of practical use. Only if there is a single surplus country while the rest of the world in deficit would the effects of the policy be confined to its target".[9]

Surveillance

The Fund under Article IV has the duty to oversee the international monetary system in order to ensure its effective operations. The Fund must exercise "firm surveillance" and adopt "specific principles" for "guidance" of members, to ensure the compatability of economic policies of the members with the objectives set out in Article IV(1) and the "compliance" of each member with its "obligations". One writer pointed out that

> "...the introduction of surveillance gave the Fund

> broader responsibilities with respect to oversight of it member's policies than existed under the par value system".[10]

Under the par value system, a member was required to seek the Fund's concurrence when it proposed a change in the par value of its currency. After the introduction the floating rate system by the Second Amendment, the Fund is to review members' economic policies - not only their exchange rate policies - but its members are no longer obliged to seek its concurrence in changes in exchange rates. The Fund adopted several decisions regarding surveillance.[11] However, the continuing volatility of exchange rates and their prolonged divergence from levels that appear to be sustainable over time, have questioned the effectiveneess of the Fund's surveillance. There are various reasons which prevent the surveillance to be of any practical significance.

Under Article IV, consultations between the Fund and member are the basic instruments for the Fund's exercise of surveillance. These consultations are carried out by the Executive Director, for the developed countriese - as it was noted in Chapter Two - the composition of the Executive Board ensures that nothing can be done against their wishes. Furthermore, the consultations result in "conclusions" - the chairman's summing up - rather than "decisions".[12] In addition, the outcome of the consultation is confidential. Dam noted that

> "... unless consultations have produced new principles that then bind members in later consultation .... the consultations do not represent from legal point of view any substantial

development from those already held by the Fund with members under Article VII and XIV".[13].

Reading through both the provisions of Article IV and Fund's decision regarding surveillance one may conclude that the formulations are too vague and general to decide whether a member has carried out its "obligations" or not; Article IV(1) ii states that each member shall

> "seek to promote stability by fostering orderly economic and financial conditions and a monetary system that does not tend to produce erratic disruptions".

It is left to each country to judge whether the market is disorderly or rate movements erratic, and to decide the kind of corrective action to be taken. Despite many proposals to enhance the effectiveness of surveillance,[14] I believe that they will yield nothing. Certainly if the surveillance is to have any effect it should be aimed at reshaping the domestic economic policies of surplus countries. The Japanese and West Germans were quite clear in their attitude regarding the question of their domestic economic policies. Their national sovereignty over domestic economic policy cannot be compromised.[15] One commentator described the outcome of Venice economic summit - among them enhancing the IMF surveillance - as "a jumble of vague generalities".[16] Ensuring consistency, or at least minimising the conflict between the objectives of macroeconomic policies, is technically difficult and politically undesirable. The economic policy of a government is determined by the bargaining power of different domestic groups. There is no reason to disrupt this pattern of interaction for the sake of the developing countries and the monetary "system".

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The IMF Conditionality

The controversy surrounding the IMF conditionality has been lingering over an extended period. Nothing can suggest that the arguments and the counterarguments regarding the IMF credit/adjustment policy will be halted in the foreseeable future. There are various reasons which give rise to the continuous disagreement about the subject: the Articles of the Agreement do not explicitly elucidate the policies which a member must follow in order to gain access to the Fund's resources, the Fund cited the temporary use of its resources under adequate safeguards as the legal foundations to justify the nature of conditions attached to its credit. On the other hand the Articles before the First and the Second amendments did not confer on the Executive Board the power to challenge a member's request for a credit. The technique that the Executive Board has utilized to develop its power is quite interesting.

The circumstances which surround the negotiations for stand-by arrangements highlight the issue of whether a member has any real scope to "negotiate" the stand-by arrangement or it has no choice but to acquiesce to the Fund's terms. The characterization of stand-by arrangements as decisions of the Fund has two serious implications namely, first, the Fund is arbitrator to monitor, modify and suspend any further transactions under the stand-by arrangements and second, as a result of such characterization, the stand-by arrangements are allowed evasion of parliamentary scrutiny. Consequently, the population of a member who bears the burden of these arrangements have no say.

The stated purpose of the stand-by arrangements is to help a member to overcome its balance of payments problems over a reasonable period without resorting to measures destructive of national or international prosperity. The economic components of the IMF programmes dispute the success of the Fund to bring about a viable balance of payments.

The first part of this section deals with the origin and the development of the Fund conditionality; the second will examine the implications of charcterization of the stand-by as the Fund's decisions and the third part will be concerned with the economic components of the IMF conditionality.

I. The origin and the development of the IMF conditionality

The origin[1] of conditionality can be imputed from the divergences of the American and the British views with regard to the right of access to the Fund's resources; whether there should be conditions attached to the Fund's credit and the question of the discretionary[2] power of the Executive Board. The British, according to their weak economic position after the World War II, were in favour of unconditional access at least to the extent of a country quota while the American negotiator preferred more discretionary power to be vested in the Executive Board to evaluate a member's request. The result was a compromised formula embodied in Article V (3)a (original): a member must present that the currency obtained is presently needed for making payments which are consistent with the Articles. The power of the Executive Board to evaluate a member's request and consequently to impose its conditions remained unsettled. According to the original Articles no power was vested in the Executive Board to examine a member's request, its discretionary power was limited to the waiver clause in Article IV (3), of which the Fund made no use[2], further, there is nothing to indicate that the waiver clause was purported to give the Fund any discretionary power and consequently impose conditions regarding its members' economic policies.[3] The Fund can deny access to its General Resources Account in specific cases for example, Article V (5) demonstrates the ineligibility to use the Fund's resources. A distinction should be made between the IMF conditionality and Article V (3) which is entitled Conditions governing the use of the Fund's general resources[4]. Here we are concerned with the first one using it in the sense of conditions which the Executive Board attaches to a credit from the general resource account by virtue of the discretionary power which it vested to itself and developed through consecutive decisions utilizing its power of interpretation to overcome any legal hurdle. The first decision adopted in this direction was in March 1948.[5] It states *inter alia*:

> "The word represents in Article V Section 3(a)(i) means declares. The member is presumed to have fulfilled the condition mentioned in Article V Section 3(a)(i) if it declares that the currency is presently needed for making payments in that currency which are consistent with the provisions of the Agreement. But the Fund may, for good reasons, challenge the correctness of this declaration on the ground that the currency is not presently needed or because the payments in that currency will not be consistent with the provisions of this agreement ... the Fund may postpone or reject the request or accept it subject to conditions."

