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INTERNATIONAL MONETARY SYSTEM
RESPONSE OF DEVELOPING COUNTRIES TO ITS SHORTCOMINGS

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ABSTRACT

Accumulation of reserves by developing countries to avoid borrowing from the IMF with whose governance and policies they are dissatisfied helped developing countries cope with the 2008 financial crisis. But it is argued that it was bad for the world economy. The need for reforms is accepted but the agreed reforms have not been implemented.

The Fund has given priority to external balance at the expense of domestic full employment contrary to the objective of Keynes and White. Also the lack of sharing of adjustment between deficit and surplus countries, as desired by Keynes, has imparted a deflationary bias to policies.

Developing countries have established facilities to provide additional BOP financing to their members. Though the amounts available under these schemes are substantial they would be insufficient in a crisis. Also the scheme do not indicate any new model of BOP adjustment. These schemes are no challenge to the hegemony of the Bretton woods institutions. They, however, are a small beginning and may be a pointer of things to come.

Key Words: International Monetary System, International Monetary Fund, Contingent Reserve Arrangement, Developing Countries.

JEL Classifications: F33, F55, N10, N20 , O19

1. Introduction

The evolution of the international monetary system (IMS) since the Second World War (SWW) can be divided into three phases. In the immediate post war period the need for reconstruction of the European economies resulted in large deficits on the current account and the balance of payments (BOP), as private capital flows were negligible. These deficits were beyond the capacity of the International Monetary Fund (IMF) to finance. The US stepped in with the Anglo-US loan and the Marshall Plan. The large current account deficits also meant that the European currencies were not convertible on the current account.[1] The second phase began in 1958 as most European currencies became convertible on the current account and lasted till the early seventies when the system put in place at the end of the SWW, the Bretton Woods System (BWS) collapsed. During this period the system successfully tackled the various problems that arose so that both developed and developing countries grew rapidly. This period is sometimes called "the golden age of capitalism" (Marglin and Schor, 1990). The breakdown of the BWS in the early 1970s resulted in a prolonged period of very slow growth. Developing countries particularly in Latin America and Sub-

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1 This implied that importers needed to obtain a license before they could import goods.

Saharan Africa faced severe pressure on their external accounts and had extensive dealings with the International Monetary Fund (IMF) and the World Bank. Despite the loans granted by these institutions and the conditions attached to the loans that were expected to lead to more rapid growth these countries faced a prolonged period of slow growth. The current IMS is the result of the attempts to cope with the problems arising after the breakdown of the BWS.

This paper analyses the evolution of the IMS since the SWW but particularly its development since the breakdown of the BWS and the recent attempts by developing countries to meet the challenges posed by this. The conditions imposed by the Bretton Woods institutions to the loans they granted to developing countries played a prominent part in determining the policies adopted by developing countries. Though the effects of these conditions on growth remain controversial, there is little doubt that growth did not pick up as was expected and also the social situation in these countries deteriorated. Developing countries became increasingly critical of these institutions particularly the IMF. They were critical of its governance structure, the manner in which its resources are raised and its lending policies. Because of their unhappiness at the conditions imposed by the IMF for its loans developing countries have tried to follow policies that would obviate the need to borrow from the IMF. A major component of these policies has been the accumulation of foreign exchange reserves. More recently, developing countries have sought to establish institutions to provide balance of payments assistance to avoid having to approach the IMF.

In Section 2 we discuss briefly the evolution of the world economy since 1973 noting the worsening performance in many developing countries. This performance, particularly that since the 2008 financial crisis, provides the background to what developing countries perceive to be the shortcomings of the current IMS and their actions to insulate themselves from its effects. In Section 3 we discuss the changes in the

system before its collapse in the early 1970s, stressing the measures taken to tackle the problems of the dependence on US BOP deficits for growth of international reserves, the adequacy of the IMF's resources and the conditions imposed on loans granted by the IMF. We end the section by discussing the causes of the collapse. In Section 4 we discuss the changes in the responsibilities of the IMF after the collapse of the BWS. This collapse and the ensuing changes resulted in the IMF mainly financing only developing countries leading to altered conditions being attached to the loans. The ensuing change in relations between the IMF and developing countries resulted in developing countries becoming increasingly dissatisfied with the IMF, its governance structure, the nature of its resources and its conditionality which are discussed in Section 5. In Section 6 we discuss the response of developing countries in terms of the accumulation of foreign exchange reserves and the consequences of this for the IMS. In Section 7 we discuss the response in terms of institutional innovation and whether this response is adequate. Section 8 contains the conclusions.

2. Evolution of the World Economy

Two features stand out in the post 1973 economic landscape. First, the world economy and many regions experienced slower growth (Table 1). However, growth rates in Asia both East and South were hardly impacted by the oil price rises. Two, is the liberalization of trade and capital flows that resulted in increases in the share of trade and foreign direct investment (FDI) in GDP (Tables 2 and3).

The economies worst affected were those in Latin America (LAC) and Sub-Saharan Africa (SSA). Between1983 and 2000 per capita GDP in the economies of LAC grew at barely 1 percent a year while it declined in SSA by 0.6 percent a year. But these economies have performed better in this century despite the post 2007 slowdown. The worst effect of the crisis has been the decline in FDI flows (Table 3).

Table 1: Growth in per capita GDP (Average annual %)

	1965-73	1974-82	1983-90	1991-00	2001-07	2008-09	2010-13
World	3.3	0.9	1.9	1.3	2.0	-1.5	1.7
High Income OECD	4.2	1.6	3.1	2.0	1.9	-2.3	1.2
EAP	4.5	4.6	6.2	7.0	8.4	7.2	7.4
LAC	3.3	2.0	-0.4	1.4	2.0	-0.1	2.7
MNA	5.1	1.8	-0.1	1.6	3.1	2.1	0.6
SA	1.3	1.8	3.3	3.3	5.4	4.3	5.4
SSA	2.2	0	-1.2	-0.7	3.4	0.7	1.5

Source: World Development Indicators (http:// databank.worldbank.org/data/home/aspx).

Note: The categories are as defined by the World Bank. EAP is East Asia and Pacific, LAC is Latin America and Caribbean, MNA is Middle East and North Africa, SA is South Asia and SSA is Sub-Saharan Africa.

Table 2: Exports of Goods and Services (% of GDP)

	1965-73	1974-82	1983-90	1991-00	2001-07	2008-09	2010-13
EAP		13.2	15.6	26.5	38.9	36.6	34
LAC	10.1	14.1	16.5	17.2	22.3	21.7	23.0
MNA	19.7	24.1	18.6	24.9	35.5	n.a.	n.a.
SA	5.1	7.0	7.2	11.7	17.2	20.5	22.3
SSA	23.0	24.4	26.2	27.8	32.2	32.5	30.8

Source: World Development Indicators (http:// databank.worldbank.org/data/home/aspx).

Table 3: FDI Flows (% of GDP)

A. Inward Flows						
	1974-82	1983-90	1991-00	2001-07	2008-09	2010-13
EAP	0.6	0.9	3.5	3.5	3.4	3.9
LAC	0.9	0.7	2.3	2.7	2.4	2.8
MNA	0.2	0.3	0.8	2.5	2.7	1.6
SA	0.1	0.1	0.5	1.3	2.8	1.5
SSA	0.6	0.5	1.5	2.9	3.7	2.4
B. Outward Flows						
EAP				1.1[a]	1.6	1.6
LAC				1.0[a]	0.6	0.7
SA				0.9[a]	0.9	0.3
SSA				0.7[a]	0.3	3.3

Source: World Development Indicators (http:// databank.worldbank.org/ data/home/aspx).

Note 'a' data is for 2005-7.

Table 4: External Balance (% of GDP)

	1965-73	1974-82	1983-90	1991-00	2001-07	2008-09	2010-13
EAP		0.6	-0.5	1.8	4.7	5.7	2.8
LAC	-0.7	1.6	3.4	-0.9	0.7	-1.0	-1.1
MNA	-0.7	-7.3	-8.1	3.2	3.4	n.a	n.a
SA	-1.6	-4.2	-3.1	-1.7	-2.8	-6.1	-5.9
SSA	-1.6	-4.6	2.3	0.1	0.1	-2.3	-1.5

Source: World Development Indicators (http:// databank.worldbank.org/ data/home/aspx).

Another important feature of recent performance has been that the current account deficit has not been large except in SA (Table 4). Also financing of the external deficits has become easier because of remittances and FDI flows. The question arises whether with this improved

current account performance there is need for additional sources of balance of payments financing.

3a Negotiating The Bretton Woods System : Its Basic Features

The Breton Woods System (BWS) put in place at the end of the Second World War was the result of intense debate during the latter part of the war on how to prevent a repeat of the collapse of international finance and trade that had occurred in the 1930s.

