15

The International Monetary System and the Developing Countries

This chapter presents an overview of the key issues that dominated the discussion on the reform of the international monetary system, following the collapse of the Bretton Woods System in the 1970s. Although the developing countries were marginal players in this debate, India, through its interventions provided the lead in voicing the opinions of the developing world. India regarded the placing of international monetary reform on the official agenda as a historic opportunity to record and set right the fundamental asymmetry between the experiences of the developed and developing countries in the functioning of the international monetary system. Throughout the seventies, Reserve Bank and Finance Ministry officials were preoccupied with various issues and aspects pertaining to the reform. The entire exercise reflected both the complexity and importance of the reform debate, and the Bank and the government played a role in this path-breaking debate. This chapter attempts to provide a perspective on the developments as seen and evaluated by the Indian authorities.

NEED FOR REFORM

To understand the need for reform of the international monetary system, it is necessary to recapitulate the causes that led to the collapse of the Bretton Woods system. In the twenty-five years since the system was created, the conduct of international trade and investment had changed radically. The rise of multinational corporations, large-scale capital flows, technological advances, greater mobility of capital and labour between the US and Europe, had all made it difficult for the economies of the key currencies—the dollar and the pound sterling—with excessively large deficits in their external accounts to adhere to the Bretton Woods system of fixed par values. The unipolar world in which the US singlehandedly was prepared to direct and maintain the system had changed economically, and the US was no

longer able or prepared to perform that role. The upshot was that the decade of the 1960s was punctuated by recurring crises, first of the pound sterling from 1964 to 1968, followed by the gold crisis of 1968 and finally the collapse of the dollar in 1971 with suspension of dollar convertibility.

The crucial factors that had led to a breakdown of the old system and its eventual demise were little understood. The US faulted the par value system for its lack of an adjustment mechanism, that is, its failure to trigger appropriate changes in exchange rates. In its view, the system suffered from a devaluation bias: it placed pressure on countries in deficit to devalue their currencies, whereas countries in surplus were let off the hook and were not forced to revalue and appreciate their currencies. Monetary experts attributed the problems to unrest in the foreign exchange markets produced by disorderly capital flows brought about by a crisis of credibility of exchange rates. The Europeans pinpointed the cause of the breakdown to the inflationary implications of large capital flows; they argued that European economies were forced to protect their economies from imported inflation and described the par value system as an 'engine of inflation'. In 1970, the Managing Director of the IMF, Pierre Paul Schweitzer, in an address to the International Financial Conference, described the international monetary system as having gone through an 'ordeal by fire'; three years later, Otmar Emminger, Deputy Governor of Deutsche Bundesbank, described the crisis of 1970–73 as 'an ordeal by holocaust'.

According to the IMF, the basic reason for the collapse of the system was that industrial countries were not willing to coordinate their policies affecting international transactions, nor were they willing to give or transfer effective control over world reserves to the Fund. Cognizant of this, the Fund, in the second half of the 1960s directed its energies towards solving the problem of shortage of international liquidity through creation of the SDR—the first major innovation towards reform of the system. It was hoped that availability of SDRs as a supplement to traditional reserves would mark the beginning of eventual control by the Fund of international liquidity. It was visualized that, in course of time, the SDR would become the principal reserve asset of the system. However, even as of now, the monetary system is yet to emerge with improved foundations, and the SDR represents only a miniscule proportion of world reserves.

Around 1971, the US lost faith in the par value system and started to believe that its interests were jeopardized by preserving that system. On the other hand, in the thinking of the IMF, the measures needed to correct the burgeoning US balance of payments deficit were liberalization of trade and non-tariff restrictions, and changes in the exchange rates. The strong

differences of views between the US and Europe increasingly convinced US officials that bilateral rather than multilateral negotiations would prove beneficial in resolving the problem. With a European Managing Director heading the Fund, US officials felt that the Fund management would be more receptive to arguments made by the European countries.[1]

With pressure building up on both sides of the Atlantic, how did the developing countries react to the emerging situation of floating rates? Towards the end of the 1960s, the developing countries had become staunch supporters of fixed rates, and the IMF Managing Director made a conscious effort to see that their viewpoint was not brushed aside and their voice was heard. Both the Fund and the developing countries believed that floating rates would divide the world into currency blocs and would fail to produce a satisfactory pattern of exchange rates. Moreover, widespread floating would prove a stumbling block for reform of the monetary system.

At the annual meeting of 1971, the Board of Governors of the IMF directed the Executive Board to study the problem and come up with suggestions to improve the working of the monetary system. The mandate given to the Board included studying the role of reserve currencies, gold and SDRs, convertibility, necessary modifications in the Articles of Agreement relating to exchange rates, and problems relating to destabilizing capital flows and suggestions and recommendations on coping with such flows. The IMF staff, at the request of the Executive Directors, prepared a draft outline of a report, which was placed on the agenda of the Board for informal discussion in mid-May 1972. The majority view was that the draft outline was fairly comprehensive. A few suggestions were made with regard to rearrangement of the chapter design: the chapter on disruptive capital movements should figure at the end of the report, SDR and development was an important topic and merited a separate chapter, and the portion relating to principal reserve holdings should precede the discussion on convertibility.

The Indian Executive Director, Prasad, while accepting the suggestions pertaining to changes in the structure of the report, emphasized that, since the document would be available for public consumption, it should not be just a technical volume, as suggested by some Directors, but state clearly the policy options from differing approaches. For instance, under the role

[1] At the 1970 annual Fund–Bank meeting in Copenhagen, Schweitzer, the Managing Director of the Fund, publicly called upon the US to use its reserves to settle its growing deficits rather than enlarge its liabilities. Again, in 1971, in a television interview, he suggested devaluation of the dollar. Frank utterances such as these, it is believed, spiked Schweitzer's reappointment for a third term as Managing Director of the Fund.

of different types of assets, not only did the concept of excess reserves need discussion, but also the concept of shortfall. Agreeing with the German and Dutch Directors that SDR and development finance should be treated separately, Prasad warned that the 'link coach' should not be detached from the 'reform train', for he firmly believed it represented the one area that was likely to illuminate the new path along which the world would have to tread in the future. As he saw it, the concept of exchange stability had to give way to wider concept of stability with growth and expanded trade.

Initially, the US Director was for ignoring the report but, sensing the mood of the Board, he eventually indicated that it should be 'short', to the point and lacking in conclusions. Obviously, his authorities were for glossing over the issues unpalatable to them. But he was overruled by the Fund Governors' mandate, and the green signal was given for preparation of the report.

Between August 1971 and the early months of 1972, there was no clear awareness of the features that a reformed monetary system ought to have and what features were required to be negotiated. The thrust, it appears, was in the direction of holding together the system of par values and trying to maintain the new realigned exchange rates to see if the system would hold. Officials of Western European countries were aiming at persuading the US to re-establish some degree of convertibility for the US dollar. The US, on the other hand, was reluctant to take on such an obligation till it could turn around its external payments deficit into a surplus. The upshot was that the main features agreed upon were prompter and smaller changes in par values, use of wider margins around parities and an escape clause that legalized temporary deviations from par values resulting in the emergence of a non-system.

Before the IMF Executive Board submitted its report, it was decided to set up a special Committee of Twenty (C-20) to negotiate a reformed system. Here, too, there were considerable differences with regard to the structure of the Committee. The US wanted the reform discussions to be centred in a forum other than the IMF and the G-10. There was also a conflict regarding which countries and which officials were to be representatives on the special Committee and what powers they would wield. In mid-1972, agreement was reached that Governors of the twenty Fund constituencies would form the C-20.

The initial resolution prepared by the IMF staff on setting up a Governors' Committee was deadlocked in the Board discussion. To break the impasse, the Managing Director of the Fund set up a small informal group of Directors to consult and advise him on a draft that would have a

reasonable chance of success. This group included four Directors from the developed countries and two from the developing countries—P.S.N. Prasad, the Indian Executive Director, was one of the six. The disagreements on the draft resolution were not so large in respect of the composition and structure of the proposed Committee. The main disagreement related to the mention of an inter-relationship between trade and monetary reform. France had serious objections to linking these two issues of monetary reform, although the majority of the Directors were prepared to accept the formulation and willing to go along with the draft version, fearing that prolonged discussions could kill the concept of a Committee of Governors. Another hiccup that arose was from the US Director, who said that, in the event of a difference of opinion, weighted voting should decide the issue. This was strongly contested by the developing countries; they argued that the Governors' Committee was only a recommendatory body and it was unnecessary to decide issues on a weighted voting basis.

When the resolution came up for discussion, although eighteen of the twenty Directors were willing to accept it, the American and the French Directors, each for different reasons, said their authorities could not go along with the draft of para 2(b), which related to matters of substance. In order to achieve a consensus, the Managing Director tried his hand at a further revision of para 2(b). The new draft was approved by the Board on 23 June 1972, with France and India abstaining. India's abstention related to the revised formulation of para 2(b), which appeared neutral and colourless, and did not specifically refer to the Fund's objectives as stated in Article I and so lacked the positive elements of the earlier draft.[2] In the Indian Executive Director's view, the second draft had significantly weakened the substance. And, despite the best efforts of the Managing Director to get the first draft accepted, stating that it was more in the spirit of the UNCTAD resolution, the French and the Americans remained adamant.

[2] *Paragraph 2(b) of the first draft*: 'In its consideration of matters covered by (a) above, the Committee shall give full attention to the inter-relation between these matters and existing or prospective arrangements among countries with respect to the expansion and balanced growth of international trade, an appropriate flow of capital, development assistance and other widely recognized objectives of international economic cooperation, including in general those referred to in Article I of the Articles of Agreement of the Fund.'

Para 2(b) of the second draft: 'In considering and reporting on matters covered by (a) above, the Committee shall give full attention to the inter-relation between these matters and existing and prospective arrangements among countries, including those that involve international trade, the flow of capital, investment or development assistance, that could affect attainment of the purposes of the Fund under the present and amended Articles.'

Even though the revised draft did not appeal to many, the fear that any delay could result in the US bypassing the Fund prompted them to support it. The news about flotation of the sterling and apprehension that the Smithsonian agreement was cracking up added to the urgency, and everyone was willing to settle for the establishment of the Governors' Committee. But one thing was certain: there was enough of an undercurrent of diplomatic pressure from the developed countries to weaken the developing countries' solidarity and soften the attachment of Latin American and African countries to the latter.[3]

The ad-hoc Committee of Governors was to consider and deliberate on the report presented by the IMF Board to the Governors at their 1972 annual meeting, and to arrive at an agreed understanding for a reformed monetary system. At its inaugural meeting on 20 September 1972, the C-20 chose Ali Wardhana, Minister of Finance of Indonesia and Governor of the Fund for that country, as chairman. To assist the Governors, a deputy-level committee of senior officials was created, with its own bureau and staff, to help with the technical and preparatory work and who could draw on experts from various countries for advice.

Informal exchanges at the deputies' level revealed to the Indian authorities that the deputies from developing countries were unable to take any common positions relating to substantive issues on the agenda. Not very familiar with the topics, many of them had not carefully formulated their views. Unfortunately, the composition of the C-20 and the group of deputies was heavily slanted in favour of conservative countries easily amenable to influence from the developed countries.

Realizing this weakness—in the composition and in the representation of developing countries as a group to articulate their views—the Indian authorities decided to set up a high-powered Technical Advisory Group at Delhi, to make an in-depth study of the issues and to aid the Indian constituency at the deputies' level to formulate their views. The Technical Advisory Group, which was to provide back-up support to the Indian delegation and make specific suggestions relating to the Indian response, comprised both official and non-official members, ranging from Secretary, Economic Affairs and Principal Economic Adviser, Reserve Bank, to the Director of the Institute of Economic Growth, and professors of econo-

[3] Rumours were rife that America had offered Brazil some kind of an informal role for consultations in a small group, and the Africans were given an assurance that the size of the IMF Board could be increased to ensure the return of the two African Directors.

mics at Bombay and Calcutta universities. The creation of the Technical Group was an indication that India viewed the deliberations seriously and was not prepared to treat the exercise lightly. The initial address of India's Finance Minister to the Technical Group stressed: 'India as a leading country had a crucial role to play and so it was essential for her to carefully work out specific ideas and strategies on issues pertaining to the restructuring of the international monetary system.' Recognizing that this was an area where purely technical and economic problems were linked with political considerations, he cautioned that conflicts and differences of opinion could not be ruled out, and advised that it was therefore necessary to keep in view the interests of the third world and work out feasible alternative solutions to ensure that the developing countries were not exploited by the richer nations.

Dr I.G. Patel, Chief Economic Secretary, who chaired the first meeting of the Technical Group on 21 November 1972, in his opening remarks, stated that the developing countries had succeeded in their efforts to acquire an active role in the decision-making process concerning the international monetary system and it was, therefore, essential for them to formulate their views on all major aspects of reform, adding that India had to give a lead in voicing the opinions of the developing countries.

The Indian delegation to the deputies committee of IMF Governors was a group of seven officials drawn from India, Sri Lanka and Bangladesh, with Dr Manmohan Singh as leader.[4] At the first meeting of the deputies, it was decided that there would be two vice chairmen—one from the developed and the other from the developing countries. The African countries publicly announced their intention to put up an African candidate. Two names were suggested but as agreement among the Africans was not forthcoming, India made it known that it was nominating P.S.N. Prasad, the Indian Executive Director at the IMF, for the second post of vice chairman. Prasad was widely respected and many developing countries recognized that his membership of the bureau of the group of twenty deputies would be a source of strength to the developing countries. However, important developed countries and their satellites among the developing countries had a vested interest in ensuring that the developing countries' representa-

[4] The Other members of the delegation were: 1. Dr Lal Jaywardane—Deputy, Sri Lanka. 2. Dr P.S.N. Prasad—Executive Director for India at the IMF. 3. Dr A.M.A. Muhith—Alternate Executive Director at the World Bank from Bangladesh. 4. Dr W.M. Tilakratna—Alternate Executive Director at the IMF from Sri Lanka. 5. Shri V.B. Kadam—Reserve Bank of India. 6. Shri R.H. Patil—Reserve Bank of India.

tion in the bureau remained weak. The fact that an Asian had been chosen to be chairman of the C-20 was effectively used by the major powers to support the claims of an African candidate for the second post of vice chairman. Sensing the mood, India gracefully withdrew in favour of the African candidate Duncan N. Ndegwa and Governor of the Central Bank of Kenya was appointed. Not very happy with this outcome, Manmohan Singh and Lal Jaywardane were determined to see that the bureau was not out of step with the aspirations of the developing countries, and seriously tried to bring in the political weight of the Group of 77 to influence the course of negotiations within the C-20.

With the setting up of the C-20, hopes ran high. Despite conflicting views, there was an air of expectation. It was a challenge to evolve a new international monetary system and initial expressions of views in the C-20 revealed a determination to make rapid progress towards this. The 1972 annual meeting speeches of Shultz, Barbar and Schmidt[5] seemed to suggest that agreement on the main features would be hammered out before the next year's annual meeting in Nairobi. But the Indian officials tempered their optimism with caution. Theirs was a difficult task—to safeguard the interests of the developing world. This was not easy in the face of the intense desire of the major powers to protect their employment and external trade, with many of the developed countries favouring floating rates.

The first meeting of deputies was held in Washington on 27–29 November 1972. The terms of reference of the committee, as outlined by the Board of Governors, were all-embracing, viz. to advise and report on all aspects of reform of the international monetary system and, in so doing, to include international trade, the flow of capital investment, asset settlement and transfer of real resources for development purposes. Manmohan Singh, leader of the Indian constituency, effectively voiced the concerns of the developing countries. A work programme was proposed by the Morse Bureau for consideration by the deputies. While broadly in agreement with the suggested topics—adjustment, asset settlement, etc.—Singh pressed for inclusion of the topic of the present structure of the IMF in the work programme. If the present structure of the IMF was to be responsive to the needs of all its members, Singh insisted, there was need to re-examine the relative shares of various groups in the Fund quotas, voting rights and the institution of appointed Directors.

[5] See summary proceedings of the 1972 annual meeting, pp. 44, 53 and 31, for statements by the Governors of the US, the UK and Germany.

The ideas of the US about reform of the system were radically different from those that India had in mind. The US officials' priority was to design an adequate mechanism to adjust balance of payments disequilibria; in other words, the system ought to contain some method of forcing even countries with persistently large payment surpluses to revalue their currencies. For them, the crucial factor in the reform exercise was how could it be applied to correct an undervalued exchange rate. The US game plan also included establishment of a new centre for decision-making, for, in their perception, the IMF staff had an excessive influence on the decision-making process of the IMF Board. The US was therefore keen to establish a new centre for decision-making away from the Fund, by appointing a high-level committee of national representatives who would meet periodically and give directions to their Executive Directors.

India was not in favour of any diminution in the authority of the Executive Directors and took the bold line that the management functions of the Executive Board should in no way be eroded. India, however, was aware that tough opposition on this aspect could not be ruled out, and conceded that the odds were heavily stacked against it and other countries not favouring this course. The Europeans held the view that the US payments deficits were due to relatively easy money policies and the resulting inflation. They believed that the special role of the dollar in international payments had encouraged the US to live beyond its means. They were no longer willing to accumulate unconvertible dollars indefinitely; asset settlement, according to the Governor of France, Giscard Estaing, was 'the touchstone of reform'.