The Fund desired to encourage drawings on its resources which were nil in 1950 and in 1951 only two states drew[6]. The Fund adopted a decision in February 1952[7] to assure members who had made a demonstrable contribution to the Fund's activities that they can count on receiving the overwhelming benefit of any doubt respecting drawings which would raise the Fund's holdings by not more than its quota. This contribution was equal to the gold subscription plus any net use the Fund was making of the member's currency minus any net use by the member of the currencies of other members. This amount was called the gold tranche although it does not necessarily remain equal to it. Further decisions were taken to materialize the tranches policy[8], perhaps the most cited one was the decision adopted in 1962.

> "The Fund's attitude to request for transactions within the first credit tranche - that is, transactions which bring the Fund's holdings of a member's currency above 100 per cent but not above 125 per cent of its quota - is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require a substantial justification. They are likely to be favourably received when the drawings or stand by arragements are intended to support a sound program aimed at establishing or maintaining the enduring stability of the member's currency at a realistic rate of exchange."[9]

The decisions made drawings under the gold tranche <u>de facto</u> unconditional by the first amendment they transferred to a <u>de jure</u> one.

The First Amendment of the Articles of the Agreement

The first amendment of the Articles put an end to the contention regarding the credit tranches policy and the Fund's competence to challenge a member's request for a credit beyond the gold tranche. Article I has been amended by adding new words in order to give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards. New provisions were added as follows:

Article V, (3)a:

> "The Fund shall adopt policies on the use of its general resources, including policies on stand-by or similar arrangements, and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.

Section (3)c:

> "The Fund shall examine a request for a purchase to determine whether the proposed purchase would be consistent with the provisions of this Agreement and the policies adopted under them, provided that requests for reserve tranche purchases shall not be subject to challenge.

Article XXX (c):

> "Reserve tranche means a purchase by a member of special drawings rights or the currency of another

member in exchange for its own currency which does not cause the Fund's holdings of the members currency in the General Resources Account to exceed its quota, provided that for the purpose of this definition the Fund may exclude purchases and holdings under:

(i) policies on the use of its general resources for compensatory financing of export fluctuation;

(ii) policies on the use of its general resources in connection with the financing of contributions to international buffer stocks of primary product; and

(iii) other policies on the use of its general resources in respect of which the Fund decides, by an eighty-five per cent majority of the total voting power, that an exclusion shall be made.

These new provisions institutionalized a series of the Executive Board decisions. The implications of the first amendment as far as the conditionality is concerned are manifold:

1) The Fund is to "help" its members in devising policies which would assist them to overcome balance of payment problems and to ensure the temporary use of the Fund's resources.
2) The Fund now is empowered to examine a member's request for a credit.
3) The Fund is authorized to adopt special policies for special

balance of payments problems: compensatory financing, buffer stock financing, supplementary financing and extended facility[10] provided that all these policies are subject to conditionality, the Fund is in position to apply different standards of conditionality. Article XIX(j) stipulates that policies other than the compensatory financing policy could not float in other words, the Fund would exclude when it calculates its holdings of a member's currency for the purpose of gold and credit tranche policies - whatever the member has obtained in transactions under the compensatory financing policy."

4) Article V (3)a made a clear reference to stand-by and the characterization of the stand-by arrangements as decisions of the Fund was included in Article XXX(b). The only substantial change which was introduced by the second amendment was in connection with the Fund facilities thus reversing the trend of the first amendment.

Two reviews of the conditionality took place - the first was by decision no. 2603 September 20, 1968.[11] It called to take into consideration the necessity for adequate safeguards for the use of the Fund's resources; the need for flexibility and uniformity of treatment of all members; the importance of consultation clauses and phasing appropriate performance criteria to evaluate the implementation of program with a view to ensuring the achievement of its objectives and the avoidance of language having a contractual flavour. The second review[13] took place in March 1979; the first paragraph aimed at encouraging members to adopt corrective policies which can be supported by the Fund's resources. The Fund recognized that an adjustment programme cannot be achieved through a short period, therefore, it provided that the period may extend up to but not beyond three years, the non-contractual nature of stand-by arrangement was further emphasized[13] thus:

> "stand-by arrnagements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent."

The implications of such characterization will be examined at a later stage. The Fund expressed its intention that it will pay due regard to the domestic, social and political objectives, the economic priorities, and the circumstances of members including the causes of their balance of payments problems.[14] The phrase "it will pay due regard" connotes something less than a direction to give decisive effect to the considerations to which the Fund must pay due regard.[15] The extent to which the Fund has implemented this paragraph is highly questionable.[16] Consulation clauses are features of stand-by, they may lead to new understandings or modify the performance criteria. The stated purpose is to monitor the implementation of an adjustment programme but they may vary according to the problems and the institutional character of a member. The guidelines on conditionality also included preconditions which must be fulfilled by a member in advance in order to gain the approval for stand-by. Paragraph 10 provides that the Fund will review the stand-by and evaluate the current macroeconomic policies of the member. The significance of the Fund's commitment to macroeconomic policies will be examined when we deal with the economic components of the IMF supported programmes. Three points must be noted. First, the IMF guideline on conditionality implies that the balance of payments problems are amenable to correction through the temporary use of the Fund's resources and by the deficit countries' action alone. Second, the characterization of the stand-by arrangements as decisions of the Fund and its implications. Third, the IMF commitment to macroeconomic policies.