During the 1930s countries faced by large BOP deficits were forced to immediately cutback imports and try to increase exports because of lack of balance of payments financing. They imposed quantitative restrictions (QRs) on imports to immediately reduce imports and depreciated their currencies to increase exports. Such policies hurt the partner countries which then were forced to adopt similar policies that in turn hurt the original country. The interactions among these policies of the different countries resulted in a much greater decrease in export activities, both in agriculture and manufacturing, than what would have occurred because of the original reduction in demand.

The negotiators sought to prevent such a collapse of the international trading and financial system through adoption of beggar-thy- neighbour policies. Both White and Keynes[2] believed that stable exchange rates were needed to provide a conducive economic environment.[3] Both also wished to preserve domestic economic autonomy so that a country's pursuit of full employment policies would not be curtailed by adverse balance of payments (Helleiner, 1994).

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2 White led the US negotiations and Keynes the UK.

3 Exchange rate movements could change the competitiveness of a country's goods and so create a demand for protection. Negotiations in the 1930s had shown that countries were reluctant to accept tariff cuts as long as exchange rates were unstable. Also exchange rate movements could nullify the effects of a cut in tariffs.

A major feature of the debate about the establishment of the IMF was the role of capital movements. Most bankers wanted capital movements to be free as they believed that speculative capital movements occurred only when governments adopted incorrect policies. Therefore capital movements would force governments to adopt proper policies. The Keynes/White combination accepted that movements of productive capital were good but not movements of speculative capital.[4] The final IMF agreement was based on the premise that capital movements should be controlled.[5] The issue of the impossible trilemma, namely the incompatibility of fixed exchange rates, free capital movements and autonomy of monetary policy, was to be solved by restricting capital movements.[6]

Whereas the US and UK agreed about capital movements they differed on a number of other issues because of their different prospects.[7] This was particularly evident in the case of the British negotiators. Some fundamental questions had to be resolved in the negotiations to establish the IMF. One was whether the IMF was to merely provide loans to countries experiencing balance of payments problems or whether it was to act more as a central bank trying to manage the level of world economic activity. In the latter case, it would issue its own currency and

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4 The US accepted the need for restrictions on capital movements. For a detailed discussion of the debate see (Helleiner, 1994). Also see Ruggie (1982) and de Vries and Horsefield (1986) Vol. 3.

5 For instance, Keynes (1980) said of the IMF agreement that "Not merely as a feature of the transition, but as a permanent arrangement, the plan accords to every member government the explicit right to control all capital movements."

6 But the bankers were successful in diluting some of the proposals. The final version allowed countries to cooperate in enforcing capital controls instead of requiring them to. Keynes/White believed that controls would be more effective if they were monitored at both ends. Also governments were no longer required to submit a list of all assets held in their country by foreigners.

7 For a discussion of the opposing interests see Strange (1976).

determine the amount of international money required for a high level of world economic activity.[8]

Apart from the important issue of the extent of resources available to the IMF, another important issue was whether both deficit and surplus countries would be required to adjust and how symmetric adjustment could be achieved.[9]

The British expected large balance of payments deficits arising from the need for imports for reconstruction and to meet pent up demand while the capacity to export would be lacking. British negotiators sought an IMS where finance would be readily available to fund BOP deficits. The institution acting as a central bank would issue necessary international money to support world trade.

Symmetry of adjustment between surplus and deficit countries would be ensured by levying sanctions if either group did not adjust. Adjustment would be through variation of the exchange rate. Rules would govern the depreciation by the deficit and the appreciation by the surplus country leaving no scope for competitive devaluations.

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8 Keynes (1980) wanted the Clearing Union which is what he called his proposed organisation to act as an international central bank and to operate on banking credit rules as explained in the next footnote.

9 For instance, the original proposal by Keynes called for automatic financing of deficits through the balances built up by surplus countries, so that the clearing union would act like a commercial bank providing loans from deposits built up by surplus countries, compulsory confiscation of reserves exceeding a certain level and/or compulsory exchange rate adjustments when balances at the Clearing Union, the name proposed by Keynes, exceeded or fell below certain levels. The US proposal said that "The resources of the Fund would not be used to prolong a basically unbalanced international position. On the contrary, the Fund would be influential in inducing countries to pursue policies making for an orderly return to equilibrium".

The objectives of the US are less clear.[10] The US, which would be the only source for loans in the immediate post SWW period, wanted to limit the demand on its resources and also control the conditions attached to the loans. But they also pushed for a more liberal trade and finance regime to provide a better market for US exports and avenues for investment of US savings. The US wanted elimination of bilateral trading arrangements or arrangements such as the Imperial Preference system constructed by the British.[11] But it is not clear from the record whether they thought exports were essential for longer term prosperity.[12]

The preferences of the US carried the day. The IMF would be merely a lender and the amounts available for lending would be limited (Strange, 1976). The IMF was established with a fixed amount of money based on countries' subscriptions which reflected their importance in the international economy. The voting rights as well as the rights to borrow from the IMF were both governed by the size of the subscriptions or quotas as they were called.[13]

To prevent competitive devaluations countries could only devalue with the concurrence of the IMF and only if they had a fundamental

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10 For the US perspective see von Dormael (1976) and Bordo and Eichengreen (1993).

11 In the case of the elimination of Imperial Preferences the objective might have been political also.

12 There were fears that after the war economies such as the US would face a lack of demand and a return of depression conditions. In such a situation a higher level of exports would enable the US economy to have a higher level of economic activity and employment. A similar belief that European recovery was essential to US prosperity prevailed in the immediate years after the First World War also but had proved to be unfounded.

13 A country could borrow upto 125 percent of its quota.

disequilibrium, a term not defined (de Vries and Horsefield 1986).[14] However, there was no pressure on the surplus countries to revalue. Furthermore, quantitative restrictions on trade could be imposed if the IMF certified that the country faced a severe balance of payments problem. But the Fund has become increasingly reluctant to grant such a certification as it is believed that the BOP should be managed through exchange rate adjustment and not trade policy. [15]

The system of exchange rates agreed upon expressed the value of the US dollar in terms of gold and the US had the obligation to convert dollars into gold whereas the exchange rates of other currencies were expressed in terms of dollars.

A system was established which provided for BOP financing of deficits in the short run, possibilities for adjustment of exchange rates in the longer run and restricted recourse to trade restricting measures to manage the BOP. Initially the agreement did not mention that any conditions would be imposed on countries borrowing from the IMF. However, later, it was agreed, under US pressure, that BOP financing would be accompanied by conditions. [16]

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14 The earlier insistence on compulsory exchange rate changes was dropped. There was considerable ambiguity of this provision. Countries argued that consulting the IMF before a devaluation could lead the market getting wind of a possible devaluation and this would create a panic n the foreign exchange market so a country would merely inform the IMF of a devaluation. As it turned out most countries were reluctant to devalue and often the Fund had to force a devaluation as a condition for a loan.

15 The WTO has also become less tolerant of QRs. Consequently only a handful of small countries still levy QRs.

16 On the adoption of conditionality see Cohen (1982) and de Vries and Horsefield Vol. 2 (1986) Also see Babb and Carruthers (2008), Buria (2003). Erica R. Gould (2006) provides a more nuanced view of the evolution of conditionality. She notes the ambiguities in the US position. She claims that conditionality was adjusted to suit the needs of the subsidiary financiers.

While the preferences of the US carried the day, many of the issues raised at that time remain relevant—the question of having adequate international reserves, whether there should be an international money or reserves should consist of strong national currencies, the distribution of the burden of adjustment between debtor and creditor countries etc.

3b The Evolution of the IMF and the Operation of the BW System

The reconstruction of Europe required high levels of imports from the US and resulted in large current account deficits which were beyond the capacity of the IMF to finance. These deficits showed the success of the reconstruction effort (Milward, 1984). Furthermore, private US finance was unwilling to finance the balance of payments deficits partly because of political instability in many European countries.[17] The US Government had to step in with the Anglo-US loan and the Marshall Plan. The Marshall Plan grants amounted to about 1.1 percent of US GDP for the four years that the programme lasted. The British government received a special loan which required it to make the pound convertible one year after the loan. (Rosenson, 1947).[18] However the government was forced to suspend convertibility within a month because of the run on the pound. This showed that the European economies were not yet ready for current account convertibility, and resulted in US acquiescence to the continuation of capital controls in European countries (Helleiner, 1994, Gardner, 1956). The currencies of the European countries became convertible in 1958, but only on the current account.

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17 Lack of cooperative capital controls and US resistance to comprehensive controls on economic transactions limited the effectiveness of controls by only the European countries and so capital controls were not used.

18 It has been argued that this requirement for convertibility reflected a resurgence of the influence of bankers in the Truman administration formed after the death of Roosevelt (Helleiner, 1994).