In November 1972, the Morse Bureau circulated the annotated agenda for consideration by the deputies. It was more in the nature of an exploratory exercise to test out the ideas and views of the deputies to decipher the direction in which the wind was blowing. The agenda covered such aspects as the need for balance of payments adjustment through a change in par values, use of sanctions, legalization of floating, controls, use of multiple exchange rates, capital movements, etc.

From the beginning India sensed a real danger in that the developed countries could form small cohesive groups for conducting effective negotiations, leaving the C-20 to function as a debating club. To forestall this, the Indian Finance Minister, in his annual address to the IMF, sounded a note of caution: 'The Committee of Twenty should not be a forum where all are heard but only a few are listened to.' Fearing that the history of the Kennedy Round may repeat itself, India's strategy was to strengthen the unity of the developing countries by seeking to reactivate the Group of 24,

instructing the Indian representatives in New York and Geneva to start canvassing for a joint statement by the Group of 77, and requesting the chairman of G-24 to immediately set up a technical group to work out a common position paper on the various issues of reform including the SDR–aid link, in which the developing countries had the largest stake.

Manmohan Singh, in his initial observations on the annotated agenda circulated among the deputies, stressed that the greatest asymmetry in the functioning of the international monetary system was the stark divergence of experiences of the developed and developing countries. Whereas the former had succeeded in maintaining full employment and reasonable rates of growth, as well as dismantling trade restrictions, the experience of developing countries in these areas was highly unsatisfactory. This imbalance needed to be redressed by explicitly facilitating the achievement of internationally agreed trade and aid commitments in support of the development efforts of developing countries. Conceding that the development of developing countries rested with the people themselves, Singh hit the nail on the head by stating that 'the task of removal of mass poverty was complicated by historic inequities of the world trading and monetary arrangements'. In short, these inequities had to be borne in mind in redesigning the international monetary system.

In the discussion on the adjustment process, the US, the UK and Italy attributed the breakdown of the Bretton Woods system to the failure of the adjustment process. Proposing that the system of par values should not be retained, they favoured small and frequent changes in parities as also a regime of wider margins. In their thinking, greater flexibility would promote orderly and smooth adjustment, and also act as an effective mechanism for dealing with speculative capital movements. The Germans, on the other hand, struck a cautious note. Traditionally favouring greater exchange rate flexibility, the German view was that the exchange rate alone should not be the dependent variable that was adjusted whenever national policies moved apart. There should be a continuous endeavour to keep national policies in line with each other on the basis of generally accepted objectives such as avoidance of inflation or deflation. Manmohan Singh said that the criteria for exchange rate adjustment worked out in the context of the developed countries were not readily applicable to developing countries. Citing the contingencies to which developing countries were traditionally subject, such as crop failures and wide fluctuations in world market prices for the primary products that they exported, Singh explained how accumulated reserves of developing members would strengthen their ability to undertake commercial borrowing which would give them the needed

flexibility in timing development projects. Likewise, Singh pointed out, because of the relatively slow response of both imports and exports to changes in relative prices, whether induced by tariff or exchange rate changes, developing countries needed the freedom to retain and use quantitative import controls as instruments of balance of payments policies.

On internationally agreed guidelines or criteria to induce countries to swifter balance of payments adjustment, the US proposed presumptive criteria based on movement in reserves. The Europeans, on the other hand, suggested basic balance as a more appropriate criterion for judging the need for adjustment. The British were opposed to any automatic criteria and India, through Manmohan Singh, conveyed strong misgivings about the usefulness of any presumptive criterion, be it reserves or market rate.

The US proposals also envisaged a strict system of inducements and sanctions to encourage or force countries to adopt the desired measures of adjustment. The Europeans were not in favour of any automatic procedure leading to sanctions and warned against repeating the mistake of the scarce currency clause in the Bretton Woods agreement, which was so lethal that no one dared to use it. India, too, made it abundantly clear that developing debtor countries' policies had already been submitted to more than necessary surveillance by donors and international financial institutions. Despite this, surprisingly, some Latin American countries favoured a system of sanctions. India warned the developing countries that while the developed countries would always be able to break the ground rules of the system when it was in their interest to do so, the developing countries would be the ones most likely to be coerced into submission. In view of the division in the ranks of the developing countries, India remained firmly of the view that any system of guidelines and sanctions that may be agreed upon would not be applicable to the developing countries—a reasonable demand taking into consideration the fact that the exchange rate regimes of the developing countries had few international repercussions, and that there were already in place effective arrangements for an audit of their performance by the international financial institutions.

On the role of trade and capital controls as part of the adjustment process, India took the line that restrictions by the developed countries on imports from the developing countries or on capital flows to these countries were indefensible measures. No new burdens should be imposed upon them; if anything, it was the developing countries that needed to use both trade and capital controls to conserve their limited foreign exchange resources for development. To relieve the mounting debt burden and assist

orderly adjustment, international acceptance of a bisque[6] clause in all new loan agreements was also mooted.

The SDR link idea found little favour with many of the developed countries, and the proposal to establish a link between SDRs and development assistance did not figure in the discussions at the second meeting of the deputies. At the insistence of the representatives of developing countries, the subject was relegated for discussion to the fourth meeting as, by then, arguments against the link would have ceased to be intellectually respectable. India's apprehension was that, should intellectual defences against the link crumble because of disunity among the developing countries, the SDR may elude the developing world. Solidarity among the developing countries alone would make the SDR link a reality. It was therefore essential that, at the third meeting of the deputies, the developing countries unitedly express their firm support for the SDR link. The world community, too, had to muster the necessary political will, for only then could technically sound and virtuous solutions be found to meet the aspirations of the developing countries. Quoting Bacon, Manmohan Singh appropriately quipped: 'Hope is a very good breakfast but a very poor supper.' Later developments confirmed that the challenge and opportunity offered to the international community was ignored.

As the date for submission of the Outline of the Reform of the International Monetary System was slated for the September 1974 annual meeting in Nairobi, the third, fourth, fifth and sixth meetings of deputies were devoted to thrashing out an agreed version of the outline. To avoid repetition, the narrative here will principally focus on the Indian response to the outline prepared by the Morse Bureau. As a whole, the Indian authorities had no great difficulty with the Bureau's formulation. Their insistence was that the new monetary order had to be so devised as to meet the needs of all members. Viewed from that perspective, socially acceptable growth of the developing countries was as necessary as the need to counter inflation. Likewise, transfer of real resources to developing countries and greater equity in the adjustment process had to figure as specific references in the objectives of a reformed system. Accepting that multi-currency intervention was not undesirable in principle, the Indian representative took the lead to point out that it would entail a larger volume of reserves, especially as it

[6] A bisque clause involves postponement of debt service payments in the face of a deterioration in the balance of payments similar to the one incorporated in the provisions of the Anglo American Loan of 1946.

was envisaged that permissible margins for fluctuations would be wider. On the currencies to be included in the multi-currency intervention package, the authorities of the currencies included would need to consciously accept the obligations attached to the role of an intervention currency. More work on this was indicated before a definitive position could be taken.

On adjustment, the Indian viewpoint was, ideally, one needs to know the outlook for all key aspects of a country's internal economy and balance of payments position before a definitive judgement concerning the accuracy of its prevailing exchange rate can be made. The basic problem, as Manmohan Singh observed, was when a country ought to adjust its exchange rate rather than use demand management policies to achieve equilibrium. Furthermore, no single set of indicators, such as movement in spot rates, changes in reserves or in price indices, could analytically provide adequate guidance for policy purposes, for they could be influenced by speculation, lead and lags or hedging or government intervention in the foreign exchange market. There has, therefore, to be internationally defined criteria for intervention. In view of the great differences in the level of development between the developing countries, India remained sceptical about the efficacy of the use of indicators as a tool for facilitating adjustment. Also, reforms should not involve compelling the developing countries to undertake exchange rate adjustment, and should safeguard their freedom under Article XIV to impose quantitative restrictions.

On sanctions and pressures, India took the line that, in the case of the developing countries, there was no way to go beyond the existing procedures followed by the Fund. On the freedom to impose controls on capital flows, India demanded that the developing countries be completely exempted from any controls adopted by the developed countries.

Floating rates were not advocated as a preferred adjustment, nor were they to be an instrument of first resort; they were supportable only where changes in the exchange rate had long been delayed.

On the settlement of imbalances issue, consolidation of the dollar overhang into SDRs—whether compulsory or voluntary—was not favoured, as Indian technocrats believed that it would have adverse consequences both on the future allocations of SDRs and on interest charges levied on SDR borrowings. Bilateral settlement of the overhang remained the preferred choice of the Indian constituency as the way to reduce the bloated quantum of liquidity.

The outline also touched on the issue of reserve assets, and on making the SDR, rather than gold, the numeraire of the reformed system. India plugged hard in favour of the SDR. It also sought removal of the reconsti-

tution and acceptance obligations and pressed that, progressively, the role of reserve currencies should be reduced.

On the link proposal, India supported the variant of direct allocation of SDRs to development financial institutions (DFIs) but, in the interest of solidarity among the developing countries, was prepared to support a compromise formula. It also pressed for widening and liberalizing the general account facilities.[7] On swap financing arrangements, India maintained that such financing should remain under comprehensive control, in view of its impact on total global liquidity.

When the deputies met at their sixth session to consider the revised outline, to Manmohan Singh's total surprise, the relevant sentence relating to finding effective solutions to the problems of developing countries in the areas of both trade and aid was neutral and watered down to the point of being inconsequential. This provoked him to lash out at the deputies and question whether they were really serious about tackling the problems of the developing countries. If that was so, he added, there must be a commitment to deal with the inter-related aspects of monetary issues in the areas of aid and trade. He suggested appropriate amendments in the wording of the draft under consideration. The delegate from Sri Lanka, Lal Jaywardena, lent strong support to Singh's amendments and said that the developing countries attached great importance to this issue. They saw the need for coordination between the various elements of reform and hoped that the proposed amendments would receive serious consideration. But the developed countries regarded the original text of the Bureau a balanced one and were disinclined to try their hand at a redraft; they left it to the Bureau's chairman to include some part of Singh's suggestions in the final version.

On the aspect of capital controls, Singh was guided by the views expressed by the Technical Group set up in India: that, in elaborating a new code of conduct for capital flows, the international community must recognize that restrictions on aid, including tying aid to procurement in donor countries, were inappropriate methods of adjusting for balance of payments imbalance. On the other hand, due to the great shortages of savings in the developing countries, if necessary, these countries must be allowed to make use of capital controls to conserve their foreign exchange. Pointing to the fact that balance of payments adjustment had become exceedingly difficult in developing countries in the face of massive debt service obligations causing

[7] These were the compensatory financing facility, the buffer stock facility and the enlarged access facility.

reverse flows of capital, Singh urged that provision be made for postponement of debt service obligations for such countries, as had been advocated at UNCTAD II.

Incidentally, to add political muscle to the C-20 negotiations, India had spearheaded a proposal that the G-24 developing countries should meet prior to the C-20 meetings, to coordinate their strategies. So, just before the third meeting of deputies of the C-20 in Paris on 23–25 January 1973, the inter-governmental group of G-24 developing countries met, with Carlos Rafael D'Silva of Venezuela in the chair. The agenda comprised four topics: creation of a technical secretariat, coordination between the G-24 and the G-9 developing countries represented on the C-20, consideration of the agenda for the forthcoming C-20 meeting in Paris, and substantive issues.

On the setting up of a technical secretariat, Manmohan Singh favoured using the nine Executive Directors of the IMF representing developing countries to prepare, with the assistance of the UNCTAD, background papers on topics such as revision of quotas in favour of developing countries, the modus operandi of the SDR and development finance link, improvements in conditional liquidity facilities, inter-relationship between monetary reform, trade and development finance, and the adjustment process from the standpoint of the developing countries. It was further agreed that the G-24 should meet at the deputies' level on the occasion of every meeting of deputies of the C-20, and questions that needed political decisions would be considered by the Ministers of the G-24.

On substantive issues, Singh took the opportunity to push the Group to adopt a resolution reaffirming their strong support for an SDR link. It authorized the chairman to issue a statement to the press restating the aspiration voiced by the G-24 Ministers at the Caracas meeting for a link between the creation of special drawing rights and development finance.

The period between the second and third meetings of the C-20 was an unsettled one for the world economy. In business and political circles, the feeling grew that in an environment of floating exchange rates, the world economy could not be left in automatic drive. Massive dollar outflows in the first two months of 1973 had created serious instabilities in world financial markets, placing the international financial order in a new and threatening light. Calls for progress in the building of an organized system increased and this, it was felt, was of considerable significance for the task of monetary reform. It was recognized that this task had long suffered from a lack of political thrust such as was necessary to over-ride the numerous technical obstacles and conflicting interests that by and large tended to make the task of restructuring immensely difficult.

A word in passing about the events that caused the instability. A significant feature of the early 1973 disturbances in the international financial markets was that they occurred in the very largest economies, which graphically brought to light that large economies were not immune from external shocks under the cover of floating rates. The second devaluation of the dollar by 10 per cent in mid-February 1973 triggered the turmoil. The devaluation, however, failed to halt dollar outflow, and the first and second weeks of March 1973 witnessed massive outflow of dollars, forcing Europe and Tokyo to close their exchanges. The declaration by the US President that there would be no further devaluation of the dollar implied that such devaluation as was inevitable in the near future would have to take the form of an appreciation of European currencies and the yen against the dollar. At an EEC ministerial meeting, it was decided by fourteen EEC countries that there would be a joint float of seven currencies against the US dollar. The alternative to the float was comprehensive European control over capital imports but this, it was realized, was useless unless it was savagely restrictive.

Apart from a general interest in a global system that had clear-cut obligations, the developing countries also had a special interest in a reformed monetary order. The uncertainty and political instability of a regime of zigzag floating rates posed real difficulties for countries whose currencies were pegged to a reserve centre, and which clearly complicated the basis on which these countries were to maintain their own exchange rates. This was an important problem for a number of sterling area and francophone countries, as it complicated their relationship with neighbouring countries, many of whose currencies were linked to different financial centres. As a result of the developments of the early 1970s, many of these countries found themselves in the backwash of the fluctuations of the dollar, the pound sterling and the French franc. In the absence of a stable international monetary asset with an assured and attractive valuation, reserve accumulations by Central Banks became inherently speculative. They were, therefore, keenly interested in the establishment of a reserve unit such as the SDR.

As a result of the setting up of the C-20 forum for reform negotiations, the developing countries believed that they had secured an influential position in the future design of the monetary system. As full partners in the bargaining process, they believed such a universal approach would help to safeguard their interest and position. But they were sadly disillusioned when the G-14 bypassed the C-20 and the common float decision of seven European currencies was made known to the rest of the world through the Paris communique of the G-14, with no reference to the desirability of an early

return to a system of stable values. What was more, there was no adequate information on the duration and range of the float or on how the floats would be managed.

On learning of the joint float, the Chief Economic Adviser, Manmohan Singh, called upon the Reserve Bank to assess its possible impact on the Indian currency. In the absence of adequate information, the then director of the division of international finance, V.B. Kadam, had to examine the problem in a general way. He indicated that there would be a significant diminution in the purchasing power of Indian foreign exchange reserves following the depreciation of both the dollar and the sterling vis-à-vis other important developed currencies, and that this would be accentuated if there were massive speculative outflows of short-term capital, pushing down the value of these currencies further. This, in turn, could push down the value of India's reserves to unacceptable levels. There was, in the reading of the Bank, need to control the range of the floats through restrictions on speculative movements of short-term capital. Those who were opposed to capital controls on philosophical grounds had to appreciate that the attempts to stabilize exchange rates since early 1971 without comprehensive controls had failed. The uncertainties of exchange rates under the floats could have adverse effects on developing countries' exports and, through that, on their planning of imports and economic development. Depending on how the floats were managed, they could vitiate the climate against creation of liquidity, development assistance flows and management of international liquidity, with inevitable consequences on the distribution of the burden of adjustment. Speeding up the work of the C-20 was therefore imperative.

A meeting of the G-24 developing countries was convened in Washington, prior to the meeting of the C-20, at the end of which, the Ministers, in a strongly worded communique, stated that the manner in which the 16 March decision was taken by a limited number of countries, outside the framework of the IMF, represented a departure from the spirit behind the creation of the C-20, and was a setback to the process of international consultation. It warned that the developing countries would not support a decision-making process in which they had no participation. Expressing concern at the arrangements that would disrupt collective management of the international monetary system and the difficulties these would create for the developing countries, the G-24 reaffirmed its strong faith in a system of stable rates based on adjustable par values, collective management of international liquidity by strengthening the role of the SDR and the creation of a link between SDRs and development finance. At the suggestion of the Indian delegation, the Group set up a working party to work out

a common position on the link for presentation to the C-20.