The Characterization of Stand-by Arrangements as the Decisions of the Fund and its Implications

The main instrument to apply the Fund conditionality is through stand-by arrangements. Although it is the outcome of negotiations between the IMF and a member who is requesting the Fund's credit beyond the reserve tranche the Articles have defined it as a Fund's decision[17] the consequence of such characterization is to give the Fund the sole power to interpret, modify, monitor and suspend any further transactions under stand-by. Another consequence which follows from this characterization is that stand-by are allowed to escape the parliamentary control. The population of a country who bears the austerity of such programmes have no say about them. It is not surprising that some writers have tended to establish a kind of a link between the implementation of IMF programmes and authoritarian governments[18]. The successful implementation of the IMF programmes in the 70's in Chile and Argentina was due to the fact that military dictatorships were in total control[19]. Carty noted that:

> "the conditionality which is accompanying the renewal of commercial loan affects directly the interests of the whole population of the developing countries. Therefore it is sensible to open up a process of economic decision making which is seen at present to escape parliamentary control and the pressure of directly effected interest groups. Without social consensus one

might expect that policies which have major distributive consequences will not be maintained."[20]

Another related question is whether governments have any real scope for negotiations. Many factors undermine "the freely negotiated" arrangements; the description of the IMF as a "lender of last resort" - regardless of the technical accuracy of this description - the governments strife for political survival and the availability of other financial resources are contigent upon the Fund's seal of approval. The same arguments can be equally applied to negate the Fund's claim that structuring of a stabilization programmes is the sole responsibility of a member who, in the first place, requested the stand-by. The member as an initiator for the IMF credit has to devise a programme which satisfies the IMF otherwise it will not gain access to the Fund's credit. This part will not engage in discussing the accuracy of stand-by characterization but rather the implications of such characterization and the need to review the IMF's unique technique.[21]

The process of negotiating stand-by is initiated by a member who approaches the Fund by submitting a letter of intent. A letter of intent is a document issued by the authorized organ of a government - usually is signed by a governor of a central bank or finance minister - and outlines the economic policy which the government intends to implement in order to get the Fund's approval for credit. A mission of the Fund "helps" in drawing up the letter. The letter is not legally binding and it is not drafted in promissory language.[22] The non-obligatory character of the letter of intent does not mean that there is no consequence for non-observance of the declared policies because the letter of intent is usually incorporated into stand-by as performance criteria[23]. The Fund is empowered to suspend any further transactions under stand-by if the member did not conform to the terms of the performance criteria. Article XXX(b) defines a stand-by as a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount. The reason for the omission of reference to the leter of intent in this definition is that the stand-by is taken to support the objectives and policies set forth in the letter which are incorporated in the stand-by and became terms of the decision. Dam observed[24] that a stand-by arrangement presents the contradiction that the drawing country does not have to establish a need at the time the arrangement is entered into and the Fund in effect waives any power to judge need at the time the drawing is made. The reason that the Fund will not challenge the member's need for drawing at the time the drawing occurs is that the Fund finds that its conditionality and the member's commitments are sufficient safeguards for the Fund.[25]

According to the Fund a member might be deterred from requesting a stand-by arrangement despite its need because of the fear of its political implications. A government's position might be worsened if the government's freedom of action is constrained by an agreement with an external authority to pursue a set of economic and financial policies.[26] The Fund thought that this deterrent may be overcome by characterization of stand-by as a decision of the Fund while at the same time it would serve the Fund's policy to encourage requests for stand-by and discourage requests for immediate transactions in the credit tranche because stand-by is the most effective way to protect the Fund's resources against improper use. The first argument is not well founded because a state is entitled under international law to conclude agreements which limit its freedom of action. The reluctance of states to enter into stand-by is attributed to the stringency of the conditions connected with the stand-by and their high social costs. Examination of the ramifications of the IMF characterization of stand-by arrangements will display the Fund's dominant position and its unfettered power in regard to stand-by.

1. Although stand-by arrangements do not include a clause enabling the Fund to terminate them, the Fund can cancel them under its general power to terminate its decision.[27]

2. As a result of such characterization the members have no judicial or other procedure available to them as a right by which they can enforce the terms of stand-by against the Fund.[28]

3. The Fund cannot modify the objectives and policies of a member as stated in the letter of intent but the Executive Board can modify the proposed terms of the stand-by without seeking the concurrence of the concerned member.[29]

4. The Fund takes the view that it is entitled to interpret the parts of the letter of intent which are incorporated into the stand-by because they become part of the Fund's decision.[30]

The other related issue is concerned with the extent to which a member can freely negotiate the terms of a stand-by arrangement. The way in which the Fund distances itself from the components of its programmes is amazing. It is the responsibility of a member to devise its economic objectives and policies, the Fund will support them by approving stand-by which is taken in support of the member's economic policies as stated in its letter of intent. Therefore, the question arises as to whether a member can devise its objectives and economic policies according to its own choice. First it should be noted that whatever the member's legal entitlement to draw may be there is no legal entitlement to a stand-by arrangement.[31] Consequently, the member has to pattern its economic policies according to the Fund's standards or otherwise it will not get the support of the Managing Director.

> "The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is in his judgement that the program is consistent with the Fund's provisions and policies and that it will be carried out."[33]

In addition, to satisfy the IMF preconditions the member's objectives and policies should be consistent with the IMF vision of what is best for the member. As it was mentioned earlier the resort to the Fund implies first of all, that other financial resources have been exhausted and the availability of new resources is conditioned on the IMF seal of approval and second, since in most cases the negotiation for stand-by arrangements occurs in the middle of an economic crisis, the government's struggle for a political survival will force them to accept what the Fund has to offer.

The Economic Components of the IMF Conditionality

The declared purpose of the IMF conditionality is to help a member to achieve a viable balance of payments by making the IMF resources available on a temporary basis, under adequate safeguards, in order to protect the revolving character of the IMF resources. It is quite legitimate for the IMF or any other institution to protect its resources, but the main issue is whether the set of policies which the IMF attaches to its credit beyond the first credit tranche is serving the purposes of protecting the IMF resources and bringing about a viable balance of payments without restoring to measures destructive of national or international prosperity. Or, whether these policies go beyond the requirements of the Articles of the Agreement. The legitimacy of these policies can be contested against the Articles, especially Article 1. The quarrel between the developing countries and the Fund is not about the principle of conditionality and the fact that the Fund's financial assistance should be conditional upon the adoption of adjustment policies, rather the contention concerns the validity of this set of economic policies aimed at bringing about a viable balance of payment without high social and economic costs. Guitian notes:[33]

> "Under most circumstances, adjustment will take place whether or not there is a policy action, in the sense that claims on resources will eventually have to be limited to those available. The issue at stake, therefore, is not whether adjustment will be carried out - because it will be - but whether it will be carried out efficiently - that is without involving unwarranted welfare losses."