The IMF had basically three tasks in the 1950s and 1960s or till the oil price rises of 1973-74.[19] The experience during those years revealed major shortcomings in the manner in which the IMS crafted at Bretton Woods dealt with the question of international reserves. One was the size and nature of reserves held by countries and the other was the adequacy of the resources of the IMF to meet the needs of a major country, particularly a reserve currency country. The first issue which came to be known as the "Triffin paradox" was about the size and nature of reserves. Triffin (1960) argued that there was an instability at the core of the arrangements. International reserves needed to grow as trade grew. But gold production grew very slowly and IMF quotas were adjusted every five years only if a review found them inadequate. Reserves were provided by the reserve currencies and, in practice, this meant dollars. The rest of the world could accumulate dollars only if the US ran current account deficits. So over time its liabilities would rise while its gold reserves would at best be constant. At some stage when gold reserves as a percentage of dollar liabilities had fallen sufficiently other countries would lose confidence in the ability of the US to convert dollars to gold, as required by the articles of the IMF. This would precipitate a lack of confidence and a run on the dollar. On the other hand, if the US did not run deficits other countries' reserves would be insufficient and this would stifle world trade. So the choice seemed to between a collapse of dollar convertibility and inadequate international money stifling world trade.

Two steps were taken to resolve this issue. One, gold was gradually taken out of the IMS. Initially, central banks stopped supplying gold to the private gold market in order to economise its use as a reserve asset. Later, gold was no longer to be used to make payments between central banks. The US was no longer obliged to convert dollars into gold and the system moved to a full-fledged dollar standard. Second, the Triffin

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19. See de Vries and Horsefield (1886).

paradox was sought to be resolved by the establishment of the Special Drawing Rights (SDRs).[20] This was international currency that could be used to make payments between central banks and its supply could be increased, if the members of the IMF so desired, and reserve holdings could increase without US current account deficits. But the US prevented the creation of enough SDRs to eliminate the use of the dollar as a reserve currency. So though the SDR potentially could avoid the Triffin paradox it was never used in that way.

The question of international reserves was closely tied to the question of BOP adjustment. Countries other than the US could not run deficits for long as they would exhaust their reserves and their capacity to borrow from the IMF.[21] They would then be forced to adjust. The smaller the reserves, the more the pressure to adjust. However, the US could run deficits indefinitely as dollars would be held by other countries as it was the international currency.[22] Another asymmetry of the system often stressed was that between countries running deficits and those running surpluses. While the former had to adjust before they ran out of reserves, the latter were under no such pressure.

A second issue had arisen in the mid-sixties when the UK was given a large loan by the IMF and the US was also running large deficits. It was feared that the IMF may run out of convertible currencies. This problem was resolved by the 10 largest economies agreeing to provide additional amounts to the IMF if such a situation arose.[23] This was the General Agreement to Borrow (GAB), under which the resources available

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20 For a discussion of SDRs including their history see Williamson (2009).

21 Private credit for BOP purposes was still largely unavailable.

22 This privilege was called the exorbitant privilege by the French President de Gaulle. Of course, the Triffin analysis called into question the existence of such a privilege but the cost of refuting such a privilege might be a collapse of the international monetary system.

23 Later Switzerland also became a party to the GAB so though the group continued to be called the 10 it had actually 11 members.

to the IMF were expanded not by increasing quotas but in an ad hoc discretionary manner. The GAB did, however, provide an escape from the IMF running out of resources. At that time large capital movements were among the developed countries, those who participated in the GAB, and so, indirectly, the GAB obviated the need to control capital movements.[24]

The third issue involved the conditions that would be attached to IMF loans. Such conditions were considered necessary to ensure that the current account deficit was eliminated and the loan repaid. The conditions were based on a view that deficits arose because of excess demand in the economy. So, contractionary monetary and fiscal policies were necessary. But these would also reduce demand for non-traded goods and create unemployment there. Therefore, contractionary policies were to be accompanied by a devaluation which would shift demand towards traded goods and so resources released by the non-traded goods sector would be absorbed in the traded goods sector.[25] Therefore, the conditions were usually contractionary monetary and fiscal policies and a devaluation.[26] The conditions accompanying IMF

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24 Per Jacobson had a traditional bankers' view of how to manage the economy based perhaps on his earlier work at the Bank for International Settlements (BIS). The BIS was a proponent of orthodox finance, balanced budgets, free capital movements etc. The BIS had more flexible working procedures than the IMF and often was the first to provide emergency funding to finance capital movements. The IMF would later follow to provide longer term financing.

25 This analysis was developed at the IMF. See Alexander (1952). Also see Johnson (1962).

26 The actual model used the programming model is described in Mikkelsen (1998). See also Polak, (1957). For a critical analysis of the model see Easterly (2002).

loans were similar for developed and developing countries; there was no special provision for developing countries.[27]

The IMF sought to prevent recourse to protectionist measures by encouraging increased use of Fund resources by becoming more liberal in giving access to these resources, creating new facilities such as the Compensatory Financing Facility (CFF) to help commodity exporters who often faced BOP difficulties because of declines in the price of their primary exports, and expanding its resources through the establishment of the General Agreement to Borrow and increasing quotas following the Fifth review of quotas (de Vries and Horsefield, 1986).

Meanwhile the international financial system was changing in ways whose full impact still lay in the future. Private capital flows became freer with the development of the Euro dollar market. This was the market in London for dollars. It meant that countries could borrow dollars without the concurrence of the US government. The development of the euro dollar market was encouraged by UK authorities, especially the Bank of England. It was a way to restore international financial business to the London financial market especially after the US restricted

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27 Though most of the above mentioned problems affected the developed countries more the Fund also responded to a specific problem that many developing countries faced. Most developing countries at this period depended on commodity exports and earnings from such exports fluctuated considerably so that periodically these countries would have large current account deficits not because they had created excess demand through inappropriate monetary and fiscal policies but because of international conditions over which they had no control. To help such countries the Fund started the Compensatory Finance facility (CFF) in 1963 to provide financing to countries that ran into balance of payments problems because of shortfalls in export earnings from their commodity exports and the conditions attached to such borrowings were much less stringent than those attached to regular Fund borrowings.

capital flows in 1963.[28] The US government implicitly supported the development of the euro dollar market as foreigners who held dollars there would not convert them to gold.[29] But yet capital controls had not been eschewed by these governments.

3c The Collapse of the Bretton Woods System: The new IMS and the IMF

The success of the measures can be seen in that the collapse of the system in 1971 was not because of any of the problems that had been feared. For instance, there was no large scale conversion of dollars into gold by central banks (De Grauwe, 1996). There was agreement that the dollar was overvalued particularly relative to the German mark and the Japanese yen. The battle in 1971 was over whether the US dollar should be devalued or the other currencies revalued. The US precipitated the 1971 crisis and forced the others to the negotiating table. The problem ultimately was met by making the dollar not convertible into gold and a combination of a US dollar devaluation and revaluation of other currencies. The negotiations also sought to build cooperative arrangements to control capital flows as had been envisaged in the IMF negotiations by both Keynes and White and to control the euro dollar market.

But no agreement on capital controls or on measures to regulate the euro dollar market could be reached and the new parities turned out to be unsustainable. Most developed countries then adopted a floating rate.

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28 Capital controls became more stringent over time and reflected the scepticism about the benefits from a liberal capital flows regime. Even the American Bankers Association admitted in 1968 that the case for free capital movements was weak, given that many such movements were speculative, unproductive, and tax avoiding, quoted in Helleiner, 1994. Also the interests of US bankers continued to be subordinated to other domestic interests (Odell, 1982).

29 Secretary of the Treasury Dillon quoted in De Cecco, 1987. The euro dollar market enabled US authorities to continue with their domestic and foreign policies in the face of increasing balance of payments imbalances.

Without capital controls governments were forced to undertake significant fiscal and monetary contractions in order to prevent capital flight. This meant the abandonment of the priority accorded to maintaining full-employment. Also for the longer term there was a move to adopt more market friendly policies and in particular to adopt monetary and fiscal policies geared towards gaining the confidence of financial markets. The US abandoned its earlier position of controlling capital flows and pushed for a fully liberal capital flow regime.

Such a regime would free the US of any restraints in its domestic policy making. Large deficits and dollar availability would lead to the dollar depreciating and there would be no need to engage in contentious negotiations with Europeans and Japanese about appropriate exchange rates.[30] A more liberal financial regime would preserve US policy autonomy even in the longer run given the size and strength of the New York market.[31] This move on capital flows was part of a broader move to more liberal market oriented policies in the US starting in the early 1970s. Other countries also liberalized their capital flow policies in order to maintain the competitiveness of their financial systems. Also a culture favouring more liberal policies had grown up nurtured in part through the frequent meeting of financial officials at the Bank of International Settlements and the Working Party Number 3 of the OECD.