The original agenda of the fourth meeting of deputies was to discuss the special interests of developing countries in international monetary reform but, in the context of the events of 12 March 1973, it was decided to put the original agenda on the back-burner and devote time, instead, to an exchange of views on the decision taken at Paris by the fourteen developed countries. It was reported that six of the EEC members had agreed to stabilize their exchange rates within a margin of 2.25 per cent, and for two members who had two-tier exchange rate systems, the agreement would apply only to the official rate. Although the UK, Ireland and Italy would continue to float individually, they indicated that in the long run they would associate themselves with the group arrangement. It was further stated that Central Banks had been freed from the obligation of intervening in support of the US dollar. Stability of exchange rates within the Group would be secured through multi-currency intervention. Despite the fact that the structure of interest rates in Germany was not attractive, it was pointed out that the German mark was singled out as the main currency of refuge; however, the source of speculative inflows was not attributable to the Euro-dollar market *in toto* but more to leads and lags in exports and imports, hedging operations and shifts in working balances out of dollars by corporations with foreign subsidiaries in European countries, and transfers by monetary authorities of reserve holdings coupled with a speculative thrust. On the issue of how long would the float last, the view held out by the German Chancellor was, as long as the dangerous combination of a big US payments deficit and a huge volume of liquid dollar funds existed. Floating rates were seen as a necessary defensive mechanism to safeguard orderly conditions in the market. On control of liquid dollar funds, the European view was that consolidation of the dollar overhang was not likely to affect those dollar balances that were a potential source of disturbance. The general viewpoint of the major developed powers was that the new exchange rate arrangements were the beginning of a new era of monetary reform, and whether these were makeshift arrangements to tide over a critical period, time alone would tell.

The sentiments expressed by the developing countries at this meeting were generally along the lines of the G-24 communique. From the diverse views expressed, one thing was clear: the degree of emphasis to be placed on flexibility as opposed to stability was not yet a settled issue.

The deputies' meeting was followed by the meeting of the Ministers of C-20 on 26 March 1973. At this meeting, the Finance Minister of India stressed that there was general agreement that the exchange rate mechanism would continue to be based on par values but would be more flexible

than the Bretton Woods system in its operations. Similarly, management of liquidity would be in accordance with the needs of an expanding global economy and the SDR would, in time, become the principal reserve asset and numeraire of the reformed system. While sharing the desire to improve the working of the adjustment process, Chavan indicated that he could not agree to any approach that involved the exercise of coercion. He reiterated that adjustment must take into account the special needs and problems of the developing countries. Stating that everything should be done to maintain confidence in the SDR, he underscored the need to make a distinction between problems arising in the realm of SDR creation and problems arising from liquidity generated through other sources. On the role of reserve currencies and gold, he was categorical that both should be phased out. He warned that, in the absence of an internationally agreed code of conduct, there was a real danger that the race towards competitive depreciation and trade restrictions could gather added momentum. Prolonged uncertainty about the direction of reform was liable to encourage ad hoc responses without regard to the international repercussions of such action. The Indian Finance Minister's intervention was not in vain; the G-20 Ministers' communique that followed reflected many of the concerns expressed by him and other representatives of the developing countries.

The fifth meeting of the deputies of the C-20 started with consideration of the special interests of developing countries. Seeing that the prospects for full reform of the international monetary system were receding, the developing country representatives repeated that they wanted an early agreement on an improved international trading system, and also a strengthened system for transferring real resources from developed to developing countries. The discussion was of an exploratory nature. Based on the Morse Bureau's agenda, the special interests of developing countries were considered under four heads: (i) a possible link between SDR and provision of development finance; (ii) developing countries' access to capital markets and international credit; (iii) IMF quota structure; and (iv) related trade issues.

With a view to facilitate the adoption of a link as part of the reformed system, the Indian constituency was active in fostering a common position. At the G-24 meeting in March 1973, it had set up a working group headed by P.S.N. Prasad for the purpose. The Indian preference was for a part of the newly created SDRs to be allocated to development financial institutions, who would provide resources for investment in the developing countries. This variant of the link, the Indian representative felt, would be acceptable to the IMF's non-developing country members, because the

resources thus transferred could be expected to be used in a reasonably efficient manner. Also, the pressure for raising interest charges could be better resisted if the SDRs were made available, and SDR allocations through development financial institutions would ensure a reasonable and uninterrupted flow of SDR for development finance. The disappointing aspect of the debate was that wholehearted support from the other developing countries was not forthcoming. The Latin American and African groups favoured the direct variant of the link, whereas the others gave muted support to the Indian proposal. To maintain developing countries' solidarity, the Indian constituency fell in line with the position advocating a direct link.

Taking advantage of the lack of unanimity in their ranks, the developed countries opposed the link proposal citing its potential inflationary pressure and negative effect on the confidence of the dollar, and they went so far as to even declare that it was not in the developing countries' own interests. On hearing this, in an effective, well-reasoned intervention that was universally appreciated for both its content and form, Manmohan Singh, the leader of the Indian constituency, sought to demolish the arguments marshalled against the link. He said that the argument that the link would weaken confidence in the SDR was entirely misconceived. After all, SDRs were held only by national authorities and were backed by international obligations created by a mutual contract executed by national authorities; he asserted that there could therefore be no question about weakening the confidence in SDRs as a result of their link with development finance. Furthermore, the link was unlikely to result in any pressure on SDR creation in excess of liquidity needs. In any event, given the voting strength in the Fund, he said the developed countries would always be in a position to negate with ease any such pressure, and queried why the transfer of resources remained at all times the residual element in the national expenditures of developed countries. In his view, acceptance of the link was a question of political will and he called for its unreserved acceptance.

Outside formal meetings, in private conversations, Singh clinched the argument about fears of an adverse impact of the link on confidence in the SDR by citing the triple A rating enjoyed by IBRD bonds, the proceeds of which were used for providing resources to the developing countries.

Following the arguments advanced in favour of and against the link, it was agreed to set up technical groups to analyse the technical aspects of the proposal.

On access to capital markets, the developing countries' demand was that no controls should be imposed on Euro-currency markets and on developing countries' access to them. There was general agreement on this, but

with a proviso that such exemption should not cover controls on placement of official reserves in foreign currencies.

The developing countries also desired significant liberalization of both the quantum of financing and the duration for which it was made available for such IMF credit facilities as the CFF and buffer stock financing. As regards the IMF quota structure, while conceding that the present quota structure was not appropriate, they were not in favour of wholesale revision. There was lukewarm support for the view that it was not logical to have a single quota structure to serve various purposes and that the possibilities should be explored of devising different quota structures for different purposes such as voting in the Fund and SDR allocations. Pleas were also made for the opening up of developed countries' markets for secondary exports of the developing countries.

The deputies thereafter broke up into six technical groups to continue advanced consideration of such topics as adjustment, intervention and settlement, global liquidity and consolidation, development of the SDR numeraire and gold. The Indian constituency was represented at various group discussions.[8] But the interconnection of controversial issues inhibited progress and the hope of presenting an agreed Outline on Reform at the 27 September 1973 in Nairobi appeared to be fast receding.

When the deputies of the C-20 assembled for their eighth meeting, it was evident that the C-20 was floundering and unable to produce an agreed version of the report; it seemed to have reached the nadir of its existence. To salvage whatever work had been done and not court dismal failure, The Morse Bureau decided to set up four technical groups—one on adjustment to study the indicator structure; the second one on intervention and settlement with the possibility of linking settlement with a multi-currency intervention system; a third one on global liquidity and consolidation; and the last one on transfer of real resources.

Here we will outline some of the diverse viewpoints to show where the debate was headed. At the July 1973 meeting, the debate on adjustment turned out to be a straight repetition of the earlier one. There was no change in the old position of the US that international consultations, adjustment

[8] Group A: P.S.N. Prasad and V.B. Kadam.
Group B: Lal Jaywardena and W.M. Tilakratna.
Group C: Manmohan Singh and V.B. Kadam.
Group D: P.S.N. Prasad and W.M. Tilakratna.
Group E: Lal Jaywardena and Prasad.
Group E: Manmohan Singh and V. B. Kadam.

action and graduated pressures should be calibrated to movements in official reserves. Nor was there any change in the European opposition to the reserve indicator system and preference for a presumptive assessment procedure. France held the view that action would be triggered in too simplified and a mechanical manner if one relied only on reserve movements; a more holistic approach would give a better picture. Italy argued that under the assessment procedure, the market would not be certain about what currencies were considered to be in imbalance and this would give less room for speculation, whereas the reserve indicator procedure would facilitate speculation.

On the issue of pressures, the US remained wedded to a more or less automatic system of pressures, whereas Japan was prepared to accept pressures as a measure of last resort and wanted that they apply not only to inaction, but also to action and inappropriate action. Many of the countries felt that individual pressures in the revised Outline were unuseful, undesirable or unenforceable. India, Malaysia and Latin America had strong reservations about publication of the Fund report but the US stated that it was essential. Surplus countries regarded graduated charges and lending to international organizations at low cost, unenforceable.

On the asset settlement issue, whether mandatory or voluntary, Dr Emminger, who was invited to report on the OECD discussions, pointed out that multi-currency intervention was not merely a technical question but had implications for relative initiatives for changing exchange rates, for the asset settlement system and for the symmetry of adjustment. If a multi-currency intervention system was to be adopted, a number of knotty questions had to be resolved, such as symmetry of adjustment, rules for holding currencies and how the actions of central participants would be coordinated. It was apparent from the exchange of views that there was little common ground on which to build a multi-currency intervention system. The major elements of a settlement procedure that needed to be considered were: how effectively the currency balances could be controlled and whether the system had adequate elasticity to meet contingencies. Compromise on these issues was not even remotely possible.

On the topic of primary reserve assets, there was not enough discussion on the SDR as the numeraire while the position on gold remained largely unchanged. Nor was there any consensus in regard to new procedures for decision-making on SDR allocation and cancellation. Likewise, agreement on consolidation and reserve management was not forthcoming, except for general support for consolidation through a Fund substitution facility on a voluntary basis.

The fourth technical group on transfer of real resources to developing countries fared no better. There was great reluctance on the part of the deputies of the developed countries to discuss the link and credit facilities in favour of developing countries, with the result that both the principle and form of the link remained unsettled issues.

The deputies agreed that they had reached an impasse and needed ministerial direction for work on the reform to move forward. No matter how hard Morse, the chairman of the Bureau, tried to put in place even a few elements of the new economic order, lack of political will marked the Committee of Governors of the C-20. By the end of 1973, it was clear that the hopes entertained at the annual Fund–Bank meeting at Nairobi in September of an early agreement on overall reform of the international monetary system would not be fulfilled. At its meeting in Rome in January 1974, therefore, the Committee of Governors of the C-20 decided to take up issues of more immediate significance, leaving full reform of the system to be evolved over a period of time. The steep rise in petroleum prices that became effective in 1974 led to radical changes in the structure of international balance of payments. Developments such as these provided a strong stimulus to deal with immediate problems, as well as a justification to defer agreement on the overhaul of the monetary system as a whole.

A word in passing about the contribution of the C-20 to the reform exercise. Although the Committee failed to reform the international monetary system, it was a colossal effort on the part of financial officials to study in depth the various techniques and options, and to prepare the ground on which to build the monetary edifice. It entailed intensive work on the part of the officials, of drafting and redrafting to accommodate divergent viewpoints. For the developing countries, it afforded an opportunity to air their views and grievances, as well as to be exposed to the thinking of the developed world and to realize that hard bargaining was needed to protect each country's own economic turf. It was not an exercise in vain but events overtook the reform. As pointed out by the new Managing Director in his address to the Board of Governors, 'The problems and uncertainties that' then 'confronted the world economy called for international cooperation of a rare quality', which, unfortunately, was missing.

HOLDING OPERATION AND THE IMF's RESPONSES

Conceding that a satisfactory solution to many of the basic ills plaguing the international monetary system since the collapse of the Bretton Woods arrangement in the latter part of 1971 was not in sight, the Committee of

Twenty, at it sixth and final meeting in 1974, accepted departures from fixed parities and only stressed observance of agreed guidelines for the management of floating exchange rates during the transitional period before arriving at a reformed system. At the same time, the new Managing Director of the Fund, Witteveen, explored ways of instituting special consultations on exchange rate policy with the major industrial members whose external policies had important repercussions on international currency relations. Another, more formal response to the evolving system in November 1973 was to revise the central rate decision. It will be recalled that the concept of central rates was introduced in December 1971 because many members were unable to establish effective par values but were eager to maintain exchange rates within specified margins. But, following widespread floating, the declared central rates for many members had become ineffective. Under the revised central rate decision, a member was permitted to establish a new central rate with or without wider margins, if it maintained a stable rate in terms of its own intervention currency or currencies. This hybrid type of exchange rate arrangement, for want of anything better, received approval from the Executive Board in November 1973.

Other measures initiated through the programme of immediate action adopted by the C-20 included: (i) the establishment of a facility in the Fund to assist members to meet the initial impact of increases in oil import costs; and (ii) a voluntary pledge by countries not to introduce or intensify trade or other current account measures for balance of payments purposes. These were essentially directed towards meeting the grave problems then faced by the world economy. The C-20 also proposed the setting up of a Council within the structure of the Fund, with powers delegated to it by the Board of Governors, for supervising the management of the monetary system, overseeing the operation of the adjustment process and dealing with sudden disturbances that might threaten proper functioning of the system. Thus the Committee of Twenty proved its usefulness as a forum for policy-making and acted as a forerunner to other committees of the Board of Governors—the Interim Committee, the Development Committee and the Council—which, in later years, became the policy-making machinery of the Fund. In retrospect, the new institutional set-up that was conceived in 1973 assisted in bringing the Fund Board and Management to the centre of the stage and back to the mainstream of policy-making.

As for the experience with floating rates, some of the drawbacks of such a regime were already discernible. Until then, floating had hardly led to exchange rates that were reasonably stable and that could be considered as 'appropriate' in the overall economic context. Speculative capital

movements and the ravages of inflation had subjected foreign exchange markets to frequent periods of turbulence and wide fluctuations in rates. During the first two months of the float in 1973, the average dollar value of ten major world currencies was some 20 per cent above the exchange parities that had prevailed in the spring of 1971. But after mid-May 1973, the dollar declined sharply with fluctuations becoming more pronounced from day to day, and, in July 1973, the dollar value of the ten major world currencies was 33 per cent higher than in the spring of 1973. However, by the end of January 1974, the average dollar value of the same ten currencies was only 11 per cent above its 1971 spring level—a drop of 22 per cent from July 1973. Fluctuations of this magnitude were regarded by many as intolerable.

In the first half of 1973, it appeared that the downward drift of the US dollar would abate with the measures taken by the major surplus countries against inflows of capital from abroad. But in the context of inflationary tendencies the world over and lack of confidence in the viability of the current monetary arrangements, liquid funds increasingly sought a haven in important world traded commodities, reinforcing the price rise particularly of industrial raw materials. Thus floating, on the one hand, did not insulate the strong countries from imported inflation; on the other hand, it promoted a rise in international prices by inducing suppliers to add larger premium as cover for exchange risks. With the wage levels in the surplus countries also moving upward, a measure of cost inflation was superimposed on the adverse terms of trade faced by countries with relatively weak currencies. Nor did floating rates free countries with external deficits from the necessity of monetary fiscal policy to support their exchange rates, as the UK and Italy discovered.

The above developments clearly portrayed the difficulties in arriving at an agreed reform of the international monetary system, despite the adoption of a deadline for achieving an agreement and a work programme to meet the deadline. Even though the US Treasury Secretary was a party to the decision of the C-20 to set a deadline for agreement on reform, at the 1974 Fund–Bank annual meeting, he made it known that the reform agreement could not be finalized until the US had run a payments surplus, for full restoration of confidence required it to encourage the dollar reflow to the US.

Another factor that delayed the consensus on reform related to a wide gap between the US, on the one hand, and Europe and Japan, on the other, over convertibility, and the differences between them on the future role of gold. The Common Market countries had already committed to using gold

in their scheme of the European Union. What was more, at Nairobi, the West Germans had added their voice in favour of a back-door revaluation of gold through Central Banks by permitting them to freely deal in gold, uninhibited by the then official price. Here, the perceptive remarks of Ossola, Deputy Governor of the Italian Central Bank, on an agreed reform system are worth recalling. He warned that negotiations on reform 'could drag on for a much longer period of time than was then being forecast'. His gut feeling was that if the current floating arrangement proved reasonably stable, there would be no support at all for a return to fixed rates, and that the ultimate agreement might be in favour of a polycentric world monetary system, with groups of trading partners creating ad hoc currency areas, and with regional monetary funds eventually taking over the surveillance of respective areas, leaving the IMF the more distant task of arbitrating between them. This, obviously, was not an encouraging scenario for the developing countries who had high expectations of the reformed system.

The only silver lining that was discernible at the Nairobi meeting was the announcement by the World Bank President of the agreement between donor governments to recommend to their legislatures a three-year IDA replenishment arrangement at the rate of US$1.5 billion a year.

The Committee of Twenty had recommended amendments in specific areas to the Fund's Articles of Agreement, on which discussions were continued by the Interim Committee and the Executive Board of the Fund. While substantial agreement emerged in respect of amendments regarding improvement in the Fund's general accounts and the characteristics of the SDR, the exercise of amending the Articles got bogged down because of differing views on vital issues such as arrangements relating to gold and to exchange rates.