There are several reasons for the continuous disagreement between the IMF and the developing countries about the subject. viz:

1. The increasing involvement of the IMF in a sphere of activities which belong to states consequently the impact of conditionality on the states' sovereignty.

2. The causes of disequilibrium: the IMF is still of the view that the domestic mismanagement of the economy is the main reason for disequilibrium. It disregards the external factors and its effects on the balance of payments.

3. As the result of the former preception the IMF policy instruments to overcome the balance of payments problems require deflationary policies: credit squeeze, devaluation, cutting down public sector expenditure. The developing countries view these remedies as anti-developmental and tend to favour the foreign investors and the private sector.

4. The lack of symmetry in the IMF programmes tend to put the burden of adjustment on the poor countries, which are asking for its credit, while there is no equivalent method to constrain the surplus countries and the reserve currency countries to adjust their economic policies which have adverse effects on the economies of the developing countries.

5. The two principles which the Fund upholds in all programmes - uniformity and flexibility of treatment[35] - resulted in disregarding the institutional character of individual countries and to double standards in applying different conditionality to the same situation. They run contrary to their declared purposes.

Each of these factors will be examined in detail.

An appreciation of the economic policy which is implicit in the Fund's Articles of Agreement would provide better understanding of the IMF policies. Article 1 exhibits a strict adherence to the classical economic theory of comparative advantage. The Fund adopts the proposition that free trade and international specialization of labour lead to increase worldwide productivity, high standards of living and even development. In the Annual Report 1976[34] the Fund attributed the cause of balance of payments problems to inefficient and indiscriminate investment patterns as follows:

> "... payments imbalance has at times been more directly associated with particular investment decisions made by a country. If investments are directed to activities which are not well suited to the country's potential, they will fail to yield adequate economic returns and will tend to weaken the balance of payments. The determination of an optimum investment pattern is, however, not an easy task. It is not always possible, for example to identify precisely the areas where the country's latest advantage in production lies ... while these basic difficulties may understandably give rise to pressures on resources and create payments difficulties, more frequently problems have arisen because allocation of investments was not based upon productivity consideration."

It is not surprising, therefore, that the Fund has aimed at the elimination of restrictions on international payments, discriminatory currency practice and conditioned the availability of its financial resources to member states on their removal of restrictions on trade and payments. Various objections can be raised against this abstract theory of comparative advantage which has consequently undermined the rationale underlying the IMF programmes. The concept that the market knows best is an illusive one because the prevailing type of market is monopolostic competition. The developing countries do not lack only the economic flexibility which permits adequate response and therefore gain from appropriate changes in the market but also they lack the existence of a substantial degree of competitive equality. The IMF ignores the deterioration of terms of trade; the manufactured products of the industrialized nations and the primary products of the developing countries. It has been noted that:

> "Twenty-four years ago, it took 200 tons of sugar to buy a 180 HP bulldozer, now it takes 800 tons of sugar at the world market price to buy that same bulldozer".[35]

While the developing countries are required to remove restrictions on trade, the Fund has not reacted towards the growth of protectionism against the exports of the developing countries. Ironically the Fund's jurisdiction lacks regulatory authority to compel the avoidance or withdrawal of protectionist trade measures the Fund is not able to validate or invalidate trade measures as such.[36] This double standard of the IMF has enhanced the notion that is not more than a vehicle of imperialism and economic colonialism. The general liberalization of monetary and tariff, the reliance on the market forces, the failure to link trade theory with the differential development of productive capacity in various countries would make it possible for the strongest countries to adopt "beggar-thy-neighbour policy". The logical implications of this policy on the domestic level are to support the groups which can take advantage of the market and consequently the entrenchment of these groups in the centres of political power.

Devaluation of a currency in order to make exports more competitive and imports more restricted is ill-conceived[37]. The exports are priced on the world market in foreign currency, thus devaluation will not effect this price although it may raise the domestic currency price and the profitability of exporting, however, this is not automatically implied by devaluation rather it is conditioned on other financial policies such as, less beneficial exchange rate for the producers. Regarding imports, the increase of the domestic price of imports may not raise to the full extent of devaluation but may even fall if devaluation is accompanied by the removal of import restrictions which kept the price at an artificially high level. Furthermore, it is well established that the effect of devaluation is purely transitory. A study of the Tanzanian experience in the 1970s showed that Tanzania's reluctance to devalue its currency is due to the fact that any attempt to devalue its currency involving an increase of its share of export would provoke retaliation. Furthermoe, the distributional affect of devaluation on income will shift income from the relatively poor producers of food to the richer exporter of cash crops which is inconsistent with Tanzania's social objectives and the goal of raising food production. In addition to exposing the developing countries to inflationary pressure it may start competitive devaluation amongst them.[38]

Another theoretical aspect of the IMF conditionality which has determined the nature of conditions attached to its credit is its diagnosis of the causes of balance of payments problems. Guitian observed that:

> "Imbalances in an economy are usually reflected in the prevalence of inflation and balance of payments deficits which are often associated with

> relatively high levels of economic activity but soon lead to low rates of employment and growth. These imbalances can be due to a variety of factors but one common element that generally characterizes them is an excessive or unsustainable expansion in aggregate demand. In most instances variation in aggregate demand and expenditure associated - as they often are - with a relatively stable aggregate supply function are the major causes of short-run fluctuations in output, prices and the balance of payments. These broad considerations are behind the demand management approach to stabilization policy, which is designed to monitor the performance of the economy over the short time in order to keep the level of growth rate of aggregate demand in line with the level and the growth rate of productive capacity".[39]

The remedy is to restrain fiscal spending or raise fiscal revenues in order to limit the size of the resulting public sector deficit to the amount of noninflationary financing available.[40]

This monetary approach to the balance of payment - which is the Fund philosophy - is based on classical principle of equilibrium economics which suggests that inflation is the result of a disequilibrium between aggregate demand and supply. The total demand on goods and services is more than the value of the output; this excessive demand inevitably inflates prices within the economy. In order to restore equilibrium, the total spending on goods and services should be equalized to the total value of a nation's production. This internal disequilibrium will adversely affect the country's international payments position. Deficit can only be persistent if it is accompanied by domestic credit creation, governments cannot continue to absorb deficit by running down their foreign exchange reserve, they will have ultimately to restrict domestic credit creation. The Fund has advocated the adoption of monetary and fiscal policies to curb excessive demand and consequently, the reduction of public and private consumption in order to increase savings necessary for investment and net capital formation.