The other significant development in the 1970s caused in part by the oil price rise of 1973-74 was the increase in commercial bank lending to developing countries. The oil price rise had resulted in large current account deficits in the oil importing countries and surpluses in the oil exporting countries. The US vetoed attempts to recycle the surpluses of

30 Changes in exchange rates and subsequent macro policies to offset the demand reducing effect of lower exports resulted in the elimination of the current account deficit of the US without the US having to take any policy action.

31 This was the result of the analysis by Fleming (1962) and Mundell (1963) who showed how capital flows could result in policies that achieved both full employment and a balanced external position.

the oil exporters through the IMF, arguing instead to let private markets largely handle the financing of the deficits. The large surpluses of the oil exporting countries were recycled to the oil importing countries mainly through the US banks.

4. The Changing Agenda of the IMF[32]

The Fund's role changed substantially after the abandonment finally in 1973 of the system of pegged exchange rates and the liberalization of financial flows and capital markets that occurred in the 1970s (Williamson, 1977; Cohen, 1977). Now, substantial amounts of private BOP financing were available.[33] The 1980s were spent mainly in dealing with the consequences of these developments.

4a The Fund and Exchange Rate Surveillance

The freeing of the exchange rates was seen as the solution to the problem of the incompatibility of fixed exchange rates, autonomy of monetary policy and free capital flows (Aizenman, 2013).[34]

A smoothly operating IMS required the major countries to stabilise exchange rates and coordinate economic policies. The question then arose should the Fund attempt to influence major countries or concentrate its energies on smaller countries where its influence was more likely to be felt (Broughton, 2001). The latter would be successful only if their own policies and not those of the major countries caused the troubles of developing countries. Otherwise, concentrating on smaller countries might be futile. We believe that the Fund failed to analyse the interconnections between the smaller and major countries.

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32 In this paper neither the underlying model behind the Fund's analysis nor the evolution of this model is discussed.

33 This was in contrast to the views of Keynes and White noted above that capital movements should not be free.

34 Freer exchange rates along with free capital movements were supposed to provide the way of attaining internal balance compatible with external balance (Fleming,1962 Mundell, 1963).

Experience dealt a blow to the belief that market determined exchange rates would be able to manage the BOP. Exchange rates often moved in the wrong direction. For instance, the dollar appreciated in the first half of the 1980s despite the large current account deficit.[35] Also this misalignment persisted over long periods of time (Mussa, 1990).

The IMF was supposed to ensure that exchange rate movements were not caused by a country's attempt to gain a competitive advantage over other countries, namely, recourse once again to beggar thy neighbour policies. Also the IMF was expected to ensure that countries followed policies compatible with a well functioning international economy. This required a framework for multilateral surveillance which undoubtedly would be complex. But a usable framework was not available nor was one developed.[36]

4b. Increasing Involvement with Developing and Transition Economies

After the adoption of flexible exchange rates the developed countries no longer required assistance from the IMF until the current eurozone crisis as exchange rate were supposed to move to manage the BOP and developed countries could borrow from international capital markets rather than the Fund in case of need.[37] Recourse to the capital markets meant that government policies were now geared towards sustaining the confidence of the capital markets.

35 The movement in the wrong direction was not just short lived. Also, models which explained one anomaly did not explain other anomalies that cropped up in future periods (De Grauwe, 2000)

36 There were disputes particularly between the US on one side and the European and Japanese governments as to the policies that the different governments should adopt to get the economies out of the stagflationary situation in the late 1970s and the dollar overvaluation of the early 1980s.

37 The last borrowings by a developed country from the IMF before the current eurozone crisis were the borrowing by Italy in 1974-75 and by the UK in 1976. The happenings in the UK and the consequences of the IMF loan are examined in Hickson (2005).

Previously IMF conditionality had applied equally to developed and developing countries. Now, the IMF became almost exclusively a lender to first the developing countries and then in addition to the transition economies. This changed the politics of the functioning of the Fund and its lending policies (Polak, 1981). The developed countries determined the conditions imposed by the Fund and these conditions were imposed on developing and transition countries. This asymmetry did not lead to harmonious relations. The increasing involvement with these economies had mainly two aspects. One was expansion of the facilities of the IMF. The second was to deal with currency crises.

4.b.i. Establishment of New Facilities

The IMF has sought to respond to the balance of payments difficulties confronting many developing countries, particularly the poorest. The managing director (MD) of the Fund at the time of the oil price rises in 1973-74, Johannes de Witteveen, got agreement to set up a supplementary financing facility (SFF)[38] to provide additional financing to countries with severe BOP problems that could not be tackled by normal level borrowings from the Fund. Furthermore, in August 1975, the Executive Board subsidized borrowings through a subsidy account for the most seriously affected members using the oil facility (https://www.imf.org/external/np/exr/chron/chron.asp). The SFF operated from June 1974 and lent $6.9 billion in 156 transactions.

The IMF responded to the balance of payments difficulties confronting many poor countries by providing concessional financing. In May 1977 a Trust Fund was established with profits from the sale of part of its gold and between 1977 and 1981 about $3.8 billion was disbursed (Ghatak and Sánchez-Fung).

Then beginning in March 1986, concessional financing was provided through the Structural Adjustment Facility (SAF), and then

38 See https://www.imf.org/external/np/exr/chron/chron.asp

through the Enhanced Structural Adjustment Facility (ESAF) beginning in December 1987. Between March 1986 and December 1987, SDR 1.8 billion (about $2.4 billion) was disbursed. Between December 1987 and November 1999, SDR 7.6 billion (about $10.7 billion) was disbursed under 90 ESAF arrangements to 52 countries (http://www.imf.org/external/np/exr/facts/esaf.htm). Loans under the ESAF carried an annual interest rate of 0.5 percent, with repayments made semiannually, beginning 5½ years and ending 10 years after the disbursement.

ESAF operations were financed mainly through contributions from a broad cross-section of IMF member countries in the form of loans and grants to the ESAF Trust, which was administered by the IMF.

In December 1993, the ESAF was enlarged and extended. In September 1996, the ESAF was made a permanent (rather than a temporary) facility. But in 1999 the ESAF was replaced by the Poverty Reduction and Growth Facility (PRGF). It was intended that the PRSP approach would result in policies that integrated better the poverty reduction and macroeconomic elements of IMF programmes, and also encourage greater participation by civil society.

The IMF had also the Systemic Transformation Facility (STF) to provide funds and advice to help the transition economies to move towards a market oriented framework.

The extended fund facility (EFF) was established for countries experiencing serious payments imbalances or serious structural imbalances that resulted in low growth[39]. Given that structural reforms to correct deep rooted weaknesses often take time to implement and bear fruit, the EFF allowed for loans for a longer period of up to three years with possible extension to a fourth year and for a longer repayment periods of ten years. The EFF stressed structural adjustment, namely

39 http://www.imf.org/external/np/exr/facts/pdf/eff.pdf

reforms to address institutional or economic weaknesses in addition to the usual policies implemented for macroeconomic stability. Normally a country could borrow till 200 percent of quota in a year so that over a three period it could borrow 600 percent of quota. In exceptional circumstances it could borrow more.

4.b.ii Quotas and International Money

At the commencement of the IMF international money consisted of convertible currencies, the US dollar and the pound sterling, gold and IMF quotas. Sterling soon fell out of fashion and the role of gold was eliminated in the seventies. So, international money came to consist only of US dollars and IMF quotas[40].

Without a quota increase a country can increase its foreign currency reserves only by running a BOP surplus. A surplus with other countries would merely re-allocate the existing supply of international money. Only a surplus with the US would increase the world supply of dollars, namely international money. Therefore, an increased supply of dollars for the world required the US to run a current account deficit. This depends mainly on US policies.

IMF quotas can be increased after periodic reviews with members' consent. Without such an increase, countries would need BOP surpluses to raise their reserves as trade grows, and they are essentially extending a low interest loan to the US. Thus the US has a vested interest in preventing an increase in IMF quotas. With a quota of over 17 % of the IMF's voting rights the US can block a quota increase which requires an 85 % vote in favour. There is a moral hazard problem as the US that gains from quotas not increasing can block any quota increase. Expectedly, quota increases have lagged behind the growth in world

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40 Countries also held limited amounts of other currencies such as the German mark and the Japanese yen which would also be considered international moneys. But their share of the total was very small.

trade or capital flows. Trade in goods has increased by a factor of almost 150 between 1950 and 2010. IMF quotas would increase by a factor of just over 80 if the latest proposed quota increases occur. With lagging increases in quotas, countries are forced to run current account surpluses to raise reserves in proportion to the increase in trade.

In brief, the supply of international money is beyond the control of almost all countries.