The proposed improvements in the general accounts related to: liberalization in the use of Fund resources, more flexibility in repurchase obligations, use of SDRs in discharging obligations payable in gold, and more flexibility in investments. The Indian representatives welcomed all these proposals with an important exception: that where SDRs were permitted to substitute gold in the discharge of obligations, the member's own currency but not other members' currencies could also be used. In their view, any suggestion that conferred a reserve role for just one or two currencies should not be encouraged.

Suggested improvements in special drawing rights included, among others, voluntary transactions between participants and greater freedom for transactions without designation.

On the question of gold, there was general agreement that the SDR should

ultimately replace gold as the centrepiece of the international monetary system. There was also general agreement on abolishing the official price of gold, and on abrogating the obligatory payments in gold between member countries and the Fund. In principle, there was also support for the use of profits from the sale of a part of the Fund's gold holdings for the benefit of the developing countries, but there was no agreement on the specific arrangements that would have to be evolved in this respect. As a result, the situation of the gold market in mid-1975 continued to be by and large uncertain. The emerging strength of the US dollar on the exchanges and the realization after US Treasury sales that the demand for US private gold holdings was modest, discouraged any upswing of the market price of gold. But this was strongly underpinned by the agreement between the French and US Presidents on 20 December 1974, to permit the Central Banks and monetary authorities to revalue their gold holdings at market-related prices, and by the South African decision not to sell on the markets its current output or any of its official holdings so long as improvement in its balance of payments persisted.

A word about India's attitude towards different aspects of the gold question. The brief prepared by the Reserve Bank for the Interim Committee meeting in Paris on 11 and 12 June 1975, clearly argued in favour of gold sinking to the bottom of the reserve pile and the SDR replacing gold as an international reserve and payment instrument. The RBI's advice was to continue to oppose moves to mobilize gold and raise the effective price of monetary gold over the official price. Its suggested strategy was not to discourage monetary demand *for gold thoroughly*. In that case, profits from sales of Fund gold were unlikely to be material. For this reason, a trust fund supported by such profits would be of little benefit to the developing countries and the proposal to set up such a trust fund should not be supported. Likewise, support for a gold substitution account should also be withheld, the reasoning being that such an account would strongly favour large official holders of gold in mobilizing their holdings at prices higher than the market prices plausible in the context of erosion of monetary demand for gold, and give a decent investment return on the holdings mobilized at such higher price levels; those not holding large stocks of gold would indirectly contribute to such a higher investment return. A further consequence could be receding possibilities of fresh SDR allocations.

On floating and exchange rates, the thrust of the draft amendment was to legalize floating. Although no consensus could be reached at the Paris meeting, there was general agreement that members should cooperate with the Fund and with each other to promote exchange stability. The members

were generally against legalization of independent floating, except in exceptional circumstances. The preference appeared to be for a return to a system of par values with provisions for establishment of central rates. In practice, the world's major currencies continued to float, and exchange rates continued to move both ways by fairly wide margins.

At the Paris meeting, modifications in the Fund's facilities for compensatory financing of export fluctuations and for assistance to members' contributions in respect of international buffer stock operations were recommended. These topics were already under active consideration in the Executive Board and there was general agreement that assistance drawn under the buffer stock facility should not impair the member's credit position in the Fund.

Under the sixth general review of quotas, it was agreed that the overall size of quotas would be increased by 32.5 per cent, allowing a doubling of the share of oil exporting developing countries as a group without a change in the present collective share of other developing countries.[9]

On the other hand, the Joint Ministerial Committee of the Board of Governors of the World Bank and IMF on the transfer of real resources to developing countries (Development Committee), at its meeting in June 1975, expressed concern over the pressing problems of developing countries arising from adverse terms of trade, and took the first concrete step to mitigate their problems by lending unanimous support to the establishment for one year of an intermediate financing facility in the IBRD, to be known as the third window, to provide long-term loans to developing countries on terms between those of the IDA and the World Bank. The World Bank was urged to establish this facility effective from 1 July 1975, to lend $1 billion to the developing countries. This assistance was to be provided at a subsidized rate of 4.5 per cent to countries with per capita annual incomes of under $375. Funding for these loans was to be raised from the international capital markets and the funds to be lent at a subsidized rate by creating an interest subsidy fund. Some of the major oil producers and a few industrial countries agreed to contribute $120 million for setting up of the $100 million interest subsidy fund.

Between the Paris Meeting of the Interim Committee in June 1975 and its next meeting at Kingston in Jamaica on 7–8 January 1976, intense preparatory work was undertaken by the Fund staff and the governments of industrialized countries to iron out differences. In an effort to get maximum support, towards mid-December 1975, the Managing Director

[9] For a detailed discussion of quota revisions please see the chapter on quotas.

of IMF circulated some new proposals,[10] covering both the use of the Fund's resources and the trust fund. On use of the Fund's resources, his proposals were extremely disappointing. He himself had earlier proposed that the first credit tranche would be doubled and this had found considerable support among half or even more than half the members of the Executive Board. However, for his fresh proposals, he had apparently paid much more attention to the views of certain industrial countries and had gone back to proposals that were distinctly niggardly. The upshot was, all the G-9 developing country Directors, without exception, opposed the new proposals and requested reconsideration of the earlier proposals as a minimum.

From the paper on the trust fund, it was apparent that the sale of the Fund's gold may not fetch more than SDR 1.5 billion, and that the sale would be spread over three to five years. At best, the Fund could disburse no more than, say, SDR 300 to SDR 500 million per year for five years or three years. The smallness of the amount made the proposal unattractive for some of the larger developing countries, such as India. To overcome the legal obstacles raised by the IMF, that direct gold sales by it would be a violation of Fund rules, Denis Healey, Chancellor of the Exchequer of UK, following the G-10 meeting of Finance Ministers convened to resolve some of the intractable issues coming up before the Interim Committee at Jamaica, in a press briefing stated: 'The Bank for International Settlements was prepared to purchase part of the IMF gold offered under the gold reform package and auction this to central banks, if they were interested.' The way was now open for the sale of gold by the special trust fund, provided this was accepted at the Jamaica meeting of the IMF Interim Committee. The G-10 Ministers, after intense discussion and some compromises, endorsed the drafts relating to exchange rate arrangements, surveillance over exchange rate policies, gold, transfer of resources to developing countries—the major issues that would have to be tackled at the Jamaica meeting.

The fifth meeting of the Interim Committee was scheduled for 7–8 January 1976 at Kingston, Jamaica. In preparation for this meeting, Reserve Bank of India and Finance Ministry officials had worked feverishly hard to prepare a comprehensive brief for the Indian delegation giving the state of play on the various issues, detailed comments on the suggested proposals and the line of reasoning to be adopted. As it turned out, the meeting at Kingston endorsed the new quotas and adopted the formulation of amendments to the Funds' Articles. It was a historic meeting in the sense that it

[10] 1. Buff 75/137; 2. Buff 75/134.

brought down the curtain on an exercise upon which the international community had embarked at the beginning of October 1971—to reform the international monetary system after the suspension by the US, in August 1971, of the official gold convertibility of the US dollar.

The Jamaica decisions brought about radical changes in the working of the international monetary system and went far beyond the recommendations of the C-20. The latter had visualized a reform based on stable but adjustable par values, an adjustment mechanism ensuring prompt adjustment action with the adjustment burden equitably borne by countries in payments imbalances, an SDR-centred system with a diminishing role for gold and reserve currencies, and adequate real transfer of resources to developing countries.

The agreement reached at Jamaica abandoned a system of stable but adjustable par values and permanently enshrined the right of members to have exchange arrangements of their choice, by legitimizing independently as well as collectively floating exchange rates, and by drawing up stipulations for future introduction of widespread exchange arrangements based on stable but adjustable par values. The Indian authorities were not entirely happy with the solutions agreed upon. In their view, the reserves discipline which, under fixed exchange rates, undoubtedly applied with rigour on countries with payments deficits, was not necessarily entirely without effect also on countries with sizeable payments surpluses and averse to domestic inflation. Despite the floating members' undertaking to follow exchange rate, economic and financial policies contributing to adjustment, and the Fund's surveillance of compliance with such an undertaking, the question was: would the undertaking adequately substitute for reserves discipline? The fear was that, in practice, compliance with the undertaking would be secured with greater vigour from small and poor economies and from economies in deficit seeking Fund assistance. The Indian assessment was, under the new arrangements, there would be no improvement but there could well be further deterioration in the distribution of the adjustment burden among economies in payments imbalances.

The right of members to float collectively as well as maintain exchange values independently or cooperatively with other members, of their currencies in terms of the currencies of other members, in the reading of the Indian authorities, would promote the reserve role of some currencies instead of reducing it. Experience had shown that the reserve role of the country issuing the currency was to avoid adjustment action and that it would do so even under new undertakings relating to exchange arrangements. It would also detract from the objectives of international control of

international liquidity—of making the SDR the principal reserve asset of the system.

The Jamaica meeting took some far-reaching decisions on gold. The official price of gold was abolished. The provisions in the then existing Articles on members' obligation regarding gold purchased at par values—the expression of the par values of members' currencies in terms of gold as a common denominator or in terms of the US dollar of weight and fineness as on 1 July 1944; the valuation of the SDR in terms of gold; and the requirement that members sell their currency to the Fund to replenish the Fund's holding of currencies—were all, at one stroke, deleted. From then on, the Fund, in all its transactions with members, was to be guided by the objective of avoiding the establishment of a fixed price for gold or the management of the gold market by the Fund. Also, gold sales to members were to be at prices agreed upon for each transaction on the basis of prices ruling in the market. By an 85 per cent majority, the Fund would be authorized to accept payments from members in gold instead of SDRs or currencies in any operation or transaction with members, but only on the stipulation of such payments being at prices agreed for each transaction on the basis of prices prevailing in the market.

Another major problem of interest to the developing countries related to the trust fund. It will be recalled that a consensus was reached by the Interim Committee on 31 August 1975, regarding the immediate disposal of 50 million ounces of the Fund's gold. At Jamaica, the Committee agreed to restitute 25 million ounces of the Fund's gold to members, in proportion to their quotas on that date and at the then official ruling price of SDR 35.00 per fine ounce, and to sell the balance 25 million ounces at market-related prices. The share of developing members in the profits from the gold sales would be given to them directly in proportion to their quotas. The remainder of the profits would go towards providing resources for the trust fund (which resources would be augmented by voluntary national contributions), for use as concessionary balance of payments assistance to low income members. In the assessment of the Indian authorities, the scheme as summarized above fell far short of the promises and anticipation aroused in September 1975, when the offer of a trust fund to the less developed countries was in effect traded by the affluent G-10 countries, so as to enable them to increase the freedom of their own operations and the availability and liquidity of their own resources, without resorting to any further creation of SDRs.

It was also agreed to authorize the Fund, by an 85 per cent majority of the total voting power, to restitute at the then official price to those who

were members on 31 August 1975 in proportion to their quotas on that date, or to sell part of the gold left after the disposal of 50 million ounces. Profits from such future sales were to be transferred to a special disbursement account, resources from which could be used, with a 70 per cent majority of the total voting power, to augment the general resources of the Fund for immediate use in its ordinary operations and transactions, and by an 85 per cent majority of the total voting power, to make balance of payments assistance available on special terms to developing members in difficult circumstances.

Further, it was agreed to delete the requirement in the Fund's Articles relating to payment in gold of 25 per cent of the increase in a member's quota, whenever quotas were changed. From then on that portion became payable in SDRs, in currencies of other members or in a member's own currency. Charges, too, earlier payable in gold or convertible currencies, became payable in SDRs or currencies acceptable to the Fund. The maintenance value of the Fund's holdings in members' currencies in terms of gold was also changed.

Apart from the substitution of gold by SDR in several provisions of the Articles, an important change agreed upon related to rules for reconstitution of the SDR, which were modified. It was also agreed that the method of valuation of the SDR would be determined by a 70 per cent majority of the total voting power, but an 85 per cent majority was needed for a change in the principle of the valuation.

The arrangements made for gold in the mid-1970s was at best be seen as a pragmatic compromise, for the solution agreed upon had something for everybody. They failed to please the developing country members who, at the January 1976 meeting of the G-24, expressed 'strong dissatisfaction' with the arrangements. India's disappointment with the arrangements was on several counts: they neither made the system SDR-centred nor promoted international control of international liquidity. Use of gold in transactions with the Fund was not eliminated, as, with an 85 per cent majority of the total voting power, the Fund could accept payments from members in gold instead of SDRs and currencies. Also, given the highly inequitable distribution of monetary gold holdings, additions to effective international liquidity ensuing from gold decisions would be distributed among members of the international community with extreme unevenness and inequity, particularly in the context of postponement of possible SDR allocations. According to the Reserve Bank's estimate, international liquidity of industrial countries could rise by up to about SDR 60 billion and that of less developed countries by about only a tenth of that amount, as a result of the

valuation of official gold holdings at market-related prices for gold. The agreements relating to gold, the exchange arrangements and the SDR valuation, in fact, had made the international monetary system even more US dollar-centred than the gold-based dollar-centred Bretton Woods system. The passage of time had proved that the lure of gold had never really ended, with demands for resurrection of its role in the monetary system persisting till as late as 1983. In 1983, Robert Mundell, in a paper entitled 'Floating Rates Lead to Monetary Chaos', against the backdrop of the global recession, was again advocating stabilization of the price of gold as the principal way to stabilize exchange rates and contain inflation.

The objective of promoting a real transfer of resources to the developing countries through the reform of the international monetary system was also not furthered by the gold arrangements, adjustment action and SDR agreements and by the absence of the link between SDR creation and development finance. Indeed, inasmuch as the arrangements were put back further in time, possible future allocations as assessed by the Indian authorities were hindered by the Jamaica decisions. Later developments have adequately proved that the Indian assessment was correct. The idea of a linked SDR was never allowed to germinate or grow.

The developing countries had also expected an enhancement of their share in decision-making in the Fund. The revised quotas endorsed at Jamaica involved only a marginal improvement in this share. The entire improvement, in itself modest, went to a sub-group of the oil-rich members. The share of non-oil developing countries as a group remained unchanged, while the quantum of their access to Fund assistance increased very modestly through quota increases, liberalization of compensatory finance and availability of resources out of profits from the sale of the Fund's gold for balance of payments assistance on concessionary terms. But this had to be set off against the disappearance of the oil facility, under which drawings by the developing countries had amounted to SDR 1.1 billion in 1974 and SDR 0.8 billion in 1975. Also, this improvement needed to be viewed in the context of developed countries' quotas and their access to Fund assistance, which had risen by much larger amounts—the developed countries were not precluded from availing of the liberalized compensatory facility, as also from the benefit of temporary enhancement in each tranche from 25 per cent of the quota to 36.25 per cent, and the freedom of official monetary authorities to enter into gold transactions at market prices. All these factors taken together raised the developed countries' owned liquidity vastly—an evaluation that could not legitimately be disputed.

Following the Jamaica accord, the IMF Board was preoccupied with

implementing the arrangements for gold, including evolving guidelines and arrangements for holding gold auctions, establishing a trust fund and determining its features, and finishing the unfinished task of the second amendment of the Articles of Agreement.

Early in February 1976, the Fund management put out the revised proposals on gold. There were no surprises; in fact, there were one or two favourable features from the viewpoint of the developing countries. For instance, the proposals did not contain a provision that any part of the trust fund's resources should be set apart, either for compensatory financing of shortfalls in exports or for subsidizing such shortfalls. The proposal that the Germans put forward and which the Americans supported was criticized by all the G-9 members from the developing countries, who pressed for its deletion.

As decided at the Interim Committee, eligible members would be those with a per capita income of up to SDR 300 and this criterion would be reviewed annually. The annual review was to give an opportunity for reconsideration because of an improvement in per capita income and because of inflation. The rate of interest proposed was 1 per cent, but a higher rate was a distinct possibility. The duration of the loan would be ten years, with a grace period of five years. Any attempt to harden these terms, the Indian brief indicated, had to be resisted. It had earlier been decided that the trust fund resources would carry a conditionality that was equivalent to a first credit tranche drawing; later, however, it was suggested that the conditionality should be increased with each successive drawing. This suggestion was vigorously opposed by the Indian Executive Director and, with the support of a few developed and developing countries, the management was forced to drop it. The most objectionable part of the earlier proposal by the Managing Director was that trust fund disbursement would be linked to a member's use of Fund resources under the ordinary credit tranches. Because of the solidarity displayed by the developing countries, this proposal was not repeated in the revised proposals. The most welcome feature of the proposals was that in assessing need, account would be taken of the repurchases made or due to be made by a member.

On the option to receive a share of the profits from the sale of the Fund's gold, either in the form of gold at the official price or in the form of currencies realized through the sale, the Reserve Bank indicated its clear preference for receiving the share in the form of gold. In the RBI's reading, non-monetary demand for gold, in all probability, would comfortably absorb the existing South African production and the 200 tonnes or so predicted in the case of the Soviet Union. In the absence of significant net sales out of

monetary stocks, the medium-term outlook for market prices of gold would hold fairly close to the ruling level. Based on this reasoning, the Reserve Bank advised the Indian Executive Director Jagannathan to support the proposed restitution of gold.