The logic of this approach entails cutting down government expenditure, lifting subsidies, reducing governments wage bills. Objections abound regarding the appropriation of this approach to the developing countries' conditions: the credit squeeze in LDCs leads to recession rather than more investment, it is too difficult to generate savings when poverty prevails, what is required is a stimulation of additional income rather than reducing consumption in order to generate savings.[41] The coalescence of credit squeeze on domestic capitalists, the increase in the costs of the imported material needed for local industry as a result of currency devaluation, and, the shrinking market will lead to take over of domestically owned business by multinational companies.[42] However, the IMF bias towards foreign and multinational companies is an obvious one, this can be deduced from its concept of balance of payments in that the IMF, by placing investment income firmly in the goods and services section of the balance of payments, ensures that restrictions on payments to foreign investors cannot legitimately be imposed under the IMF rules.[43]

The IMF approach, as noted earlier, is insensitive to the external factors and their impact upon balance of payments, by attributing domestic mismanagement as the principal cause for balance of payments problems, the Fund assumes that the governments of the developing countries are in full control of their economy which is an unrealistic assumption since managing economic policy has proved to be a very tricky work even in developed countries. The developing countries are much more vulnerable to external shocks especially since most of them are dependent on their earnings from exporting primary commodities. Introducing new facilities - like compensatory financing facility - does not indicate any serious shift in the Fund's attitude that imbalances call for adjustment regardless of their origin and there is no need to change the policy instruments. These facilities are conventional short term programmes.[44]

The credit ceiling device requires a highly developed financial system. Controlling public expenditure has proved technically very difficult even in Britain with its developed financial system.[45] The same applies to increasing of taxes. In addition, many developing countries are too poor and too politically weak for a high tax burden.[46] Despite the degree of professionalism of the IMF staff in devising stabilization programmes, these programmes are going to be implemented within a geo-political environment, consequently, these programmes should be adapted to suit such environment and should have regard to the administrative capacity to run such programmes in the developing countries.

The most serious challenge to the IMF monetarism which has its profound influence on the Third World claims to change the rationale of the IMF programmes comes from the structuralist school. It argues that IMF programmes have no lasting effect because they fail to indentify the causes of disequilibrium. This school of thought originated in Latin American countries when the stabilization programmes designed for the Chilean government in 1955 went under scrutiny by the United Nations Economic Commission for Latin America and by a team of private consultants.[47] They argued that the historical development of Latin American economies had resulted in a structure of production and trade and institutional features that inhibited smooth alterations in supply in response to changes in the composition of aggregate demand that would be expected to occur as growth proceeded. According to them the structural imbalances in the economy are the source of balance of payments problems, these imbalances in turn arise from the fact that growth and development involve a discontinuous process of structural change. For example, they identified that institutional factors such as land tenure arrangements are the main source for the bottleneck in the supply of agricultural commodities - landowners are not involved directly in agricultural production and tenants had neither the motivation nor the resources to exploit the land potential; consequently, the agricultural output is often unable to respond to the increased demand. Rising urban population and increased incomes in the industrial sector deriving from the import substitution activities increased the demand for food. Given the inelastic supply, inflation presure was inevitable. Second, a low and unstable rate of earnings due to variable demand for primary commodity exports coupled with the need to import physical capital which requires foreign exchange would lead to a foreign exchange shortage. This shortage would entail a contraction of capital goods imports coupled with a fall in investment and growth. Finally, the inadequacy of the government finance which is heavily dependent on export taxes for revenue. The unequal distribution of income and the accompanying concentration of political power tended to make significant tax reform impossible and resort to inflationary deficit financing was viewed as a structural problem. The merit of the structuralism will be discussed in the next chapter.

With regard to the symmetry problem, conditionality demonstrates the growing leverage of the IMF on the countries which are forced to ask for its financial assistance. The IMF system has not developed instruments which are conducive to surplus countries and reserve countries currency to adjust their economic policies which result in repercussions on the economics of the developing countries. The upsurge in the interest cost of foreign borrowing from both public and private institutions is the direct result of the financial and monetary policies applied by the industrial countries in dealing with inflation and consequently, they worsen the imbalance of payments position of the developing countries.[48] The inconsistency of the Fund's policies is obvious, while they seek to encourage the exports of the developing countries at the same time they advocate further reduction in the aggregate demand in the industrial countries - which provide the principal markets for LDCs export supply in order to combat inflation.[49] The logic of the IMF policies is that if nothing can be done against the surplus countries there is no choice for the deficit countries but to adjust accordingly. The adjustment cannot be seen as a matter of disciplining deficit countries to restrain their fiscal and monetary policies. There is the question of symmetry of adjustment responsibilities.

The Uniformity and the Flexibility of Treatment Between Countries

The IMF programmes seek to uphold two principles: uniformity and flexibility of treatment among its members.[50] Uniformity of treatment requires

> "... that for any given degree of need the effort of economic adjustment sought by the Fund in

programs be broadly equivalent among its members.[55]

Killick noted[51] that

> "... however seriously the staff may seek to achieve this outcome. They are unable to do so. Executive directors, civil servants and members of the Fund's staff all agree that in practice there are considerable inequalities of treatment".

This is due to the political pressures in the decision-making process in the Executive Board as explained in the second chapter. Flexibility takes into account the institutional characteristics and the particular circumstances of different countries. The adjustment will vary according to the need of a particular situation. Some elements of flexibility were identified in the Fund's programmes.[52] However, the question which is yet to be answered is whether the flexibility of IMF programmes is in response to the economic and institutional needs of a country or to the political colour of the government concerned.

Judging IMF conditionality is a very difficult task because of the absence of professional consensus on the IMF policy instruments.[53] The effects of its programmes are undetermined, but clearly these programmes are fraught with gaps. A reorientation of the IMF policies is absolutely necessary to enable them to respond to the needs of the developing countries. This idea will be expanded in the following chapter.