4.c.iii IMF and Structural Adjustment

Many developing countries borrowed heavily from banks to finance the deficits arising from the oil price rises of 1973-74. When interest rates skyrocketed in the early 1980s as the Federal Reserve in the US sought to control inflation these countries became unable to meet the huge interest payments leading to a debt crisis (Sachs, 1991). These countries approached the IMF for financing. The IMF sought to place these countries on a permanently more sound macroeconomic path. Increasingly the Fund accepted the idea that the BOP payments problems of developing countries were the result of structural weaknesses and rigidities, but believed that these arose mainly from government interference in the working of the market. Therefore, conditionality was extended from monetary and fiscal policies to manage aggregate demand, to all aspects of the economy that were felt to be a market interference and so preventing a supply response. The conditions imposed as a package by the IMF came to be known as structural adjustment. They are also often referred to as the "Washington Consensus" reflecting the agreement for their need by the IMF, the World Bank and the US Treasury (Williamson, 1991). The case for extending market oriented reforms was further strengthened as the central planning countries began their move to market economies. There was no limit to the scope for conditionality. Conditionality was even extended to the contingency and compensatory funding facility (CCFF) which had been a low conditionality facility. As a result countries stopped borrowing under that facility.

However, these structural adjustment policies were not able to return these economies to a high growth path, as we saw above, and their social costs were considerable. Ultimately a substantial amount of debt had to be forgiven or written off for Latin America though the Brady Plan (Cline, 1995)[41] and for low income countries mainly in Sub-Saharan Africa though a special initiative for highly indebted poor countries (HIPC). The HIPC initiative involved strong conditions that countries had to fulfill before the debt would be forgiven. The IMF sought to develop general principles to deal with debt restructurings. But most debt is still treated on a case by case basis.

During the eighties and nineties the IMF provided financing, sought to convince banks to continue lending, and also helped in debt rescheduling.

The availability of private financing raised other questions about IMF policies. Should the IMF borrow from private sources? That has not happened as yet. Should the Fund seek to influence the behavior of providers of private BOP finance? Usually in providing assistance to countries in BOP difficulties with substantial private borrowing the IMF has insisted on agreement with private finance to ensure that they contribute so that the assistance does not merely help repayment of private obligations.

4.b.iv Outcomes of Structural Adjustment

There are so many factors that influence the behavior of an economy that it is difficult to analyse the effect of the structural adjustment programmes (SAP). It depends on the counter factual that is used for the comparison (Mosley, Hartigan and Toye, 1991).

Two different views have been advanced for the rationale for the diminution of the role of the government and the shift towards more

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41 The earlier Baker Plan had proved to be inadequate.

market determined allocations (Toye, 1987; Bruton, 1992). Bruton notes that the earlier import substitution policies had mixed outcomes with increases in growth rates and in savings rates; but also failures with repeated BOP problems and slow increases in employment. He then argues that in such a situation the existing policies required fine-tuning rather than a complete rejection. Furthermore, the SAP neglected the question of how to increase exports rather than believing that liberalisation would bring it about automatically. Consequently, BOP problems persisted as exports grew slowly so that growth remained low (Table 1).

Toye (1987) on the other hand argues that the shift in policy was guided more by political considerations and notes that at the same time similar shifts were occurring in the US and the UK under President Reagan and Prime Minister Thatcher. A formal evaluation of the SAP found that structural adjustment was successful in improving the current account, but more because of imports falling than exports increasing (Mosley, Hartigan and Toye, 1991). Also bringing down inflation and the government budget deficit was more difficult.[42]

4.b.v IMF Dealing with Currency Crises

With the shrinking of commercial bank lending to governments in developing countries following the debt crises new forms of lending arose. Commercial banks lent either directly to enterprises in developing countries or through banks in those countries. Governments issued bonds to raise money in the major capital markets of the world. However, the 1990s saw a series of currency crises. The first was in Mexico in 1994 followed by the Asian crisis in 1997, crises in Brazil 1998-99, Russia in

42 A lesson being repeated in the euro-zone as countries there follow policies that are essentially similar to the SAP. They are less bedeviled by inflation as the euro has not been devalued.

1998 and in Argentina in 2001.[43] In most cases, except finally in Argentina and in Russia, the IMF stepped in with special funding to deal with the currency crises. This funding was often arranged outside the normal operations of the IMF. Therefore, the stability of the world economy depended on ad hoc and short-term increases in the Fund's resources and on a spaghetti ball of bilateral or regional safety net agreements, some of them out of sight beneath the table, their aggregate stabilising effects unknown (Broughton, 1991). Ad hoc funding arrangements were also accompanied by conditions that seemed to have little to do with the crisis.[44] While there were calls for a new financial architecture after the Asian crisis not much was accomplished.

The crises in the 1990s further shifted the mode of how developing countries accessed private capital. Countries liberalised their FDI policies and FDI became the main component of capital inflows that financed current account deficits.

Models that sought to understand how crises occur gradually became more complex as each crisis could not be predicted on the basis of existing models. The initial model (Krugman, 1979) showed that a government budget deficit would inevitably lead to a crisis if there was a fixed exchange rate.[45] The simple policy advice was that the budget should be balanced. But later crises such as in the European Monetary System (ERS) in 1992-93 and in Asia in 1997-98 occurred even when there was no deficit in the government budget. So, second generation

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43 See Sachs, Tornell and Velasco (1996) for an analysis of the Mexican crisis, Radelet and Sachs (for the Asian crisis, Desai (2000) and Kharas et. al. (2003) for the Russian crisis, Goretti (2005) for the Brazilian crisis and Mulraine (2005) for the Argentine crisis.

44 For instance, in the case of Korea during the Asian crisis the IMF called for privatization when the crisis was not caused by excessive government borrowing or large budget deficits but by excessive private sector borrowing itself caused by liberalization of capital flows.

45 This came to be called the problem of the twin deficits. A deficit in the budget resulted in a BOP deficit.

and third generation models were developed. In these, for instance, there might be multiple equilibria and an event could shift people's expectations and require a large change in the equilibrium exchange rate and this would be accomplished through a crisis. Or the behaviour of the private sector could lead to crises (Calvo and Mendoza, 2000). The more complex models did not lead to any simple policy rules.

One consequence of the Asian financial crisis was the establishment of a programme, the Financial Sector Assessment Program, run jointly by the IMF and the World Bank. Under this programme, the financial systems of countries were examined to see whether they were complying with international standards in banking, auditing, stock market operations etc. The financial systems were also analysed from the viewpoint of their ability to withstand various shocks. But the general belief was that the problem of weak financial systems was one in developing countries. The US refused to have its system examined though it was systemically more important than most developing countries.

5. Unhappiness of Developing Countries with the IMF

Developing countries have been unhappy mainly with the governance of the IMF, the response of the IMF to various international developments and the conditions attached to its loans.

a. Governance of the IMF

By convention the Managing Director (MD) of the IMF has always been a European. In addition, of the 24 members on the executive board of the IMF, 8 are from Europe and 1 each from the US, Canada and Australia. Also, the developed countries have more than 50 percent of the voting rights. But their decision making power is even greater as major decisions currently require 85% of votes. The US alone with about 17% of voting rights wields a veto power. It has held the veto power over the entire period of operation of the Fund as when its voting share has fallen the voting percentage required for major decisions has

been increased. A small group of European countries could also wield the veto.[46]

The second in command, who was initially the Deputy Managing Director and since 1994 the First Deputy Managing Director, as the number of deputy directors was increased to three, is a US citizen.

The G20 had agreed to a shift in voting rights to developing countries[47], reform of the governance structure of the IMF with European representation at the Board reduced and that of African countries increased, and that the selection of the MD would be made more democratic. But a result of the voting shares can be seen in the implementation of the 2010 agreement which had two components, a quota increase and board reform which would reduce the number of European directors. Acceptance by three-fifths of the Fund's 188 members (or 113 members) having 85 percent of the Fund's total voting power is required for reforming the Executive Board.[48] As of May 8, 2015, 147 members having 77.25 percent of total voting power had accepted the amendment. For the quota increases under the 14th General Review of Quotas to become effective, the consent by members having not less than 70 percent of total quotas (as of November 5, 2010) is required. But the US has linked the two so the implementation of the quota increase requires the entry into force of the proposed amendment to reform the Executive Board. Therefore, though 164 members having 80.34 percent of total quota had consented by May 8, 2015, the quota increase could not be implemented.

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46 A group of developing countries could also wield the veto. But this would require a relatively large group.

47 This reform would still leave the share of developing countries at less than 50 percent

48 Acceptances of the Proposed Amendment of the Articles of Agreement on Reform of the Executive Board and Consents to 2010 Quota Increase. Last Updated: May 8, 2015. http://www.imf.org/external/np/sec/misc/consents.htm

When Mr. Strauss-Kahn resigned as MD of the IMF in 2011, despite the acceptance of the need for a more democratic process, the Europeans jumped in and proposed Ms. Lagarde as the MD arguing essentially that only a European could understand European problems which were at the centre of the IMF's concerns at that time.