However, the Bank had reservations on the proposal that gold should be restituted to the developing countries with the obligation to provide in exchange freely usable currencies or currencies acceptable to members with a superior gold tranche who, in turn, would provide the Fund with currencies that were acceptable to it; in other words, it should be possible for members to pay the Fund SDRs in exchange for the gold restituted to them. The IMF staff's approach on the Fund's gold—both restitution and sale for the benefit of the developing countries—essentially as an exercise in replenishment appeared questionable. The Indian interpretation was that the replenishment technique was part of the current Articles of Agreement, which were squarely anchored on fixed parities and an official gold price. Replenishment provisions were essentially a technique of augmenting the general resources of the Fund. But the agreement arrived at by the Interim Committee relating to the immediate disposal of 50 million ounces of the Fund's gold was clearly an essential ingredient of the agreement to abandon the Bretton Woods fixed parities and to change the role of gold in the monetary system.

UNBORN REFORM INITIATIVES: PROPOSALS FOR A SUBSTITUTION ACCOUNT

The establishment of a substitution account was first considered in 1974 and then again in 1980, in the context of the international monetary reform. The idea first arose when the US dollar displayed persistent weakness in the early 1970s and Central Banks were looking for alternatives to the dollar-based system of reserves. Setting up such on account in a more broadbased form was an important element of the reform exercise considered by the C-20. Even though no such account existed at that time, its operational implications and modalities received careful consideration by at least two technical groups,[11] and there was willingness to accept the idea as a realistic possibility but at a future date.

Substituting US dollars with the SDR as a reserve asset was offered as a solution to the dollar overhang but was discarded at first owing to US

[11] The Technical Groups on intervention and settlement and on global liquidity and consolidation.

indifference. In retrospect, the Fund's reading was that it was not a viable solution as nearly 70 per cent of all official reserves were held in dollars. If a Central Bank was to reduce the exchange risk on its reserves, the obvious way would be to diversify into other widely traded currencies, which, in the early 1970s were the Japanese yen and the German deutsche mark. But reluctance on the part of these other currencies to take on the role of reserve currencies rendered the proposal a non-starter. In the assessment of the Fund, such diversification contained the seeds of potential destabilization, for shifting the composition of reserve portfolios for monetary gain could destabilize currency markets and erode the confidence of the monetary system. The C-20, as part of its study then, also considered proposals that would require members to replace a portion of their existing reserves with SDRs. Some members favoured, mandatory scheme while others plugged for voluntary substitution. As no consensus was forthcoming, the final report, while endorsing the idea, failed to draw up a specific proposal. The substitution proposal was then put into cold storage until circumstances were appeared more propitious for its consideration.

With the US attitude of indifference gradually turning into positive interest, the idea was revived in 1977. The continued pressure on the US dollar and the reluctance of other major powers to take on the role of a reserve currency, provoked the IMF Managing Director, Witteveen, just before his retirement, in the spring of 1978, to reopen the issue informally with groups of the Fund's Executive Directors. Two differences marked the new proposal: the substitution account, to gain approval, would have to be voluntary; and to minimize the inherent asymmetry between the effects on the US and on other countries, the US should be excluded or discouraged from participating. If any country could deposit dollars in exchange for SDRs, then alone the US could finance a deficit by issuing its own currency and bypassing the foreign exchange market. At the Mexico meeting of the Interim Committee in April 1978, the formal and attenuated version of Witteveen's proposals did not receive much support. Even the US resisted the resurrection of the idea, somewhat haughtily citing the numerous thorny and complex questions such an account would raise, and averring that it would not be feasible to implement the scheme.

It took some time for the new Managing Director, de Larosiere, to reassume his predecessor's initiative; by February 1979, he had become an equally ardent crusader. There had also been a distinct softening of attitudes, particularly in US official circles. The US indicated that it had no basic objection to the idea, while not wanting to peddle it. In fact, the US was seen publicly giving its qualified support to a plan that would increase

the role of the SDR and reduce that of the dollar. The US Treasury Under Secretary, Anthony Solomon, at a symposium in Austria, was reported to have said that the substitution account would be a concrete move forward towards wider use of a full international asset, the SDR. However, it was made clear that on no account should US support be construed as designed to bail the US out of its currency problems.

The change, it would appear was attributable, in part, to the unrelieved instability in exchange markets and the severe pressure on the US dollar towards the end of 1978. The new policy presumption was that stability of the monetary system would be served better through increased reliance on a single internationally created and managed asset. In the changed world economy, there was need for rethinking on the innate strength of the almighty dollar, and a controlled and systematic reduction in the dollar's role as the ultimate calibrator and settler of payments imbalances was seen as an option worth considering.

Capital markets outside the US had grown considerably in importance and this had resulted in a loosening of capital flows. The formation of the EMS, with its emphasis on intervention in the currencies of participants rather than the dollar, was another important shift to be reckoned with. Despite these underlying shifts, the US continued to supply the world's liquidity needs to a disproportionate degree and this, to some extent, prompted the US to gradually reduce its currency's international role. The substitution exercise was seen as the first modest step in the evolutionary process of securing a stable monetary system.

Several European countries felt that the creation of such an account involving deposit of the US dollar and issue of SDR claims would promote the accepted objective of making the SDR the principal reserve asset. Oil surplus countries saw in the substitution account, a safer avenue for investment of their surpluses. In the developing world, the initial reaction was one of deep-rooted suspicion about the compulsory character of a package stamped 'voluntary'. They were not enthused about 'locking in' significant portions of their freely useable reserves largely in the form of working balances and saw some risk with regard to the maintenance of the capital value. Their attitude softened somewhat as they directed their efforts at extracting the maximum concessions out of an interested US. Their participation in such an account was made conditional upon the adoption of other measures. Advocating a package approach, Directors from India and Brazil demanded a satisfactory structure to the account, a special SDR allocation and measures to allay fears of stringency in the capital markets.

By March 1979, the Interim Committee was able to support the

proposed diversification of official foreign asset holdings and give a mandate to study the setting up of a substitution account. At this point, it might be useful to sketch the outlines of the proposed account. A prerequisite for its creation was that a minimum number of countries and a minimum amount of deposits would have to be forthcoming. The account would receive US dollars and issue in exchange claims denominated in SDRs. It would be set up as a trust administered by the Fund, with an assembly of participants who would exercise effective control in certain matters, and with voting power linked to the size of the participants' deposits. Participation in the account would be voluntary. The dollar receipts would be deposited in a special account in the US Treasury and the latter would pay market-related rates. This point turned out to be a troublesome feature of the negotiations. In turn, the account would pay interest to the holders of SDR claims at the combined market interest rate used to determine the interest payable on SDR.

The most irreconcilable problem was that depositors were to bear the exchange risk for an account that would hold dollar assets and SDR liabilities. The IMF staff's evaluation was that the financial design of the account precluded the presumption that, in the long run, losses were more likely than profits, but the British and German simulations indicated that the possibility of losses could not be ruled out.

At a later stage in the evolution of the proposition a further complication was thrown in, in terms of using Fund's gold for maintaining the financial balance of the account. Such gold backing, it was felt by many, had an element of inequity. From the outset, the Indian authorities were opposed to sale of the Fund's gold and utilization of the proceeds to meet an interest liability or capital shortfall during the life of the account. They remained firmly of the view that the Fund's gold should not be deployed to underpin the proposed substitution account, either by way of guaranteeing exchange risks relating to the asset of the account or for covering the deficit on interest receipts in relation to the SDR claims. In one of his interventions, the Indian representative, I.G. Patel, categorically asserted that the substitution account had to be viewed as a limited operation and the Fund's gold should not be permitted to be used for such limited purposes. Instructions were given to the Indian Executive Director to oppose any move that sought to use the Fund's gold as a backing for the substitution account. The proposal to use gold strengthened the demand of the developing countries for a package approach, requiring that any use of the Fund's gold was matched by a corresponding benefit for the developing countries. Since the establishment of the substitution account using the Fund's gold required an 85

per cent majority, the developing countries possessed a trump card to press for a package approach to extract the maximum concessions.

The revised proposal that emerged in the first half of 1979 was that the Fund would establish and administer an account in which Central Banks would voluntarily deposit dollars.[12] In exchange, they would receive SDR-denominated claims, which could be used by the participants in a limited manner. The account would convert its assets into longer-term dollar-denominated claims on the US Treasury, which would pay a suitably long-term interest on them. To the depositors, interest would be paid[13] at the official SDR rate,[14] thus covering the exchange risk through the difference between the long-term US bond rate and the official rate.

Two supplementary mechanisms—designation and encashment—were designed to ensure liquidity of the SDR claims; but these were made subject to balance of payments need and a transaction charge. The Germans and the Americans wanted a restricted use of designation and prior challenge regarding existence of need, so that undue resort to this device would not inhibit the growth of a secondary market and unwind the substitution effect. The developing countries, on the other hand, argued against the need criteria and designation mechanism, and pressed for the right to encash their claims. India opposed the levy of a transaction charge but favoured the use of a back-up mechanism that was wide enough to cover the desire of participants to change the composition of their reserves. The suggestion was examined but it was felt that use of the designation mechanism as a tool for diversification of reserves could adversely impact on designees as well as on the market, and would not prove helpful.

With these broad indications but nothing concretely settled, De Larosiere decided to present the idea to the Interim Committee, which exchanged views over a working lunch in March 1979. The parleys reflected an openness to the idea and a go-ahead was given to the Managing Director for active consideration of such an account. This was the first sign of a general willingness not only to make the SDR the principal reserve asset of the monetary system, but also to combat the weakness of the dollar through diversification of reserves.

Hitherto, the IMF Board's discussion on the account had revealed an excessive concentration on minute technicalities with little evidence of the

[12] Short-term US Treasury bills.

[13] In 1979 the official SDR interest rate was below the market rate.

[14] The proposal was to levy a charge of 1 per cent.

major powers wanting to come to grips with the broad issues—much less to commit to them. On the side, however, the Central Banks of several developed and developing countries, with the bulk of their reserve assets in US dollars, were conveying to the Fund that their preference lay in diversifying their reserves and that they were prepared to bear some cost in exchange for a stable investment vehicle. But this was not the thinking of the US administration. No doubt, its interest lay in stabilizing the demand for dollars and removing the overhang, but the rate of interest to be paid by the US to the account remained a fuzzy area.

In Board discussions, several Directors had argued that, taking into account the non-negotiability of dollar deposits with the US Treasury and the almost non-terminable nature of the deposits, the US should pay an interest rate higher than the market rate. This additional amount, they argued, was not a premium; it reflected the virtual interminability of the dollar deposits. Most Directors, including the Indian chair, showed preference for an interest rate that was higher than the market yield on three-month US Treasury bills and on long-term US government obligations (say, twenty years). But the US consistently argued that any 'premium' would not be acceptable, for it was not justified and would be frowned upon by US Congress; market yield on three-month paper was all that the US was prepared to offer. Besides, simulations of past data had shown that short-term values were more attractive. The other issue raised related to encashment of the instruments: would they be on face value or at the going rate? The US response was that encashment had to be market-related. The issue was crucial, for encashment at a discount would adversely impact the viability of the account.

On the formula for sharing profits and losses on liquidation of the account, the Indian viewpoint was that losses should be shared between the US and the holders of claims in the ratio of 75 to 25, and profits in the ratio of 25 to 75, as the dollar was one-third the value of the SDR.

The summer of 1979 saw support gradually broaden for the account. This was reflected in the Interim Committee's communique of October 1979, which directed the Executive Board to give priority to designing such an account. But the support was shortlived, despite the Managing Director's frantic efforts to build bridges of understanding and remove the barnacles that threatened to clog progress. At the G-10 deputies' meeting in Paris on 25 March 1980, Economic Counsellor Polak put forward a new draft outline based on the replies provided by the members to the comprehensive questionnaire circulated by the Fund staff towards the end of December

1979.[15] The draft was conceived in such a way as to aim at maximum progress at Hamburg towards agreement on the substitution account.

The US authorities refused to accept the idea of converting short-term liabilities of Central Banks into a long-term liability of the IMF. They saw no merit in such conversion, for the costs would far outweigh the benefits. On the other hand, would-be depositors baulked at converting US Treasury bills into assets by paying the lower official SDR interest rates. They argued that the gains of a stable SDR claim were inadequate compared to the direct financial loss resulting from SDR claims. What was more, the IMF scheme provided no guarantee regarding the future financial viability of the account. The Indian demand was that the US should pay a premium over market rates, in view of the fact that the funds would be invested in non-negotiable instruments virtually in perpetuity. India also opposed any charge being imposed for encashment; as encashment would be availed of only in times of balance of payments need, the levy of a charge would result in SDR claims being quoted at a discount in the market. The asymmetry in the treatment of participants, with losses being made good by the participant immediately at the time of withdrawal but having to wait until liquidation of the account for securing a share of any gain was seen as a ploy to prevent participants from opting out easily. This went against the grain of voluntariness that had been universally agreed upon. Finally, India said the share in decision-making should not be calibrated entirely to the quantum of participation.

The debate revealed that neither side was willing or ready to compromise on absorbing the risk or the cost. The IMF staff then came up with an alternative plan: for the Fund itself to absorb a part of the risk by pledging part of its gold stock. Under the new proposal, 7–9 million ounces of the Fund's stock of 103 million ounces of gold would be sold, and another 23–32 million ounces would be placed with the substitution account as a backing for the account. The sale proceeds would be invested in interest-bearing assets, and the income earned would go to subsidize the cost of credits given from the SFF and to finance the rising cost of remuneration to creditors. Although the proposal had something for all members, it failed to catch on. Members were wary of disposing of a part of the crown jewels.

[15] The Reserve Bank and the Finance Ministry prepared replies in conformity with the view expressed by the Indian representatives at earlier meetings, and forwarded the same to the Indian Executive Director as his brief for the forthcoming negotiations.

In March 1980, the Executive Board met to consider the Managing Director's proposal as given above. There was support for use of the Fund's gold, but conditional upon the main participants undertaking to shoulder the responsibility of sharing the costs relating to the account. The US Executive Director made it plain that his authorities were in no position to provide any budgetary support for the account. The developing countries, including India, were equally categorical that they did not favour use of the Fund's gold for underpinning the substitution account or for maintaining the financial balance of the account. The Indian Executive Director, Deshmukh, based on the brief provided by the Finance Ministry, went on record to state that 'the Fund should not compromise its ability to reserve its gold for the benefit of low-income developing countries'.

Seeing that the Board representatives had little leverage to settle politically sensitive issues, the Managing Director, de Larosiere, not wishing to let the opportunity slip by to set up the substitution account, decided to throw all his energies into securing a political settlement. Enlisting the assistance of the Interim Committee chairman Fillippo Maria Pandolfi, he first sought to assuage the fears of the developing countries by explaining that the systemic benefits of the substitution account would outweigh narrow concerns.[16]

Here mention may be made of two developments, of which cognizance needs to be taken for a complete historical record. First, a research paper looking at the matter from the point of view of developing countries, was produced[17] by the Fund. Second, UNCTAD commissioned V.B. Kadam, a senior official of the Reserve Bank of India and counsel for the G-24, to produce a study on the pros and cons of the proposal for a Substitution Account as seen from the developing countries' viewpoint. The Fund document did not add materially to the arguments already advanced by the defence. But the UNCTAD study by Kadam ably and appropriately launched a fresh attack on the manner in which major propositions were reasserted by the Fund without satisfactorily dealing with the concerns of the developing countries. While recognizing that it was necessary to evolve substitution arrangements, Kadam underlined that these arrangements should, at the minimum, meet the requirements of liquidity, protection of value

[16] Pandolfi and Polak made a whirlwind tour of several Latin American capitals to explain the value of the proposed scheme for the developing countries. Although they were not completely successful in removing doubts, they apparently succeeded in defusing overt criticism. See *Silent Revolution* p. 942.

[17] A Substitution Account and the Less Developed Countries SM/79/236 August 1979.

and the rate of return-points, which the Indian Governor had time and again stressed in his interventions at earlier Interim Committee meetings. Since the revised Fund proposals failed to meet the concerns of the developing countries and he saw little possibility of that happening given the logic of the proposals, Kadam advised the Governor and Finance Ministry officials to withhold support till the minimum requirements were met.

Deshmukh, the Indian Executive Director at the IMF, in a letter of 6 September 1979 addressed to Manmohan Singh and copied to I.G. Patel, adopted a pragmatic approach and advised the government to extend more than lukewarm support to the substitution account. Admitting that the scheme would not be a giant step forward towards monetary perfection, he said that it nevertheless might enable the countries to progress diagonally to a more satisfactory payments system. Adopting a somewhat different stand from Kadam, Deshmukh urged the government to look at the scheme with an open mind, for he was persuaded to believe that the substitution account would place in the hands of the participants an asset that would in time appreciate in value vis-à-vis the US dollar and sterling. In Kadam's assessment such a proposition was not tenable. Substitution as embodied in the Fund proposal, according to Kadam, did not move in the direction of reform and he failed to see even a semblance of a logical step towards it. Deshmukh, however, cautioned the government to not look at the scheme with distrust, the proposed instrument was bereft of all debilitating features and once the minimum requirements, both positive and negative, were met; in other words, to keep the door open for negotiations to move forward. His advice was based on the positive feedback he had been privy to in his interactive exchanges with the Directors.