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CHAPTER FOUR

THIRD WORLD DEMANDS

The power structure of the IMF executive organ is a very contentious issue for Third World countries. As discussed in Chapter 2 of this work the decision-making formula is geared to sustain the dominant position of the 'Big Five'. This position was further enhanced by inter alia the increase in the regime of special majorities giving one country, the U.S.A., effective veto power over key issues which affect the entire community; the economic and financial centre of power formed by the major industrial countries ensuring for them a hegemonial role which overlaps the IMF jurisdiction and conflicts with many of the interests of the majority of members; and the strategy of the IMF with regard to debt rescheduling where one debtor country has to deal with all its creditors.

An examination of the composition of the Executive Board would reveal the shortcomings of the developing countries' representation. One executive director represents twenty-four states[1]. In addition, a country representative of developing countries may not have similar experiences or interests, for example, it is quite difficult to envisage the extent of common interests between Jamaica and Canada[2]. Furthermore, the Western Hemisphere Department which includes Latin America and the Caribbean has a U.S. citizen as its director[3]. It was estimated in 1979 that twenty-one LDCs with more than seven per cent of IMF votes were represented by northern countries[4].

The necessity for proper representation and active participation of the developing countries in the decision-making process of the IMF should be a precondition for any institutional change within the IMF. Several documents and reports have embodied demands for "proper" representation for developing countries but it should be noted that developing countries, despite their common economic disadvantages, do not constitute a homological group. Some of them are oil producers and consequently capital exporters, others are dependent on one or perhaps two primary commodities so that they differ in their economic structures. Any change therefore in the executive organ of the IMF must take account of such disparities and allow for representation reflective of such important differences.

Interestingly, despite the numerous studies regarding claims for change in the decision-making process of the IMF, none has produced an alternative. For example, "the Declaration and Principles of the Action Programme of Lima"[5] called for the introduction of provisions in the Articles of Agreement of the IMF in order to increase the number of votes allocated to these countries; the Rio Report noted that:

> "... if the chosen structure is not genuinely participatory, it cannot hope to succeed. Among other things, it must define the degree of participation appropriate to all interest groups represented."[5A]

The 1980 Brandt Report[6] argues for the establishment of a broad-based leadership to manage the international monetary system "including provision for a growing role for the developing countries in the decision-making process". The South-North Conference on the "International Monetary System and the New International Order", which took place at the Arusha International Conference Centre in Tanzania, concluded that the main attribute of a new monetary system must be 'Democractic management and control' while at the same time admitting that significant influence will be weilded by economically powerful countries, in reality, however, there is an absolute necessity for clear reflection of the interests of the majority of the world[7].

Dismantling of the oligarchic power structure of the IMF should be a priority. The "Declaration on the Establishment of a New International Economic Order" adopted by the U.N. General Assembly stated in its preamble that a new international economic order should be based on equity, sovereign equality, interdependence and co-operation among all states and called for at paragraph C:

> "Equal participation of all countries in the solving of world economic order in the common interest of all countries."[8]

Part II paragraph d provides for:

> "Full and effective participation of developing countries in all phases of decision-making for the formulation of an equitable and durable monetary system and adequate participation of developing countries in all bodies entrusted with this reform and, particularly, in the proposed Council of Governors of the International Monetary Fund"[9]

to ensure effective participation of developing countries in the decision-making process through the reform of the existing voting system. The "Charter of Economic Rights and Duties of States" followed this pattern. Article 10 provides:

> "All states are juridically equal and, as equal members of the international community have the right to participate fully and effectively in the international decision-making process in the

solution of the world economic, financial and monetary problems, *inter alia*, through the appropriate international organization in accordance with their existing and evolving rules, and to share equitably in the benefits resulting therefrom."[10]

On a perusal of the above documents one may conclude that first the developing countries do not totally reject the existing system of international economic organizations since they did not propose to abolish them nor set up new organizations, neither did they pay much attention to offering any theory regarding the advancement of further institutional development of international economic organisation[11]. Second, they were unanimous in their demands for changing the voting system and argued for more involvement of the developing countries in the decision-making process especially in the IMF.

The emphasis on sovereign equality is indicative of a rejection of the weighted voting system on the ground that it represents an inroad on the sovereign equality of states. Yet no one has proposed a formula which guarantees "effective participation in the decision-making process of the IMF". It is, therefore, being submitted that such a formula should be based on the following considerations, viz.:

- one state one vote;
- a majority system which should not allow a small group of states to have total control over the decision-making process;
- the regrouping of developing countries;
- the Executive Board should take into account the institutional and economic differences of developing countries. In other words, oil producing countries should not be placed on equal footing with those countries that are dependent on one or two commodities;12

- the voting system of the IMF should not be based, as it is at present, on the "power of the purse"[13], rather it should be replaced by a formula which links the drawings entitlement with financial needs. It is paradoxical that the countries with the least need for the Fund's financial resources should exercise the greatest power in determining the manner in which the funds should be spent while the countries which are in most need of credit have little say;
- the staff of the various departments of the IMF should be characterised by an increase of Third World personnel especially in areas involved in designing IMF programmes. The main reason is that nationals of states are more aware of their countries' social and economic priorities. Clearly, the advantage of having more Third World staff is that they may be instrumental in encouraging their countries to adopt corrective policies thereby negating the impression that the policies are imposed upon them by outsiders;[14]
- the independence of the Executive Board should be guaranteed by a new formula which would enhance its autonomy. The effect would be that the Executive Board, rather than defending a set of national policies, would be representative of the interests of the international community.
- the setting up of an independent dispute settlement body. As noted in the second chapter of this work, the concentration of power in the IMF Executive Board permits it to interpret and suspend transactions according to its own judgement. This authoritarian character of the Executive Board should be removed and the power of interpretation and assessment of the implementation of IMF programmes should be assigned to another body within the

organisation.[16]

Although these propositions attempt to establish "minimum standards" in the "world of disparities", it is doubtful that the industrial countries would allow them any avenue for real implementation. There is no reason for the industrial countries to upset the present mode of decision-making in the IMF and there exists no supranational power to enforce change in the decision-making process.