In brief, despite all the talk and agreement at various formal venues little progress in reforming the IMF is seen on the ground

5.b. IMF Conditionality and Developing Countries

The unhappiness of developing countries with the functioning of the IMF was compounded in Asia by what was perceived to be slow response of the IMF to the Asian crisis, the intellectual inadequacy of the response and the irrelevance of some of the conditions. These countries contrasted the very rapid response of the IMF to the Mexican crisis in 1994 to the very slow and prolonged negotiations they went through.[49] The intellectual inadequacy was shown by the neglect by the IMF of the effect of the programme in one country on its neighbours so the combined effect of the programmes was severely contractionary and this was completely misjudged by the IMF, as it later admitted.[50] An

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49 In the case of Indonesia there was a suspicion that this was deliberate to bring about a regime change (Khan, 2011). Krugman (2015) has argued similarly in the case of Greece: Breaking Greece "So what is happening? Is the goal to break Syriza, the Greek political party that has formed the government? Is it to force Greece into a presumably disastrous default, to encourage the others? At this point it's time to stop talking about "Graccident"; if Grexit happens it will be because the creditors, or at least the IMF, wanted it to happen." Also note."When crises broke out in Latin America and Asia, the IMF promptly came up with a standard package of recommendations without any hesitation and dictated policies though many were subsequently shown to be mistaken or questionable. Now, (2007), the epicenter of the crisis is in the United States, and for the time being, has affected primarily U.S. and European financial markets. The Fund had little to say that was practical. It has been excessively cautious in its recommendations." Mantega (2007)

50 It was somewhat amazing that an international organisation set up to prevent adoption of beggar-my –neighbour policies and so to take account of interactions completely failed to do so.

example of irrelevance of a condition is that of insisting on privatization in Korea. The crisis in Korea was caused by unregulated foreign borrowing by the private sector and which had not been hedged against. So the private sector was severely hit when the devaluation of the Korean won raised the debt servicing costs of many firms forcing them into bankruptcy. It was not clear how privatization would resolve this issue.

Developing countries have expressed their unhappiness in the form of reluctance to borrow from the IMF. Many countries prepaid their loans so that the interest income of the IMF fell. The losses forced the IMF to retrench before the 2008 crisis. Developing countries have also responded to their unhappiness with Fund conditionality by increasing their reserves so that they do not have to approach the Fund for balance of payments support and developing alternate sources of financing.

6.1. Response of Developing Countries: Accumulation of Reserves

Earlier, the rule of thumb was to hold three months of imports as reserves (Olivier and Rancier, 2006).[51] Later Guidotti, former Argentinian finance minister and Greenspan a former chairman of the Federal Reserve in the US suggested that countries should keep reserves equal to their short term liabilities to meet any withdrawal of credit facilities (Jeanne and Rancière, 2006).

Developing countries have been increasing their reserve holdings beyond such previous rules of thumb. The major countries have increased the level of reserves whether measured as a percentage of GDP (Table 5) or of imports (Table 6). All the 11 countries that are members of the G20 but may be considered not fully developed increased the level of reserves

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51 Countries with greater variability in export earnings or import payments might find it prudent to keep larger reserves. But this necessity lessened after the establishment of the compensatory finance facility at the IMF in 1963 to enable a member to borrow to meet a temporary shortfall in foreign exchange earnings due to circumstances beyond its control. It was extended in1981 to cover sudden higher costs of cereal imports.

Table 5: Reserves (as % of GDP)

	1997	1999	2001	2003	2005	2007	2008	2009	2010	2011	R1	R2
Argentina	7.7	9.3	5.4	10.9	15.3	17.7	14.2	15.6	14.2	10.4	2.3	0.6
Brazil	5.9	6.2	6.5	8.9	6.1	13.2	11.7	14.7	13.5	14.2	2.2	1.1
China	15.4	14.9	16.6	25.4	36.8	44.2	43.5	49.1	49.1	44.5	2.9	1.1
India	6.7	7.8	10.0	16.8	16.5	22.3	21.0	20.9	17.6	16.0	3.3	0.7
Indonesia	8.11	19.5	17.5	15.4	12.1	13.1	10.1	12.2	13.6	13.0	1.6	1.0
Korea	4.0	16.6	20.4	24.2	24.9	25.0	21.6	32.4	28.8	27.5	6.3	1.1
Mexico	7.2	6.6	7.2	8.4	8.7	8.4	8.7	11.4	11.6	12.9	1.2	1.5
Russia	4.3	6.3	11.8	18.2	23.9	36.8	25.7	35.9	32.2	26.8	8.5	0.7
S Africa	4.0	5.6	6.4	4.8	8.3	11.5	12.4	14.0	12.0	11.9	2.9	1.0
S Arabia	9.8	11.4	10.3	11.4	49.9	80.4	94.8	111.8	101.9	96.5	8.2	1.2
Turkey	10.4	9.8	10.2	11.7	10.9	11.8	10.1	12.2	11.8	11.4	1.1	1.0

Note: R1 is ratio of 2007 to 1997 and R2 is ratio of 2011 to 2007.

as percentage of GDP and of imports between 1997 and 2007. While China had a high level of reserves it did not have the highest level of reserves. As a percentage of GDP it had the second highest level of reserves and as a percentage of imports it had the third highest level. Nor did it have the fastest rate of increase in these percentages.

Five countries increased the share of reserves as a percentage of GDP more than China did. Also, 5 countries increased reserves as a percentage of imports more than China did (Table 6). Even after the financial crisis only three countries, Argentina, India and Russia saw a decline in the ratio of reserves to GDP; in addition to these three another two countries, Korea and Turkey, saw a fall in their reserves to imports ratio.

These 11 countries have also increased their reserves as a percent of short term debt. As short term loans borrowed by developing countries might not be rolled over or could be withdrawn the Greenspan Guidotti rule was enunciated that countries should hold reserves equal to their short term liabilities.

But these large economies have been reducing their level of short term debt as a percentage of reserves and reserves are considerably larger than their short term debt (Table 7). The ratio comfortably meets the Greenspan- Guidotti rule even after the financial crisis except for India and Turkey. A few countries have short term debts slightly greater than reserves, a ratio of 1.1, and surprisingly China is included in that group.

Why are these large economies holding such large reserves whether measured in terms of GDP or imports or short term debt? One possible explanation is that outflow of short term loans is not the only danger that developing countries face. With the significant capital account liberalization that has occurred domestic individuals and companies can convert their liquid assets into foreign currency and transfer them out of the country. M2 is a measure of liquid assets. So adequacy of

Table 6: Reserves (as % of Imports1 of Goods and Services)

	1997	1999	2001	2003	2005	2007	2008	2009	2010	2011	R1	R2
Argentina	59.9	80.6	53.1	76.9	79.9	87.0	68.8	97.7	76.9	53.1	1.5	0.6
Brazil	65.8	57.3	48.0	73.9	52.9	111.5	87.0	132.1	113.1	112.6	1.7	1.0
China	89.1	85.0	81.1	92.7	116.8	149.4	159.5	220.3	184.0	162.9	1.7	1.1
India	57.2	58.7	75.2	109.1	75.0	91.3	73.4	82.0	66.8	52.6	1.6	0.6
Indonesia	28.8	71.2	56.9	66.7	40.6	51.9	35.2	57.4	59.2	52.2	1.8	1.0
Korea	12.0	51.4	60.9	73.0	68.2	61.9	39.9	70.4	57.9	50.8	5.2	0.8
Mexico	23.7	20.4	24.2	31.4	30.6	28.5	28.8	38.9	36.9	39.2	1.2	1.4
Russia	19.3	24.0	48.9	76.3	110.9	171.0	116.3	175.3	148.7	120.1	8.9	0.7
S Africa	17.1	24.8	24.7	19.0	30.0	33.6	32.0	49.5	43.8	40.6	2.0	1.2
S Arabia	37.5	48.9	42.8	47.4	179.4	212.9	255.4	259.8	263.7	314.9	5.7	1.5
Turkey	34.2	50.7	43.6	48.8	42.9	43.0	35.6	49.9	43.9	34.8	1.3	0.8

Note: R1 is ratio of 2007 to 1997 and R2 is ratio of 2011 to 2007.