In January 1980, there were indications that the G-5 Finance Ministers had agreed on many but not all the substantive issues. This was further corroborated by the utterances of the German Finance Minister, Hans Mattofer, who signalled the strong support of his government. The March 1980 interactions with US officials also confirmed that negotiations on some of the thorny issues were proceeding smoothly. This was further strengthened by the strong endorsement of support conveyed by the US Treasury Secretary, G. William Miller, in his meeting with de Larosiere. There was thus every indication that the forthcoming Interim Committee meeting in Hamburg would set the stage for wrapping up an agreement. At that point of time, the Managing Director had no inkling that major players would renege on their support to the proposal. It came as a rude shock to him when, at Hamburg in April 1980, the expected support from the US and

Germany evaporated without any warning, with the representatives of both these countries and of Australia declining to speak on the matter. The other industrial countries who supported the proposal did so on the assumption that the US would shoulder a part of the cost. The developing countries that offered their support did so on condition that the proposal would be adopted along with the Programme for Immediate Action of the G-24.

Hamburg turned out to be disaster that aborted the substitution account and sealed its fate for all time. It is legitimate to question why reform of the international monetary system through the creation of a substitution account did not become a reality. The reason was that although people clamoured for it and talked as if they were yearning for it, they were really chary of ushering it in. The debate, lasting over two years, a classic illustration that the will to do something concrete was missing.[18] The US was unable to make a tangible and objective demonstration of its faith in this part of the reform exercise. Lack of agreement on how to cover the risk and lack of consensus on the use of the Fund's gold as a burden-sharing solution were the key reasons for the withering away of support. Without the active support of the US, it was hardly possible to bring about far-reaching constitutional changes. The continued and decided opposition to the substitution account, in retrospect, has to be seen as implying a release from any moral obligation to assist in any manner, any monetary moves. Creation of the substitution account would have changed the monetary landscape as it would have helped to strengthen the role of the SDR in the monetary system. It is indeed ironic that the Polak–de Larosiere plan fell through because of concern over its potential cost. An *ex poste* simulation by the Fund staff revealed that had the substitution account been established in 1980, by 1985 it would have generated a cumulative profit in SDRs equal to more than 40 per cent of the initial deposits, and that profit could have been invested to ensure the future sustainability of the Account. The opportunity missed was an opportunity lost. Moreover, the SDR, which in the 1970s was seen as a promising primary reserve asset of the system, has, over the last two decades, lost much of its lustre and relevance with no allocations and with its share in total world reserves sinking to a low of about 1 per cent.

[18] The Fund attributed the withering away of American support partly to the exit of Soloman from the US Treasury. See *Silent Revolution.*

IMF QUOTAS

Quotas, a basic constituent of the International Monetary Fund's original financial structure, assumed increased significance in 1966–78. Each member, upon joining the Fund, was assigned a quota and was required to pay a subscription equal to that quota. Until the second amendment of the Articles of Agreement of the IMF, which became effective on 1 April 1978, all subscriptions were paid partly (25 per cent) in gold and partly (75 per cent) in the members' own currencies. The significance of the quota rested on the fact that it determined the amount a member could draw from the Fund and the member's voting rights, and, if a member was a participant in the special drawing rights (SDR) scheme, it provided the distribution key for multilaterally created international liquidity, viz. SDRs.

Quotas acquired added significance in the period covered by this volume because the members made heavy use of the Fund's resources during these years. This was a period of great uncertainty and turbulence, and, with the need for international liquidity on the increase, it witnessed a heightened distinction between conditional and unconditional liquidity; the volume of conditional liquidity was related to quotas. Quotas also became the yardstick to determine a member's SDR allocations. As a result, the quinquennial quota reviews were subject to minute scrutiny, intense debate and considerable negotiation in the twelve years that ended with 1978, with the larger industrial quota countries less inclined than earlier to contribute to IMF resources because of their own financial difficulties. The gold problem also rendered payment of gold subscription to the Fund difficult in connection with the quota increase, and studies were on to find alternative ways to mitigate this difficulty.

In the six years ended 3 December 1971, the aggregate of Fund quotas almost doubled, increasing from a little under $16 billion to nearly $27 billion. The increase brought about in its wake considerable changes in the relative position of members within the structure of quotas; it also brought about changes in the distribution of votes cast by the Executive Directors and in the constituency-wise representation on the Fund's Executive Board.

This section captures the developments that influenced the quota increases and seeks to bring out how the ensuing discussions and negotiations impinged on India's representation on the Fund's Executive Board. It all began in 1964 with talk about the need for radical changes in the world's monetary system. High-level confabulations among the 'big ten' yielded no concrete solutions, for they were still not ready at that point in time to entrust the Fund with any significant and unconditional liquidity-creating

powers. The only substantive issue that arose out of these deliberations was an increase in the IMF quotas in the wider context of international liquidity.

At the fourth quinqennial review of 1965–66, the US, the UK and the developing countries favoured a 50 per cent general increase but the Europeans were prepared to agree to only a 25 per cent increase. France, however, remained unconvinced regarding the need for increased quotas, for in its view, there was no shortage of international liquidity. From the Indian standpoint, a 50 per cent increase was the most useful option because India was interested in strengthening IMF resources, particularly since the role of the US and the UK as providers of international liquidity was dwindling and France and Germany were poor substitutes. Developing countries like India, which faced special balance of payments problems, regarded strengthening of IMF resources as the most beneficial option.

In a note jointly prepared by C.S. Krishnamoorti, Joint Secretary, Ministry of Finance, and V.G. Pendharkar of the Reserve Bank of India, it was emphasized that India's interest lay in safeguarding its permanent seat, which could be in jeopardy if the selective quota increases were large. At that point of time, India had the lowest quota of the permanent five—US$600 million. India's fear was that if the general increase was small, there was every possibility that Italy, Canada or Japan, who were fast-growing economies, would battle for large selective increases, and, if this happened, India would be dislodged from its permanent position. The note urged that, to circumvent such an eventuality, the best course would be for the Indian Executive Director at the Fund to plug for a substantial general increase in quotas, with suitable limits for gold payment and a modest selective increase (bearing in mind that the *inter se* position organizationally did not get affected); and, finally, if support for the large general increase was not forthcoming, then, to press for a selective increase for India, on the ground that in terms of strains and short-term liquidity problems relating to development and trade accounts, India too should be considered for a selective increase.

If none of these alternatives seemed probable, then a last-ditch effort to protect India's permanent seat would be to press for an increase by, say, four to five in the total number of permanent seats through an amendment of the charter. Apprehensive that larger selective increases would be given to Canada, the Federal Republic of Germany and Japan to reflect their faster growing trade and economic strength relative to that of other members, as in the earlier 1959 quota revision exercise, and aware that prestige conside-

rations would weigh with the fast-growing economies to press for permanent seats, the Indian authorities wanted to forestall the situation by mooting four to five additional permanent seats. Although this would safeguard its permanent membership, such an outcome, India was well aware, was a remote possibility, as it would reduce the excessive Anglo-Saxon influence the UK and the US wielded in the IMF and which those two powers would hawkishly want to protect.[19]

Anticipating that the Tokyo annual IMF meeting would call upon the Fund's Executive Board to study the question of general and selective quota increases, the Reserve Bank advised the Indian government that 'strategically India should make her voice heard before Tokyo', so that no consensus was privately arrived at between the western powers to unseat India, and to informally let the US, the UK, Canada, Germany and France know India's very strong views on the organizational aspect of this exercise. The RBI's brief was insistent that high-level diplomatic manoeuvres should begin right away, so that India's views were not discounted as last-minute fears. It also suggested special follow-through discussions at the Commonwealth Finance Ministers' conference at Kuala Lumpur. As part of the strategy, the Indian Ambassador to the US was to call on the Managing Director of the Fund and the Treasury Secretary of the US to seek their support.

Initial studies conducted by the staff recommended a general quota increase *of 58 per cent* but in the final analysis this was scaled down to 25 per cent, at the insistence of the G-10 industrialized countries. After an intensive debate on mitigating the impact on the developing countries of the gold payment portion of the quota increase, it was finally agreed that members with low reserves could avail of Article III4(a). Although India had pushed for the mitigation option in the debate, on the advice of RBI Governor Bhattacharyya, it did not avail of the option and instead went for outright payment of gold with a view to strengthen its position as a nominated 'first five' member, as well as to aid its 'tranche position'. In this way, India scored a tactical victory by appearing as a spokesperson for weaker countries. A compromise solution was finally hammered out that offered relief through the technique of special drawings, which would not take the borrower into a higher credit tranche.

The fourth quinquennial review of quotas resulted in another round of general increase in quotas of 25 per cent, plus a special selective increase

[19] The relative positions with an increase of five permanent seats would be as follows: USA 4125, Canada 550, West Germany 787.5, Japan 500, India 600, UK 1950, China 550, France 787.5, Italy 500, Australia 400.

for sixteen members, raising the total quotas to $19.411 billion as on 30 April 1966. India managed to retain its fifth position and the right to nominate its Executive Director by a wafer-thin margin, mainly because Canada and Japan were persuaded not to press for the entire increase determined on the basis of their calculated quotas. This was primarily the outcome of India's lobbying that the formula for quota determination was heavily biased in favour of the developed nations.

It may be of interest to note that the question of India's position in the Board of Directors in relation to the quota revision was considered way back in 1958, to accommodate Germany's and Japan's demand for a revision of their quotas. The special increase then provided to Germany had raised its quota to $787.5 million and placed it among the 'big five'. India agreed to the special quota increase of Germany, provided China's quota was frozen at the then existing level of $550 million. Through this fiat, India was able to retain its right to appoint an Executive Director. Prime Minister Jawaharlal Nehru observed in 1958, 'I am particularly interested in India retaining a permanent seat on the Board of the Fund, and, sternly reprimanded the lobby that had complacently argued that 'no serious harm will be done' if India ceased to be a permanent member, for the sheer size of India's quota was so large that it would have no difficulty in getting elected regularly on the Board. Nehru sharply retorted that he 'entirely disagreed with this weak attitude. It was essential that India should have a permanent seat and if deprived, it would be an insult, not only to us but to Asia.' After all the fuss of holding the last annual Fund–Bank meeting for the first time in a developing country, it would be amazing if India was deprived of a permanent seat. He was reluctant to take Taiwan into consideration. In no uncertain terms, Nehru insisted that it should be made clear that India cannot compromise on this issue. The expression of these sentiments resulted in the Canadian authorities refraining from pressing their demand for a nominated seat for well over a decade after 1958, as they did not wish to offend India's susceptibilities. Besides, Canada did not wish to find itself unable to join with Ireland and Jamaica, which countries it would have had to drop if it became entitled to an appointed seat.

The fifth general review of quotas was due for completion by end-December 1970. However, in view of the prospective activation of the SDR and realizing that the fifth review was likely to raise some intractable issues, the Board decided to advance the review with an informal exchange of views to mid-1969. From the interaction between the Executive Directors, it was evident that interest in the fifth general review would be intense and that some hard bargaining was in store about issues such as: should more ade-

quate consideration be given to economic factors, and should the emphasis be on general or selective increase?

The mid-sixties had witnessed a rapid increase in world trade and shortage of international liquidity. The developing country Directors were plugging for a large general increase in the range of 25 to 50 per cent. Madan (India) and Kaflka (Brazil) contended that the world's need for liquidity—conditional and unconditional—had increased, and that the Fund should keep pace with the growing world economy. They were influenced in their reasoning by the large selective increases that would become available to a number of developed industrial countries. They saw clear danger in a trend that would affect the structure of Fund quotas in terms of reducing the share of the developing countries. In the subsequent quota revision discussions, Madan, on the instructions of I.G. Patel, kept hammering the point that the proposals under consideration placed weight in favour of the industrialized countries and away from the less developed countries. Already, two-thirds of the voting power was vested in the developed countries, and 86 developing countries held just one-third of the voting power and share in SDRs. This would be reduced further in the new pattern of quota increases and there was need to prevent such slippage of the voting power of the developing countries. Furthermore, linking SDRs with quotas and changing the latter in a way that might reduce the weightage of developing countries in decision-making would be a retrograde act, not conducive to international cooperation. If the present situation was not to be aggravated, some rectification by way of a link between SDR creation and assistance for development should find place in the scheme of things.

On the other hand, Directors representing the industrial countries were for a much smaller general increase with selective increases of a similar size; one extreme position was to limit the entire increase in quotas to selective increases. With such radically contrasting views and no consensus in sight, the chairman of the deputies of the Group of Ten, Ossola, obtained the support of the G-10 for an overall increase of 30 per cent, plus or minus 3 per cent. This figure was subsequently endorsed by the Ministerial group of the G-10 and communicated to the Executive Board by the European Executive Directors as a compromise, with the upper limit of 33 per cent regarded as non-negotiable. Some of the developing country Directors articulated their annoyance and displeasure by saying that the IMF Board ought not to be faced with non-negotiable issues.

To assist the Board to come to a decision, the IMF staff provided several permutations and combinations, ranging from a 25 per cent general increase and the balance selective, to a 20 per cent general increase and

$4.5 billion in selective increases. The US, the UK and Germany indicated that they would refrain from taking up their full potential quotas, while no quota was calculated for China—even so, the total exceeded the 33 per cent limit. The idea of a differential general quota increase by country groupings was suggested but the idea failed to get support as the majority of the Directors rejected the differential principle on the ground that it smacked of discrimination.

While the search for a solution continued, the outcome of the Canadian proposal, which was played out on the sidelines, needs to be documented, as it was of direct relevance for India. Even before the 1970 quota negotiations started in right earnest, in 1968, Canada informally sounded out its Executive Director, Hansfield Jones, on a proposal to abolish the distinction between appointed and elected Directors. At that time, India's quota was $750 million, Canada's $740 million and Japan's $725 million. Canada was not entitled to an appointed Director and was keen on securing the right to do so by getting its quota raised. While communicating Canada's proposal to I.G. Patel, Special Secretary, Economic Affairs, Madan, the Indian Executive Director at the Fund, also stated that Canada had made it plain that 'this time it could not withhold its claim to a larger quota than India's and was therefore initiating the proposal to overcome that difficulty'. According to Madan, informal soundings showed that Japan and the EEC were strongly in favour of the proposal. The US was not willing to reveal its card but hinted that Canada was keen to continue to represent other countries. Presumably such a procedure would also do away with the reserved seats for Latin American countries. The Canadian argument was that such a procedure would be ostensibly more democratic.

Madan's evaluation too was that it would be most sensible way of handling the problem, for it would be difficult for India to resist any longer the demand for a special increase in Canada's quota. Secondly, it was unlikely that a proposal to increase the number of appointed Directors would have the required support. Thirdly, with an all-elected Board, India could represent other smaller countries, which it was precluded from doing as a nominated Director. Fourthly, the pressure for higher quotas emanated on account of US balance of payments deficits and the Fund's need for more reserve currencies of strong countries. Madan's assessment was that 'India's election was an arithmetical certainty.' The Canadian proposal was examined in depth by the Reserve Bank and it agreed with Madan that instead of seeking an enlargement of the number of permanent Directors, it would be better to abolish altogether that class of Directors. While there was a contrary view in the Economic Affairs Department, according to a noting by

Governor L.K. Jha, I.G. Patel, with whom he discussed the subject, seemed to agree with the RBI view. But he had sought clarifications on two counts: first, if permanent Directors were done away with, what were the chances of India retaining a seat without reliance on anybody else's support, since such support may not be forthcoming and may be conditional on reciprocal support from India in subsequent years; second, what would be the repercussions of the change in India's position on the World Bank.

Jha requested Deputy Governor Anjaria to give thought to the issues raised by Patel. After a detailed examination of the issues by Pinto of the Research Department, Anjaria confirmed that a move to abolish the appointed category in the Fund would evoke a similar move in the Bank. What was not acceptable to India in the Canadian proposal, however, was the Canadian desire to continue to have within its fold, the three countries it currently represented. This was untenable; Anjaria was averse to giving large quota countries a position from which to corner more votes from the 'aligned' countries. Pinto's note suggested regional distribution of seats and gave hypothetical calculations to show that regional distribution would be an elegant way for India to retain its seat without assistance from any country. Anjaria suggested that, for a while, India should argue for geographical representation, expounding the dangers of making the Fund a replica of economic power distribution. However, it was realized by all that it would not be possible to retain India's seat on the basis of its own vote, and, sooner rather than later, it would be necessary to seek the votes of two or three other countries.

In the late 1960s, during the discussion on the 'Programme of Work', Madan took the opportunity to make a reference to the relevance of population in future quota formulae from the point of view of the developing countries. The Board's and staff's attention was drawn to the following pertinent points: the developing countries' ratio of population to that of developed countries was less than 3:1, whereas the aggregate of their quotas in relation to the total of developed countries was not much above 1:3. He underlined that the individual was the unit for production and consumption and the hub of all economic activity, and that the relative size of a country's population was a factor to be reckoned with in any quota formula. Madan further suggested that the debt servicing burden should also figure as a factor in the quota formula. While Directors from the developed countries were averse to reopening the quota formula, the developing countries commended Madan's suggestions for consideration by the IMF staff.