Not only is the decision-making process of the IMF in need of reform but also its economic policies have always remained a subject of much discontent among Third World countries. The changing patterns of economic relations question the validity of the IMF policies and underlines the need for radical changes in both the rationale of these policies and the structure of the organization itself.

The deterioration of the balance of payment position in many developing countries emanates from a very hostile economic environment - the increase in the oil price; the falling of their exports' receipts as a result of a shrinking market coupled with the ever-growing protectionism; the decline in real value of commodity prices compared with the rise in prices of manufactured goods from the industrial countries and the consequent rise in the cost of the physical capital needed for development projects; the adverse effects of industrial countries' policies - which lead not only to greater deficit but also to qualitative deficits which are not liable to correction through IMF financial terms. The authors of 'The Quest for Economic Stabilization' have made the point thus:

> "A large proportion of oil-importing LDCs is faced with persistent unviable BOP deficits. A great

deal of the deterioration in their payments situation in recent years has been the result of largely irreversible adverse movements in their commodity terms of trade - a deteriorating current account is no longer prima facie evidence of the pursuit of excessively expansionary domestic demand policies -- ; and restoration of a healthy BOP requires longer-term changes in the structure of production and demand."[16]

Developing countries' balance of payments problems are, therefore, admittedly of a structural character and dealing with such deficits would necessitate permutations in the volume of finance as well as the instruments and objectives of the IMF programmes. The argument of the IMF that its Articles of Agreement compel it to provide financial assistance for purposes of balance of payment problems is not well-founded. First, Article 1 states quite categorically that one of the purposes of the Fund is the maintenance of high levels of employment, income and economic development through balanced growth of international trade. However, the Fund's obsession with reduction of inflation has tended in practice to disregard the negative impacts of its programmes on the primary objectives. Second, the distinction between balance of payments assistance and development assistance is difficult to draw. One writer notes:

"A development programme which involves industrial diversification may in the long term have a very tangible effect on the balance of payment, whilst balance of payments assistance which enables internal adjustment to be undertaken less rapidly

> than it would otherwise need to be may have definite implications for the pattern of development."[17]

He further states:

> "Given that the IMF is basically a short-term balance of payments stabilization institution, it can be seen that the conditionality of financial assistance may either help or hinder development, depending on the causes of any particular balance of payments deficit."[18]

Evidently the IMF economic policies work to the disadvantage of developing countries both internally and in their relations with the international community. As a consequence a change in the philosophy of the IMF is inevitable. Following are submissions regarding changes aimed at reconstructing the IMF programmes.

It is important that IMF programmes be aimed at achieving healthy balance of payments through structural change by reorientating the productive systems, stimulating output and focussing on key bottlenecks and constraints within the productive system as well as diversification of the industrial structure in order to minimize the conflict between development policy of the country concerned and the objectives of stabilization programmes, thus lessening the high social and economic costs of its programmes.[19]

It has been noted that it is easier to solve the absorption problem by raising incomes rather than by cutting expenditure thus financing the government's budget becomes easier causing sustained saving levels necessary for investment. However, the better course would be to explore areas in which countries have the potential to increase their exports thus diversifying the tradeable goods rather than relying on traditional commodities. Ways should be sought to reduce imports through efficient import-substitution. Such a strategy requires placing more emphasis on the supply-oriented measures rather than undue emphasis on the control of aggregate demand.[20] However, this should not lead to the conclusion that the control of aggregate demand is not significant. In fact it should be supplementary to the supply-oriented measures.

Micro-economic measures should be introduced within the IMF programmes[21] because although the IMF claim that its policies are committed to macro-economic measures only, in effect the distinction between macro-economic and micro-economic instruments tends to be blurred in the context of adjustment and growth.[22] While macro-economic instruments affect the productive sectors in differential ways, micro-economic measures aimed at specific activities can make an important contribution to the macro-economic objective of balance of payments adjustment.

Structural change requires a lengthy period. The institutional reform of productive capacities in any given society cannot be carried over one year or even three years as provided for in the conventional stand-by arrangements. Rapid BOP adjustment is less appropriate. What is required is a slower but consistent adjustment in order to allow gradual and smoother alteration in the society instead of the "shock treatment". Implementation of such strategy requires quantitative increase in the Fund's resources. It was estimated that the value of the IMF resources as a percentage of world trade has fallen from 12.3 per cent in 1960 to 3.2 per cent in 1981.[24] The current deficit of non-oil LDCs amounted to $233bn. Net Fund credit has financed less than $10bn in 1974-79. The increase of financial help to the deficit countries should correspond to the size of balance of payments problems.[25] This increase in financial flow can be achieved by:

1) increase in the developing countries' quotas.
2) linking the allocation of SDRs to financial needs,
3) channelling of the Fund's earnings from the sale of gold to developing countries" favour,
4) giving the IMF a greater role with regard to recycling surpluses,
5) enhancing the IMF's supervisory role regarding Bank lending.[26]

Another complaint emanating from the Third World is that "the Fund uses an almost medieval bargaining technique" in negotiating programmes. It tries to extract maximum concession. As noted in Chapter 3, the govenments have limited scope regarding "negotiation"[27] with the IMF. It is being submitted that the Letter of Intent should be negotiated during the visit of the Fund's mission to the country in question. The current practice of presenting a pre-drafted Letter of Intent does not appear to represent any real commitment on the part of the particular government. Such a document should emanate basically from the government and broad consensus in drafting the letter is more desirable than use of the Fund's one-sided bargaining power. This should lead to successful implementation of adjustment policies and ultimately more awareness of the country's social and economic needs. The precondition clauses should be abolished.[28]

Additionally, the Fund should pay greater attention to the political consequences of its stabilization programmes and their effects on income distribution. It is the view of many developing countries that "a number of the Fund's staff members lack sensitivity to political and social realities". The IMF staff is not professionally qualified to undertake systematic political analysis.[29]

Greater weight should be given to the political and economic structure of the country concerned. This can be overcome, as it was suggested earlier, by increasing the Third World staff in the organization and by avoiding too much emphasis on the technical considerations. The capacity for adjustment does not solely pertain to economic factors rather it relates to many other variables such as labour mobilization, access to other sources of credit, the administrative capacity to run to IMF programmes for example. All these factors differ from one country to another, consequently, a reinterpretation of the principle of uniformity of treatment is necessary.[30]

With regard to the effects of the IMF policies on income distribution, it was noticeable that there is an absence of any protection to the poorer classes in the society[31]. These policies tend to enhance and preserve the power of the rich while reducing drastically the incomes of the working class. An apt description of the policies is that they cut the champagne of the rich and the bread of the poor.