Table 7: Short Term debt (as % of Reserves)

	1997	1999	2001	2003	2005	2007	2008	2009	2010	2011	R1	R2
Argentina	143	112	137	158	124	42	43	41	27	36	0.3	0.9
Brazil	67	80	79	50	45	22	19	17	19	12	0.3	0.6
China	22	9	2	21	18	13	10	10	12	15	0.6	1.1
India	18	11	6	6	6	13	17	16	19	26	0.7	2.0
Indonesia	188	73	71	54	32	33	40	36	34	35	0.2	1.1
Mexico	97	76	33	39	30	31	30	28	32	34	0.3	1.1
Russia	34	128	52	39	15	21	17	12	13	14	0.6	0.7
S Africa	183	144	110	101	69	73	75	54	50	39	0.4	0.5
Turkey	91	96	82	65	73	56	72	66	91	95	0.6	1.7

Note: R1 is ratio of 2007 to 1997 and R2 is ratio of 2011 to 2007.

Table 8: Reserves (as % of M2)

	1997	1999	2001	2003	2005	2007	2008	2009	2010	2011	R1	R2
Argentina	28.9	29.6	20.0	36.3	48.8	57.5	54.3	56.6	48.6	36.0	2.0	0.6
Brazil	15.8	14.2	13.2	18.0	11.2	21.3	18.3	21.2	19.6	19.1	1.3	1.9
China	13.2	11.0	11.6	16.3	24.1	29.2	28.7	27.4	27.2	24.7	2.2	0.8
India	14.4	15.4	17.5	27.0	25.6	31.4	27.8	26.8	23.1	20.8	2.2	0.9
Indonesia	14.5	33.4	34.3	32.6	28.1	31.5	26.4	32.1	35.4	33.5	2.2	1.1
Korea	9.6	26.8	28.4	33.5	38.0	41.1	32.3	44.7	38.1	35.2	4.3	0.9
Mexico	20.3	19.4	23.5	31.1	31.8	31.9	32.6	37.2	37.2	41.2	1.6	1.3
Russia	22.1	30.6	49.5	60.8	71.5	86.0	65.1	73.0	61.2	50.8	3.9	0.6
S Africa	7.4	9.8	11.0	7.7	11.9	13.9	14.7	17.2	15.4	15.7	1.9	1.1
S Arabia	22.3	22.8	21.4	22.3	107.3	145.8	180.5	151.9	157.6	168.6	6.5	1.2
Turkey	28.0	25.0	22.3	33.3	26.8	27.0	20.8	22.3	20.9	20.7	1.0	0.8

Note: R1 is ratio of 2007 to 1997 and R2 is ratio of 2011 to 2007.

reserves should be measured against M2 as M2 maybe a good first approximation as to what can be converted into foreign exchange and transferred.

On this measure China has one of the lowest ratios—it has the 8th smallest ratio (Table 8). Further capital account liberalization may require China to increase its reserve holdings.

One of the consequences of IMF conditionality and the reluctance of countries to borrow from the Fund has been the building up their reserves as a precautionary measure. As Brazilian finance minister Guido Mantega (2007) said of the consequences of a failure to reform the Fund: "*We will seek self-insurance by building up high levels of international reserves and regional monetary institutions, and we will participate in regional reserve-sharing pools. The fragmentation of the multilateral financial system, which is already emerging, will accelerate*."

Such reserve accumulation by poor countries implies lending by poor countries to the much richer US which is a misallocation of resources. This also reduces the incentive for the US to change the system. The increase in reserves by almost all developing countries and not only China has meant that the US can and has run large deficits.[52] This pattern of current account balances is held by the G20 leaders to have been a cause of the crisis and its elimination is considered essential for restoring the world economy to stable and balanced growth.

Developing countries have increased their reserves whether measured against their imports, or short term debts or GDP or M2 as a precautionary measure (Aizenman and Lee, 2005). There is a sharp increase in these ratios after the 1997 Asian financial crisis. During the Asian crisis borrowed reserves were promptly withdrawn so that many

52 Detailed analysis shows that of the 11 non developed countries in the G20, namely those other than the G7 and Australia, China is usually in the middle in the extent and speed of its reserve accumulation (Agarwal, 2013).

countries will only feel comfortable if the reserves are accumulated by current account surpluses (Williamson, 2010). About half of the total reserve accumulation has been the result of developing countries running current account surpluses (Williamson, 2009).

7. Institutional Innovation

Developing countries have also undertaken new initiatives to provide additional BOP financing. Two of the main initiatives are the Chiang Mai Initiative Multilateralised (CMIM) and the Contingent Reserve Arrangement (CRA). The CMI was originally established as a bilateral swap arrangement among East Asian countries in the wake of the Asian financial crisis of 1997-98. It was later multilateralised and the amounts under the scheme were increased. The CRA is a financing arrangement among the BRICS countries.

The CMIM has the characteristics of its origin as a network of bilateral swaps. Its membership is limited to the original members, China, Japan, Korea and the ASEAN countries, with no provision in its articles for new members. The reserves continue to be owned by the countries and would only be available if another country makes a request. Also a country can opt out of meeting a request; there seem to be no conditions specified under which a country can opt out.[53] At the time of the Asian financial crisis undoubtedly Korea would have opted out. Many analysts believe that only China and Japan would be in a position to meet any request that was made.

A macro surveillance unit has been set up under the CMIM to analyse the macro policies of the countries and determine whether a country's policy can maintain external balance and, particularly, whether they are sufficient to return it to BOP sustainability (Siregar and Chabchitrchaidol, 2013). But no analysis of its work seems to be

53 Countries can opt out of meeting a funding request by the IMF if their BOP position is not comfortable.

available.[54] It is not clear what macro framework is used for any analysis and whether it differs from that used by the Fund. Nor has the advice proffered, if any, been revealed and whether the countries have been receptive to that advice.

Since the inception of the CMIM in 2000 the amounts available under the Initiative have been increased, currently the total available is US $ 240 billion (Siregar and Chabchitrchaidol, 2013). Also the amount that can be borrowed without a Fund programme has been increased to 30 percent of a country's drawing and is to further increase to 40 percent. But the conditions that would be attached to the loan to ensure its repayments have still not been determined.

Countries are limited to the amounts they can borrow under the Multilateralized Chiang Mai Initiative and the time for which they can borrow which may have prevented any borrowing from it as yet. Korea and Singapore preferred to activate their bilateral swap programme with the Federal Reserve of the US at the time of the 2008 crisis rather than borrow under the CMI and Indonesia asked the World Bank for financial assistance.

The CRA was created at the Sixth BRICS summit held at Fortaleza, Brazil in August 2014 "to forestall short-term balance of payments pressures, provide mutual support and further strengthen financial stability".[55] It seeks to achieve this provision of "liquidity and precautionary instruments in response to actual or potential

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54 In particular, it is not known whether the members are more heedful of the advice of the macro unit than they are of the IMF.

55 Article 3bi gives the Governing Council the power to admit new members, but lays no conditions for who can be a new member. This is in contrast to the New Development bank which was set up at the same meeting. Any UN member is eligible to become a member of the Bank with a minimum subscription of 4100,000 and a maximum subscription of 7 percent of the total capital. Available at http://brics.itamaraty.gov.br/media2/press-releases/220-treaty-for-the-establishment-of-a-brics-contingent-reserve-arrangement-fortaleza-july-15. Accessed on August 1, 2015.

BOP pressures". The BRICS have established the CRA with US $ 100 billion to which China will contribute $41 billion, Brazil, India and Russia each 18 billion and South Africa 5 billion. The procedures for drawing on the facility and the conditions have yet to be determined.

7.1 Governance Structure of the CRA

The governance structure consists of a Governing Council (GC) and a Standing Committee (SC). Each member country will be represented on both. Though the Governing Council can approve the entry of new countries, it is not specifically stated whether the new members will be represented on the Governing Council or the Standing Committee. Nor is any criteria specified as to who is eligible to apply for membership. Presumably the GC will also decide on the contribution of any new entrant. Unlike in the case of the New Development Bank where many of these matters are explicitly dealt with in the agreement this is not the case for the CRA.

The party that chairs the BRICS shall act as the coordinator of the GC and the SC, which implies that the coordinators' positions will be short term ones. All decisions of the GC will be by consensus. Also all decisions of the SC will be on the basis of consensus except those related to the use of the resources of the CRA. These will be by a simple majority of the weighted voting power. [56]

The CRA will come into force thirty days after the deposit of the fifth instrument of accession.

7.2 Resources of the CRA

The amount that each country can borrow is a variable multiple of their contribution; the multiple is 0.5 for China, 1 for Brazil, India and

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56 5 percent of the votes will be divided equally among the members. The rest will be apportioned according to their contributions.

Russia and 2 for South Africa. So China can borrow up to $20.5 billion, Brazil, India and Russia can each borrow 18 billion while South Africa can borrow 10 billion.