But the more difficult and contentious question related to the size and structure of the Executive Board. One or two of the Directors were in favour

of a staff paper that would cover many issues, apart from size, like the question of basic votes, reservation of seats for the Latins, appointment of Executive Directors, reorganization of the Board on a geographical basis, etc. The heavyweights on the Board were reluctant to open up what they felt was a Pandora's box, for the subject by its very nature was one that ran up against entrenched positions and would stir strong reactions. On the issue of an increase in the number of basic votes, the Indian view was that the proposal need not be revived. On the reservation of (three) seats on the Board for the Latins, two possibilities were raised: (i) of doing away with the reservation altogether; (ii) of extending the reservation to other continents. Although the first solution was technically an easier one, no one was willing to dislodge the Latins from their pedestal of privilege, as they had thrived under the protective wing and preferred treatment of the largest Fund member. No one was willing to upset the historical nature of this relationship. On the appointment of Executive Directors, although regarded as a non-democratic feature borrowed from the United Nations constitution, any change in this, it was apparent, would get bogged in the quagmire of Capitol Hill. The majority view appeared to be that even if India was dislodged from the appointed position, standing at the head of the elected category was sufficient assurance, and, therefore, the abolition of appointed Directors was not favoured. On reorganization along geographical lines, the problem seemed to assume staggering dimensions in the eyes of many and the natural inclination was to shy away from such an exercise. The admirable analysis given by Madan greatly facilitated the task of both I.G. Patel and L.K. Jha to come to grips with this problem.

Again, in mid-1971, in a somewhat desultory informal discussion on the size and structure of the Executive Board, the idea of doing away with the category of appointed Directors and fixing a rigid minimum of votes for all Directors was brought up, but enthusiasm for the idea was distinctly lacking. Other matters discussed related to: (i) the implications of mini states joining the Fund for the structure of the Board; (ii) the feasibility of adopting a geographic or regional basis for selection; (iii) the problem of basic votes; (iv) additional assistance to Directors representing a large number of countries; and (v) new election rules for the nominees of large groups of members.

In preparation for this discussion, at the initiative of P.S.N. Prasad, the Indian Executive Director who succeeded Madan, the developing country Directors met to evolve a common strategy, keeping in mind the diversity of interests that existed among the various groups. After two long sessions, a common statement was agreed upon. Prasad and Kafka (of Brazil) were

instrumental in helping to formulate the statement, the substantive part of which was that the endeavour of the quota revision exercise should be to at least stabilize 'the present equilibrium', as Kafka put it, and 'the present weight and distribution', as Prasad described it. In concrete terms, this meant preserving the three Latin and two African seats and not less than three seats for Asia, which meant creating one more seat for Asia and by enlarging the size of the Board to twenty-one. This formula had the endorsement of the developing countries.

At the informal Board meeting, the developed countries opposed expansion of the Board and also groupings on regional considerations. Prasad pointed out that the original Bretton Woods design had provided for India and China to each have an appointed seat and that that had ensured fair representation of the developing countries, which was later eroded. As a result, 91 developing countries today carried 32 per cent of total votes, while twenty-six developed countries exercised over 67 per cent of votes. The present weightage was thus heavily skewed in favour of the developed countries and came in the way of efficient working of the Fund. This could partially be corrected by adding one more seat on the Board which could be occupied by countries now floating in Southeast Asia and elsewhere. The upshot of the discussion was a mandate by the Board—not terribly specific or clear—to prepare a resolution reflecting the views expressed by the members.

On the issue of mini states, there was agreement that a decision was inevitable but that, in no way should it entail enlarging the size of the Board. There were no takers for an increase in basic votes. On the subject of amending the election rules, the consensus was that there was no need. In the light of this discussion, Prasad advised the Indian authorities that the only practical way of handling the quota increase issue, as far as India was concerned, was to seek out and cultivate countries like Ceylon and Burma or Afghanistan and, if that was not possible, Mauritius and Fiji could be aimed for. He was doubtful of Burma joining the Indian constituency, as the Thais were known to have been aggressively cultivating them for some time. In Prasad's assessment, a Fijian partnership was a possibility, for Fiji was disenchanted with Australia after the latter withdrew from a large sugar venture; Prasad hinted that if India made appropriate overtures to assist Fiji in the running of that project, it may prove fruitful. This showed that certain amount of 'horse-trading and behind-the-scenes' manoeuvrings were necessary in the quota revision exercises.

To revert to the fifth quota general review, the question again surfaced as to whether the burden of the members' gold payments to the Fund should

be alleviated and, if so, how? The possibility of using SDRs for gold in this connection had been ruled out earlier, at the Stockholm meeting in March 1968, by the G-10 Governors. On this occasion, it was decided to exercise the discretion given to the Fund by Article III Section 4(a) to reduce the proportion of quota payable in gold, depending on the member's monetary reserves in relation to the increased quota to which the member had consented. Although mitigation techniques for payment of the gold portion of quotas had been considered on two occasions, the Executive Board had rejected the proposals on both occasions. At the fifth general review, although total waiver of gold payment was not agreed to, the Executive Board conceded to invocation of Article III Section 4(a), requiring a member to undertake to repurchase the excess holdings of the member's currency in five annual instalments.

In a brief memorandum to the Central Board of the Reserve Bank on the outcome of the fifth review, the Deputy Governor stated that it had given India an increase of US$190 million, raising India's quota in the Fund from $750 million to $940 million, and that India had communicated its consent to the increase on 30 November 1970. As in the past, special increases in addition to general increases were offered to some members, in recognition of their relative strengths. The memorandum further pointed out that special increases had resulted in India ceasing to have the fifth largest quota in the Fund, as, under the Articles, only the five largest quota holders were entitled to permanent seats on the Board; India would lose its appointed seat at the next election in 1972. Between the fourth and the fifth quota revision exercises, India had slipped from the fifth to the eighth position,[20] and although it would have an assured elected seat, India would need to seek out other friendly partners to join its constituency.

A supplementary grant covering the additional subscription was voted by the Parliament and non-negotiable non-interest-bearing rupee securities worth $142 million were handed over to the Fund. The Reserve Bank's gold was not to be used and gold subscription of the value of $47.5 million would be paid out of the non-monetary gold stocks held by the government. The implication of the new quota increase, it was explained, would enable India to meet balance of payments deficits subject to Fund's usual requirements. As SDRs were allocated on the basis of quotas, and the second allocation was due to be made on 1 January 1971, payment of additional subscription before the end of 1970 had made India eligible to the second SDR allocation on the basis of a higher quota.

[20] Japan, Canada and Italy having bagged the fifth, sixth and seventh positions.

Towards the end of 1970, it was further decided, as on the previous occasion, to purchase $30 million worth of gold at the IMF parity from the Federal Reserve in New York and to send the same through Air India to Bombay, the intention being that the gold received would go towards replenishing the non-monetary stocks utilized for payment of India's gold subscription to the Fund. Madan at the IMF and Seshadri at the RBI were instructed by S.V. Ramakrishna, Director, Ministry of Finance, to coordinate the transaction regarding purchase of the gold, its insurance from vault to vault and transport by Air India, and to charge the Reserve Bank for all expenses incurred.

Following the increase in IMF quotas under the fifth general review to $940 million—which took effect in December 1970—the IMF's financial position strengthened marginally in 1972. This strengthening occurred through both the increase in quotas and the steady increase in membership. The increase, however, turned out to be inadequate with the sudden and precipitous increase in oil prices and the turbulent global exchange rate scenario of the early 1970s. The demands for IMF financial support increased and these were met through the creation of the oil facility and borrowing arrangements made with some of the surplus industrial and oil producing countries.

Wittaveen, the new Dutch Managing Director of the IMF, noted for his skill and energy, quickly perceived the need for a further increase in quotas in order to strengthen the Fund's liquidity. Aware of the time taken on the earlier occasion to come to a decision and of the 1969 requirement through the amended Articles that the general review of quotas was to take place at intervals of not more than five years, he initiated the sixth general review in early 1974, so that the review could be completed before February 1975. Wittaveen realized the unexpected impact the oil crisis would have on the non-oil producing countries, the growing danger of marginalization faced by the most vulnerable non-oil producing developing countries, and the need to resolve the oil crisis through the establishment of the oil facility, by borrowing from the oil economies and the creation of the extended fund facility which would help these countries overcome their balance of payments deficits. Accordingly the Committee of the Whole, comprising of all the Executive Directors, with the Managing Director as the chairman, was constituted a year in advance, to decide on the size of the total increase of quotas, its distribution and the mode of discharging the increased subscriptions that would become payable upon the increase. It was generally understood that there would be a spurt in the demand for the Fund's resources and hence the quota increase would have to be sizeable.

Another issue that needed to be settled was how the gold portion of the subscriptions should be paid—in SDRs, foreign exchange or in the member's own currency—and, arising therefrom, the legal status of the gold subscription. The whole exercise bristled with numerous difficulties. Based on the broad general directives of the January 1974 communique of the Interim Committee, the Fund staff presented illustrative quota calculations based on various assumptions. At the very first meeting of the Committee of the Whole on review of quotas, it was evident that there were wide-ranging views. The nine developing countries' Directors unanimously favoured an increase in the region of 70–100 per cent, as recommended by the Managing Director. Knowing that substantial increases in the voting power of the oil exporting countries and the Indonesian group were in the offing, the developing country members demanded that the collective share of the non-oil countries should on no account be reduced to accommodate the larger share of the major oil exporters. Prasad, supported by one or two others, rightly pointed out that the proportion of the developing countries' quotas in total Fund quotas had remained more or less stagnant since Bretton Woods, but, taking into account the fact that allocation of SDRs would depend on the quotas, it was more important now than ever before, that the industrial and other primary producing countries were agreeable to bear the brunt of the decline needed to accommodate the increases in the share of oil producers.

At the other end of the spectrum, diametrically opposite views were expressed by the industrial country Directors, notably the German Director, who opted for no or a small increase, and harped on the inflationary character of a large increase. The US position was in favour of a very small general increase, buttressed by the argument that balance of payments financing needs could be met by recourse to private banks. Some of the European Community Directors took a middle position. Complicating the issue was the US demand that it would not stand for any reduction in its existing share. The US quota was 22.5 per cent of the total which gave them 20.80 per cent of the voting power in the Fund. Its main concern was to protect the possible erosion of its veto power. With the growth in Fund membership, and the probability of China soon rejoining the Fund with an enlarged quota, the US was perceptive enough to realize that the relative share of the US quota would be reduced. The US officials hinted that the lowering of US voting power to below 20 per cent would be counter-productive, as it would weaken the US commitment to the Fund and such a development would prove contrary to the interests of the Fund itself. The firing of this salvo by the US was yet another factor that narrowed the scope

for the manoeuvring needed to settle the conflicting claims made by the twenty members.

Such contrasting views made the task of arriving at a consensus that much more difficult and the greater part of 1974 was spent in discussions on these issues. As time was running out and with no solution in sight, the Interim Committee, in January 1975, reached an understanding on some of the aspects that would guide the deliberations of the sixth review of quotas. There was agreement that the Fund quotas would be increased by 32.5 per cent[21]—an increase of SDR 10 billion. This was much below the increase favoured by the Directors from the developing countries and the Managing Director but their disappointment was moderated by the agreement that the seventh review would commence immediately, and that the seventh quota increase—'a fairly sizeable increase'—would become operational in three instead of five years. The Netherlands chair argued that, on balance, there was a need for increase in conditional liquidity and that it would not impact on total liquidity. At the other extreme, the French Director argued for revaluation of gold at higher prices, which would obviate the need for a large quota increase.

Prasad, the Indian Executive Director, apprised Finance Minister C. Subramaniam of the possible implications that the new configuration of quota distribution could have on India, based on some preliminary calculations made by his office.

His analysis was as follows. (1) The five largest quota holders and the Latin Americans would have eight seats amongst them, leaving twelve seats for the remaining members (2) The substantial increase in voting power of the oil exporting group would enable the Middle Eastern countries, together with the Indonesian group, to have four seats instead of the three they were then holding and it was for them, based on certain assumptions to obtain a significantly larger voting power for each of these four seats than what the Indian constituents would be able to have. (3) The Nordic and the Canadian group would continue to retain their present seats, while the other European countries, with the assistance of South Africa, could form four instead of three groups. The constituency that could have difficulty in retaining its seat was the Australian group. They may decide to throw in their lot with the other European group, and if they did that, it was possible for all four European seats to have more votes each than the Indian group. This would leave two seats to be shared among the Africans and Indians. Should the Africans press for guaranteed seats, like the Latins, then India

[21] Rounded to SDR 39 billion.

would be in difficulty. In the past, there had been an unwritten understanding that the two African seats would be maintained and there was a move to exercise that guarantee. No doubt the situation was fluid and could evolve differently. Prasad therefore, advised the Indian government to press for a twenty-first seat on the Board, and also to consider other possible alignments, like joining hands with Australia or with radical oil countries like Libya, Iran or UAE, or other developing countries in the neighbourhood like Nepal, Burma or Afghanistan. Later, during a visit to India, Prasad called on the Finance Minister and, in the presence of Governor Jagannathan, clarified that there may be no threat to the Indian seat in 1976 but one could develop in 1978—in short, he alerted the authorities to weigh their options carefully and evolve a strategy that would be both practical and desirable.

There was an unusual flurry of behind-the-scenes activity, particularly confabulations between the IMF staff, the industrial country Directors and the Managing Director, to arrive at a consensus. Apart from, numbers, there were, on this occasion, other technical points for debate. For instance, the Resolution of Understandings reached at the second meeting of the Interim Committee in Washington read: 'There was a consensus that because an important purpose of increases in quotas was strengthening the Fund's liquidity, arrangements should be made under which all holdings of currency would be usable in accordance with its policies.' Prasad was quick to perceive the implications of this. He queried whether it meant all members would accept convertible currency obligations, even if the currency was an Article XIV currency, making it convertible in fact. This, he pointed out, would pose grave difficulties for countries like India. Prasad, however, was assured that it was not the intention of the Fund to sell weak currencies even if the legal position was that a currency was usable.

For formulating a package of recommendations before June 1975 on quota increases and amendment of the Fund's Articles of Agreement, another issue that needed resolving was amendment of Article III Sections 4(a) and 4(b) with regard to the mode of payment for the increased subscriptions. Discussion in the Board threw up a heterogeneous set of alternatives. There were some who pressed for payment in primary reserves and leaned heavily in favour of an SDR-based system that would reinforce the Fund's liquidity and yield some income. There were others who wanted the mode of payment to be spelt out in the Articles and not left to the Board of Governors to reopen at each review. There were yet others who pitched for a flexible approach including allowing payment up to 100 per cent in local currency; but there was one Director who was vehemently opposed to this

type of flexibility and wanted everyone to pay their 'pound of flesh' in primary reserves. Ultimately, broad agreement emerged that as far as 25 per cent of the increase in subscriptions was concerned, members could have the widest available choice of media and if any member chose to pay the amount in its own currency in excess of 75 per cent of the quota, the excess holdings of member's currency would not be subject to the usual repurchase provision.

The Interim Committee meeting in Paris in mid-June 1975 noted the progress made in arriving at an agreement on principles but, despite several quota calculations put forward by the Managing Director, agreement on the final hard numbers was not forthcoming. Among the developed countries, the US was not satisfied with the size of quota allotted to it. Australia was unhappy that the ceiling of 45 per cent on special increases for developed countries should also be applicable to the developing group, some of which were receiving substantially large special increases. According to the guidelines provided by the Interim Committee, the share of 'other developing country groups' was to remain the same, at 20.85 per cent of the total, which Prasad described as unfortunate. The adjustments made to arrive at this result, Prasad argued, were 'unnatural' and 'artificial'; he voiced dissatisfaction at the manner in which so many developing countries were allotted no greater proportion of the quotas than before and insisted that in quota adjustments, some degree of 'political negotiating was inevitable'. But the fact was, several developing country constituencies had opted for a smaller general increase and there was little support for a higher general increase. Failure to put up a united front resulted in the developing country group having to yield to accepting a symbolic general increase from 20 to 20.85 per cent. Despite Prasad's insistence to give adequate weightage to other considerations, this was not seriously considered; and, so, India's quota was reduced from 3.22 per cent of the total quota to 2.94 per cent.

The month of July 1975 was spent by the groups in tinkering around with potential quota increases, and in distributing the windfall amounts that became available on Lebanon declining to pick up its offered share and the IMF staff discovering an error in the quota for Panama. Together with the rounding off of the new total quota, in all, SDR 64 million became available for distribution to the other developing countries' group. As pointed out by S. Jagannathan, who by then had taken over as Executive Director from Prasad, in a letter to M.G. Kaul, special increases were given to sixteen 'growth countries' among the other developing countries' group, of which Brazil, Mexico and Korea benefited the most. It was apparent that the increases had all gone to countries on which the USA looked with favour.

The Indian constituency came out of this marginal adjustment with Bangladesh and Sri Lanka's shares unaltered and India moving down from 2.94 to 2.72. The rounding exercise, however, did not take into account the 'China kitty' (i.e. the quota available to but not taken up by Taiwan). Against the view of the non-oil developing countries that the China kitty should be distributed among them, Wittaveen ruled that China stood, as it were, in a group by itself, and so should be excluded. He closed the matter taking shelter behind the Interim Committee guideline of January 1975. In speaking for the non-oil developing group, Jagannathan made the point that populous countries like Egypt and Pakistan were hurt by the Managing Director's new approach and that the rounding exercise should not increase disparities or bring down anyone's quota percentage.