Furthermore, achievement of symmetery[32] of the Fund's operations is essential to ensure equitable and fair treatment. The IMF has never been equipped with either the resources or the legal instruments to influence surplus countries. Its institutional weaknesses are readily observable as already noted, in the areas of surveillacne and scarce currency clauses which have been characterised by gross inefficiency. Anthony Carty[33] has properly questioned the reasoning behind the insistence or adoption of policies which adversely affect the welfare of developing countries while developed countries are unwilling to accommodate any restricting policies. The Finance Minister of Brazil has raised a similar argument in questioning the rationale behind the idea that the interests of multinational banks should take priority over the welfare of the people of Brazil.

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CONCLUSION

The existence of the international Monetary Fund as it functions at the present is justified by a very orthodox economic legal concept. The Articles of the Agreement are too general and vague to be considered as the "world economic constitution". As an organization it has lost its autonomy. All the major decisions in the international monetary relations are taken by a small group of states in response to their economic interests with a disregard of the monetary "system". International monetary "cooperation" in practice means cooperation among the group of ten. The IMF has limited its role to commendation of the merits of the economic summits of the major industrial countries, the outcome being merely political diplomatic statements rather than any commitment to specific measures.

The IMF policies have tended to widen the gap between the North-South division, creditor-debtor nation. Admitting that the special needs of the developing countries do not mean that they constitute a separate class, the main purpose of these policies is to ensure the repayments of its credit and loans to the multinational banks. Furthermore, these policies offer a temporary solution to the disorder in the international financial relations rather than address the causes of the disorder. On the domestic scale any success in bringing about a viable balance of payment without involving destructive measures to national and international prosperity is highly questionable.

The developed countries have neither the will nor the interest to enhance the role of the IMF except to the extent that the IMF serves their intersts and their foreign investments. They have worked out their own institutional alternatives.

The developing countries' demands for changes in the IMF lack any comprehensive framework because they have focused only on three issues, namely, appropriate representation, symmetry of the IMF programmes, and increase in the Fund's resources and furthermore these demands do not provide for instruments to realize their ends. They are formulated in general imprecise language. At best they are appeals to principles of justice and equity and have never been enhanced by any action. It is very doubtful if moral persuasion can produce any tangible results. It would have been more fruitful if the LDCs attempted to advance a kind of legal framework for their demands.

A prerequisite for an economic order is a legal order. The monetary arrangements which have been evolved can best be characterized as diplomatic arrangements. They are non-binding declarations of intentions. Their vague, general wording and formulations meet the technical requirements of legal norms to a very limited extent. If these arrangements are to acquire the character of "law", they should be objectively definite, binding and uniform. Article IV of the Articles of Agreement, for example, in outlining general obligations of members declares that:

> "... a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability ..."

Such wording lacks the force of law, the words "orderly underlying conditions" have not been defined. Similarly, Article IV(ii) speaks of "erratic disruptions" which is lacking in precision in the same manner as the formulation "to gain an unfair competitive advantage ..." in Article IV(iii).

Contrary to the claim that the decentralized nature of the international society entails such general and vague formulations, this horizontal nature of the international society is a forceful ground for having precise rules and to set up limits to the discretion of states to decide whether they are bound or not.

The other related issue of this monetary-diplomacy is the pragmatic approach to the monetary relations. The introduction of compensatory financing facility or rescheduling debts will never "heal" the problem of the developing countries. There is a deliberate avoidance of the causes of these problems. The economic policies have tended to deal with the effects of the imbalances in the world economy rather than tackling the origin of these problems. Furthermore this approach precludes developing "consciousness" of a system. By system is meant a set of legal rules which ensures coordination of various economic policies between sovereign states with different political, economic, social and legal ideologies, ends and methods, in order to make a comprehensive legal theory an essential precondition for rationalizing the whole complex issue of the international economic process. Only legal and organizational rules can constitute a desired long-term framework for the economic process.

The legal aspects of the international economic relations should be emphasized. Economics is not a rigorous discipline but rather a controversial one. For example, in identifying the causes of inflation, Friedman attributed the blame to the policies of full employment, welfare states policies, which raise governments' spending, while Bullock and Yaffe said that the declining profitability among private capitalists will tempt them to acquire the profits required for further accumulation by increasing prices thereby effecting an increase in money supply through the extenion of credit and state loans providing the guarantee that commodities will be sold at these prices. There is not any economic concept or principle to determine the optimal exchange rate. Instead of undue emphasis on economic concepts, attention should be directed toward exploring legal criteria to delineate the right and the wrong in national decisions which have repercussions on the international monetary conditions. This is judged not only by the controversial nature of economics but also by the fact that national economies are highly connected with each other.

Under the present monetary arrangements it is left to the discretion of the national policy makers to formulate their external and domestic policies. It is normal that priority will be given to the national interests. A country whose currency constitutes a major trading currency can devalue or revalue according to its national interests. Consequently, the national policy makers can directly influence the monetary conditions on a global scale which would impact on other states, for example, the upsurge in interest rates and the volatility of the exchange rates in the international scenario are the direct results of developed countries' internal financial policies. It is, therefore, vital that national decisions be subject to international standards. Ironically, the Second Amendment of the Articles gives the member states a "free hand" in their exchange rate policies. The New International Economic Order by its undue emphasis on economic sovereignty also sanctions individual freedom of action which is inconsistent with the setting up of international standards to govern the global financial relations.

The approach that national decisions be subject to international standards questions the usefulness of the classical notion of economic sovereignty in accordance with the international economic interdependence. It is one example that explains how legal concepts can participate in solving the dilemma of international economic relations. It is the task of the legal writers to advance a theory for economic relations between sovereign states that would lay down criteria to encourage orderly and systematic approaches to the present disorder in monetary relations thus enabling effecting participation of all countries with a view to solving world economic problems.

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