For the request to be considered the party shall not be in arrears with other BRICS countries or their public financial institutions. Nor must it be in arrears to any other multilateral or regional financial institution and it must be in compliance with surveillance and provision of information obligations to the IMF. 30 percent of the eligible amount is de-linked from the IMF. So, China would be able to borrow US$ 6 billion and South Africa US $3 billion while the other countries would be able to borrow about 5 billion. To access the other 70 percent the country must provide evidence that it is on an "on track arrangement with the IMF that involves a commitment by the IMF to provide financing to the requesting country". Another country can opt out of supplying the requested amounts if this is justified by the BOP and reserve position of the country.[57]

The amounts that the countries can borrow from the CRA can be compared to what they can borrow from the IMF. China's quota at the IMF is about 13.4 billion, that of India and Russia is just over 8 billion while that of Brazil is about 6 billion and that of South Africa is 2.6 billion.[58] Countries can borrow upto twice their quota in any year and cumulatively upto 6 times their quota under the extended fund facility (EFF). So in any year China could borrow almost 27 billion, India and Russia about 16 billion, Brazil about 12 billion and South Africa about 5 billion. The amounts these countries can borrow from the CRA while not inconsiderable is about what they can borrow from the IMF in any

57 A country can also opt out by an event of force majeure such as war or natural disaster.

58 The quotas are expressed in terms of SDR and the value of the SDR is determined in terms of a basket of currencies and so its value fluctuates with respect to any currency. The above dollar values for the quotas are based on the dollar value of the SDR in September 2014.

year, though they can borrow much more cumulatively from the IMF. The ability to borrow from the CRA is particularly substantial for South Africa as it can borrow twice as much from the CRA as it can borrow in a year from the IMF. However, countries also can borrow from the IMF under other programmes. Under the Precautionary and Liquidity Line (PLL) they can normally borrow up to 250 percent of their quota, but this can be increased to 500 percent of their quota if they are faced by a particularly severe BOP situation. Under the PLL for a two year programme they could borrow 10 times their quota. Obviously these amounts are considerably larger than what they can borrow from the CRA.

The amounts they can borrow from the CRA can also be compared to their current account deficits (CAD) in recent years. The CAD that Brazil, India or South Africa are currently running are much larger. The CAD of Brazil averaged about US $ 50 billion during the years 2010 to 2012, that of India averaged almost US $ 7 billion during these years and that of South Africa averaged US $ 12 billion.

The amounts available from the CRA can also be compared to some recent IMF programmes. The IMF approved lending to Russia of $38 billion (SDR 24.786 billion) in the 1990s. In 2002 alone, the IMF approved a stand by programme for Brazil of $ 30 billion. These amounts should also be compared to the 50b package for Mexico in 1994, 21 b for Thailand, 23 b for Indonesia and over 58 b for Korea. Since then international capital movements have increased further so that the required bailouts may be larger.

The period for which countries can borrow from the CRA is only three years much shorter than the period for which they can borrow from the Fund.

7.3 New Institutions and the IMS

MCMI and CRA provide countries with an additional source of funding. But they cannot ensure that adjustment is undertaken by both

deficit and surplus countries. The asymmetry can only be removed through a multilateral system which requires both surplus and deficit countries to adjust. Without a proper multilateral system the asymmetry between deficit and surplus countries will continue. Deficit countries usually adjust by adopting deflationary policies and this will impart an overall deflationary effect on the world economy.[59] This deflationary impact may not have mattered in the 1950s and 1960s during which period the world economy grew at unprecedented rates, and which some authors have called the 'golden age of capitalism' (Marglin and Schor, 1990). But since the 1973 oil price rise the world economy and most regions in it have grown at much lower rates (Agarwal, 2008) and Fund policies may have contributed to the slowdown, though this hypothesis has not been examined. [60]

Furthermore, new international money that can respond to the needs of the world economy and those of developing countries, in particular, is created by neither of the two schemes. Presumably the loans to countries requiring BOP financing will be in convertible currencies, mainly the dollar, and will be repaid in those currencies.[61] Since no new international money is created the member countries will have no control over the supply of international money. While the schemes would increase the amounts that would be available to their member countries to meet any BOP crisis the amounts available are unlikely to be sufficient to meet a serious crisis.

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59 The lower income would reduce demand which, in turn, would lower the demand for imports and so help to improve the current account. In a sense the system was operating like the pre World War I gold standard where there was no domestic policy objective of maintaining full employment and all that mattered was to achieve external balance.

60 Economists such as Krugman (2013) and Stiglitz (2003, 2015) have criticized such policies as being inappropriate. Though the Fund admitted at that time that its policies had been too restrictive it has continued to champion fiscal adjustment even in the current crisis as shown by its World Economic Outlook and the conditions on loans to countries such as Greece.

61 This is explicitly stated in the CRA agreement.

A second important issue is that of adjustment. A serious shortcoming of the current schemes is that they do not incorporate any new model of BOP adjustment. Historically there have been two broad modes of adjustment to a BOP deficit. One is to reduce demand and output in the economy and so demand for imports. This is how the gold standard operated for most countries. The other is through changes in the exchange rate. The members of CRA or CMIM have not indicated what their preferred mode of adjustment is, or whether they have an entirely different adjustment mechanism in mind.[62] The CRA has not yet set up any macro analysis unit as has been done by the CMIM.

The establishment of the CMIM and CRA are, however, small beginning to break the monopoly of the Bretton Woods institutions. It may be a signal that the developed countries should be more serious about reforms at these organisations. However, the developed countries are unlikely to be serious about the reform of the Bretton Woods institutions unless they believe that the BRICS or other groups of developing countries are mounting a serious challenge to the hegemony of the Bretton Woods institutions.

Furthermore, there are no rapid response procedures to handle a fast developing emergency. Some analysts believe that it would be difficult to actually release funds as these can only be released subject to surveillance and conditionalities and as yet even though an implementing agency has been set up there are no institutional mechanisms for surveillance or to monitor conditionality.

8. Conclusions

Developing countries dissatisfied with the governance and policies of the IMF have been running BOP surpluses in order to accumulate

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62 Since exports are important for all the members devaluation may be frowned upon as it might be considered a beggar-thy-neighbour policy.

reserves as a precautionary measure. The reserve accumulation policies adopted by developing countries have helped them cope with the 2008 financial crisis and its aftermath; but it is ironic that the accumulation of reserves has meant that developing countries have been lending to the richer countries, particularly the US rather than the richer countries lending to the poorer countries to raise their investment levels. A proper monetary system that would help the international allocation of savings is still needed. Too often private capital flows have flown into the housing sector leading to real estate bubbles whether in Thailand or Spain or Ireland with ultimately a crash with disastrous effects of the affected country's growth rate and the welfare of its citizens.

Discussion of the reform of the IMF has centred on altering its governance arrangements. The changes proposed have included eliminating the convention that the head of the IMF should be a European. It has also been argued that the number of chairs occupied by Europeans should be reduced and more representation given to African countries on the IMF's Board. In the same vein it has been proposed that the voting percentages of developing countries should be increased. There is agreement on many of these reforms at the G20 or other bodies. But these reforms have not been implemented.

A more fundamental question about the IMF is its function. What objectives should the IMF serve and how can it achieve its objectives. Keynes and White had sought to build a system where external constraints would not prevent countries from achieving and maintaining full employment. Keynes had also sought to create an international money and an authority able to adjust the money supply to maintain a high level of activity in the world economy. He had also sought to craft a system where the burden of adjustment would be shared by deficit and surplus countries.

However, the IMF has supported orthodox policies, balanced budgets and free flow of capital. The conditions have amounted to

giving priority to external balance at the expense of domestic full employment. The system has become very similar to the GS except where governments fear a popular backlash some of the policies may be ameliorated at the edges mainly through adjustment of the exchange rate. But unlike in the theoretical GS, adjustment has not been symmetric. The pressure to adjust has been on the deficit countries. Where the exchange rate cannot be depreciated as in the countries in the euro zone, the policies are very reminiscent of those adopted during the great depression particularly in the gold bloc countries. Such policies have resulted in imparting a deflationary bias to policies in deficit countries with no pressure on surplus countries to adjust. The amount of international money and therefore the state of the world economy depends largely on the policies of the US, the key currency country. There is no actor at the international level to play the role of the central bank in a national system, and the international monetary system remains a half-built house.[63]

Developing countries have also established facilities such as the CMIM and the CRA to provide additional BOP financing for their members. Though the amounts available under these schemes are large compared to their quotas at the IMF they are small compared to the amounts that have had to be mobilized to meet the different BOP crisis over the past couple of decades. Also the schemes do not indicate any new model of BOP adjustment. The onus would also continue to remain on deficit countries.

These schemes are no challenge to the hegemony of the Bretton woods institutions. They however are a small beginning and may be a pointer of things to come.

63 See Paul de Grauwe (2000) for a discussion of the evolution of national monetary and monetary control systems and a comparison of developments in the international monetary system with these national developments.

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