As the time approached for the 1975 annual meeting, 111 members had agreed to the quotas offered to them but agreement on quotas for the fourteen industrial members was still wanting. This was achieved at a G-10 meeting where Finance Ministers and Central Bank Governors met, and, in a spirit of compromise, agreed to a reduction in the group's share in the total Fund quotas from 63 per cent to 59 per cent. The burden of this reduction fell on the US, whose share declined from 23 to 21 per cent and the UK, whose share moved down from 10 to 8 per cent.[22]

The sixth general review of quotas was a tedious and tortuous exercise, and took over five years to complete. It entailed, for the first time, acceptance of differential treatment of groups. For the Indian constituency, the outcome was a real disappointment, the relative positions of all three members—Bangladesh, India and Sri Lanka—having declined. Even though the resolution on an increase in the quotas by SDR 10 billion to SDR 39 billion was adopted by the Board of Governors on 22 March 1976, it took till 31 October 1978 for all the Fund members' legislatures to approve the increase.

Anticipating a delay before the new quotas became effective, Wittaveen proposed to the Board a temporary technique for increasing members' access to the Fund's resources: widening each credit tranche by one half, so that each tranche would be equivalent to 37.5 per cent of the quota instead of 25 per cent. The Fund Board was receptive to the proposal, but when it came to the size of widening of each tranche, differences surfaced. The developing countries pushed hard for larger widening, particularly of the

[22] Others similarly affected were France, Austria, Canada, Denmark, Italy and Norway. On the other hand, Belgium, Germany, Japan, the Netherlands and Sweden came out of the tricky balancing exercise with marginally increased shares.

first tranche, as that was the tranche most used by the them because of its relatively low conditionality. On the other hand, developed countries like the US and Germany were apprehensive of the new concept and its impact on the Fund's supply of useable currencies. The Managing Director, aware of the fact that the oil facility would soon come to an end, was eager to empower the Fund to allow members to draw larger sums through temporary enlargement of credit tranches. As agreement was not forthcoming, the matter was referred to the Interim Committee who upheld the arguments of the industrial members and agreed to a temporary enlargement of credit tranches from 100 per cent to 145 per cent with the tranches'[23] conditionalities remaining unchanged.

SEVENTH QUOTA REVIEW

Disappointed with the outcome of the sixth general review, which had produced a lot of heat, arguments and statistical computations but little liquidity for the Fund, Wittaveen, in mid-1977, in a buff statement, chalked out for consideration by the Board, the procedures and issues that required to be addressed for a quick and satisfactory resolution of the seventh general increase of quotas. As on the previous occasion, he advocated a substantial quota increase that would bring the size of the Fund nearer to SDR 80 billion. To cut short the debate, on this occasion, the Managing Director suggested a procedural change. There would be informal consultations with individual Executive Directors, in order to reach a consensus expeditiously, and, based on the Managing Director's informal exchange with them, a status report would be placed before the Board for submission to the Interim Committee. On the controversial selective increases issue, he indicated that a few special adjustments would be justified but did not spell out which countries would qualify for such increases. As the concept of country groupings had posed problems on the earlier occasion for a meaningful and acceptable classification of countries, and since it had introduced its own form of inflexibility in effecting quota adjustments, the Managing Director advised the Board to leave unchanged the shares of the vast majority of members and confine the special adjustments to a few countries.

The Managing Director, having secured sufficient support from the Board, began his informal consultations. On the size of the overall increase, it was apparent that agreement on a very large increase would be difficult.

[23] The overall size of each tranche was increased from 25 per cent to 36.25 per cent of the quota.

The main hurdle was the US administration's inability to take a position on this, as the Congress was still debating the proposed supplementary financing facility. On the one hand, the US, Canada and Germany favoured a modest increase of 25 to 33 per cent; on the other hand, there were a good number of members, particularly from the developing countries, that argued for a larger increase in the range of 50 to 100 per cent.

At this point of time, with the exit of Jagannathan as the Indian Executive Director at the Fund and the delay in the appointment of a new Indian Executive Director, Rasaputram, the Alternate Executive Director from Sri Lanka, who was holding charge, sought the viewpoint of the Indian authorities on a number of important issues coming up before the Board. On the proposed informal discussions with individual Directors, the RBI Governor Narasimham instructed the prospective Executive Director, S.D. Deshmukh, to advise Rasaputram on the strategy he may adopt. On the overall size of the increase, the Indian viewpoint was in favour of a moderate but not too large increase, in the range of 35 to 45 per cent and an overall increase to SDR 50–55 million. Deshmukh felt that a moderate increase would be to India's advantage, as it would give some leeway for unconditional liquidity creation. On the distribution aspect, Rasaputram was instructed to agree with the Managing Director that selective adjustments would raise difficulties and so the seventh quota exercise should be confined to a simple equi-proportional increase. The idea was to throw in India's lot with those who agreed that a large-scale realignment in relative positions was not necessary. On the suggestion of a few special adjustments, the instructions were to oppose piecemeal adjustments, which would benefit only a handful of members. This would mean identifying countries whose quotas were seriously out of line, using techniques and formulas used in the past. India was rightly opposed to the use of a formula that measured only one characteristic, viz. the economic strength of countries. This formula had succeeded in undermining the relative position of the developing countries, particularly the Indian constituency, at every round of negotiation. The time had come to break new ground and the Fund staff had to be pressed to include new variables, such as share of agriculture in national income, liquidity needs and debt service payments. In short, every effort had to be made to prevent a further slippage and, to do this, selective increase had to be shelved to the next round, by which time appropriate, need-based formulae could be evolved.

Armed with these instructions, Rasaputram, in his informal exchanges with the Managing Director, cited two factors that needed to be taken into account in settling the size of the overall increase: the supplementary credit

facility was unlikely to achieve the target of SDR 14 billion, and the third basic period for SDR creation would, in all probability, be an empty one. The other arguments for a substantial increase rested on the premise that it would help the Fund scale down its reliance on external borrowing. But those arguments weighed little with the US authorities, who argued back that the Fund officials had to recognize the ground realities confronting industrial countries in obtaining large amounts of money for the Bretton Woods institutions.

On the distribution issue, to avoid controversy, the Managing Director had proposed that the vast majority of members should get equi-proportional increases and only a few, whose quotas were seriously out-of-line with their global standing, could be considered for special increases. The eligibility criteria suggested were: (i) if a member's calculated quota by the new calculation exceeded the sixth review by a substantial margin; (ii) if a member had contributed to enhancement of the Fund's liquidity; in other words, increasing quotas that would strengthen the Fund's liquidity. The tilt of the informal exchange was evident—the majority favoured an equi-proportional increase but of modest dimensions, for fear that if it was large, it would, in turn, spark demands for special increases. India's was the lone voice battling and pleading for modification of the Bretton Woods formula but virtually with no support. The Indian authorities were decidedly opposed to piecemeal adjustments that would benefit a handful of members and result in protracted wrangling over who should qualify. Contribution to the Fund's liquidity was strongly supported by Germany, Japan and the oil producing countries. The informal meetings sent out strong signals as to which way the wind was blowing. They further indicated that till the US decided on the size of the increase, no agreement would be forthcoming.

As there was little progress, the informal discussions were halted and the IMF staff reverted to the tedious task of calculating quotas by measuring the extent of out-of-lineness.[24] The computation showed nine major oil producing countries as having the largest excesses. India, Bangladesh and Sri Lanka figured in the lowest excess category. The results naturally provoked intense debate on the formula underlying the computation. The non-oil developing members came out rather poorly—and their relative share came down substantially. The bigger and more intractable issue was

[24] It involved measuring the excess of a member's calculated quota over its actual quota. This excess was expressed not in absolute amounts but as a percentage of the quota agreed upon in the sixth review.

the extent to which the excess of a member's calculated quota over its actual quota should determine the eligibility for a selective increase. While the major oil producers, supported by Japan, pushed for the use of calculated quotas to determine selective quota increases, the USA, the UK and several others favoured equi-proportional increases in the region of 25–30 per cent with few a selective quota increases. There was considerable opposition to giving selective increases to Japan and Germany. These countries were seen by many of the industrial countries as aggravating the balance of payments adjustment by refusing to adjust their large balance of payments surpluses. Rewarding them, therefore, seemed unjustified. The question of the form in which the additional subscriptions had to be paid also needed to be considered. The diversity of views that surfaced made agreement before the meeting of the Interim Committee in Mexico in April 1978 well-nigh impossible. All around, disappointment was evident that after one-and-a half years of discussion, no agreement was in sight.

Meanwhile, Wittaveen left and it fell to the lot of the new Managing Director, de la Rosiere, to iron out the wrinkles and present a proposal before the 1978 annual meeting.

Through an aide memoire, de la Rosiere put forward a proposal in the hope of finding a solution. He recommended a 50 per cent general quota increase (SDR 19.5 billion) as the minimum required to restore a reasonable relationship between the size of the Fund and the balance of payments financing needs of all the members over the next five years. He further suggested that an understanding could be reached that there will be no general adjustment in quotas for the next five years. This was a clear concession to the firm stand taken by the US and some developed countries. On the other hand, he suggested selective increases to eleven developing countries whose calculated quotas exceeded by four times the actual quotas.[25]

While forwarding the Managing Director's aide memoire, Deshmukh advised the RBI Governor that the 50 per cent increase in quotas seemed a reasonable compromise and that, since selective increases were given to eleven developing countries, India should go along with the proposal—particularly because, even with the selective increases, the voting strength of the developing countries would reflect a decline from 37.9 per cent under the sixth quota review to 36.8 per cent under the proposed seventh quota increase. In the first, rather brief round to consider the aide memoire,

[25] The selective increases would go to Iran, Saudi Arabia, Kuwait, Libya, Korea, Iraq, Singapore, the UAE, Qatar, Oman and Lebanon. The selective increases would not exceed SDR 388 million, derived as the sum of the China (SDR 275 million) and Cambodia kitties.

there was little thawing of entrenched positions. The US Director harped on the point that the Fund's liquidity position had improved and that it had useable currencies. Also, the supplementary credit facility would soon be activated and with a weak demand for resources the need for a quota increase was not evident. Germany, too, questioned the need for a 50 per cent increase and considered 25–30 per cent adequate for the next five years, while the Japanese chair was not convinced that an airtight case had been made for a 50 per cent increase in quotas. On selective increases, there was considerable support for the Managing Director's proposal, except for Brazil, who vehemently opposed selectivity, as also linking the size of the share of each country to the credit extended by that country.

The US wanted the entire process to be delayed by a few months on account of the serious domestic and international problems facing the US economy; the US administration was reluctant to support measures that would force confrontation with the Congress. As US support was crucial for any proposal on quota increase, the prospects of positive agreement emerging on SDR allocation or quota increase appeared remote.

Deshmukh apprised RBI Governor I.G. Patel and Economic Secretary Manmohan Singh on the ramifications of the Managing Director's proposal to link the size of the share of each qualifying country to the credit extended by that country to the Fund. This, as mentioned, was strongly opposed by the South American constituency, which insisted that only acceptable way of distributing the available SDR 388 million was to divide it on a pro-rata basis among all developing countries, regardless of how thinly the margarine would be spread. The Latin fear was that, as Saudi Arabia and other Arab states required only a few thousand votes to bag a total of three seats in the Fund Board, the fall-out of such a development could be either one Latin American or one African country being unseated. To prevent this from happening, the Latin American Director called on the Indian Director to seek his support.

Knowing that both the Reserve Bank of India and the government were opposed to selective increases and taking into account the political configurations and sensitivities, Deshmukh suggested abstention rather than a negative vote as tactically the more appropriate option, and sought the approval of his authorities. While agreeing with the line of action suggested, the Reserve Bank advised the Executive Director to forcefully reiterate the position taken by the RBI Governor at Mexico City, that the criteria used by the Fund in quota calculations needed a thorough review and that additional factors needed to be taken into the calculations. In order that such a review did not delay the seventh review, the Governor had urged that the

exercise could be taken up after completion of the seventh review. The Governor had also severely criticized the practice in the Fund of making calculations of absolute levels of individual member quotas on the occasion of every increase in the size of the Fund, as if there was a clean slate to write on every time. Deshmukh was further instructed to state that calculations of the kind attempted by the Fund so far should not be resorted to in connection with special increases.

The Executive Directors held further discussions on the seventh general review of quotas but, although a certain convergence of views was in evidence, complete agreement was not forthcoming. The outcome that was forwarded to the Interim Committee by the Executive Directors once again reflected differences. To the surprise of many, the Interim Committee, which met in Washington just before the 1978 annual meeting, gave its assent to a 50 per cent general increase for all members except China and Democratic Kampuchea; agreed on selective increases for eleven developing members; and indicated that 25 per cent of the increase in quotas was payable in SDRs for participants in the SDR department, while a non-participant was required to pay 25 per cent in the currencies of other members but as specified by the Fund. Regarding distribution of the special quota increases, the impression was that a consensus had been reached at a closed session of the Interim Committee. But at a later meeting of the Board, the Managing Director explained that the Interim Committee did not get the opportunity to address the issue of alternative forms of distribution, as presented by the staff in Tables I and II, and the issue was open and needed to be decided by the Board. While Italy, Australia, Argentina, France, the African group of countries and India favoured Table I and were opposed to Table II, which sought to correlate the quantum of credit provided by a member to the Fund to the quantum of the special increase, the USA, UK, Canada and Indonesia supported Table II. According to a reliable source, only Table II was circulated to the Interim Committee and this was strongly criticized by the countries opposed to increases on the basis of Table II; in fact, the Managing Director was at pains to emphasize the complete innocence of the staff and management in handling this matter at the Interim Committee, and said that Table II reflected the feeling of the Board at an earlier meeting. He discounted the allegations made that the distribution of Table II at the meeting would have influenced the views of the big powers and, to appease ruffled feathers, assured that it would not be made a precedent for subsequent reviews.

The final report of the Executive Directors was submitted to the Board of Governors on 11 October 1978. Communicating the despatch of the

report and outlining the drill to be followed by a member consenting to an increase in the quota, the Indian Executive Director invited the attention of Governor Patel and Finance Secretary Manmohan Singh to the reference in the report that, 'in the context of the Eighth General Review of Quotas, the Executive Board will examine the quota shares of members with a view to adjusting the shares to better reflect members' relative economic and financial positions in the world economy'. This formulation was inserted to satisfy countries which were disappointed with the small special increases agreed to in the seventh review, and Deshmukh suggested adopting a low posture in this regard.

After two years of intensive discussion, the resolution on the seventh general review of quotas was adopted by the Board of Governors on 11 December 1978. All that remained was to have the consent of individual members to the quota proposed for them. This too was long in coming, principally because the United States, the single largest quota contributor, had not completed legislative action and not notified the Fund of its acceptance of its quota increase. With the passage of each quota review it became increasingly apparent that expansion of the Fund's resources through increases in quotas was a politically difficult exercise, subject to non-economic pulls and pressures.

As a result of the seventh quota review, Fund quotas, which added up to $9 billion at the start, came up to a level of SDR 61 billion as on 1 January 1981, while the total membership increased from thirty-nine countries at the start of the IMF to 146. To sum up, quota increases during the 1970s threw up two issues concerning the structure of Fund quotas: the relative position of individual members and the relative position of the developing members as a group. The sixth and seventh general reviews effected profound changes in the structure of quotas. The revision of quotas placed Germany, Italy, Japan, Canada, Mexico, Iran, Iraq and Korea at a higher ranking among member countries by upward revision, not only of absolute amounts, but of shares in the total quotas of all countries. On the other hand, the quotas of countries like the USA, the UK, Australia and India declined in terms of percentages of the total quotas of all countries.

India lost its nominated seat and had to settle for an elected seat. India's position even within the elected category was further eroded when the government of the People's Republic of China sought to re-enter the Fund in April 1980 and China's quota was raised from SDR 550 million to SDR 1.2 billion under the sixth general review and to SDR 1.8 billion under the seventh review, thereby making it the eighth largest quota country in the Fund membership.

On the second issue, namely, the relative position of developing countries, the sixth general review in 1974–75 further agreed that the relative collective share in Fund quotas of non-oil developing countries should not go down, in order to satisfy the demand coming from the oil producing countries for enlarged quotas. But the fact remained that the demand of the oil producing countries had to be accommodated and this naturally resulted in upsetting the long-standing relative quota structure of the Fund and, correspondingly, voting shares. Such changes were a reflection of political realities—apart from the financial aspect of how much funding would be available to the Fund. The seventh review of quotas recognized this situation and opened the door for a review of the customary method of calculating quotas in the eighth quota review—a demand that had been repeatedly made by India. It was now left for the eighth review to grapple with this knotty issue.

To sum up, by the early 1980s, reform of the monetary system had become an evolving process. Considerable changes that were made included the creation of new facilities that accelerated use of the Fund's resources, transformation of the surveillance process, improvements in the characteristics of SDRs, creation of the trust fund, holding of gold auctions and restitution of gold. Quota negotiations also assumed considerable significance during the period. It was a challenging era, no doubt marked by frustrations and disappointments, but behind the façade of nationalist attitudes lurked the desire for international cooperation. That spirit needed further energizing in the years to come.