096969

76-0339

C.2 096969

UNITED STATES
GENERAL ACCOUNTING OFFICE
JUL 15 1975
LIBRARY SYSTEM

U.S. GENERAL ACCOUNTING OFFICE
STAFF PAPER

LM096969

CONSIDERATIONS ON INCREASED QUOTAS FOR THE INTERNATIONAL MONETARY FUND

Department of the Treasury

ID-75-78

JULY 15, 1975

702397 096969

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	Quota increases	1
2	EVOLUTION OF INTERNATIONAL MONETARY SYSTEM	5
	Creation and purposes of IMF	5
	IMF record through 1970	6
	Breakdown of international monetary system	7
	Movement toward reform	8
	Oil price increases	10
3	NEED FOR A QUOTA INCREASE	12
	Appropriateness and size	12
	Distribution	16

ABBREVIATIONS

IMF	International Monetary Fund
SDRs	Special Drawing Rights
GNP	gross national product
OECD	Organization for Economic Cooperation and Development

GENERAL ACCOUNTING OFFICE
STAFF PAPER

CONSIDERATIONS ON INCREASED QUOTAS FOR THE INTERNATIONAL MONETARY FUND
Department of the Treasury

D I G E S T

PROPOSED QUOTA INCREASE

The member countries of the International Monetary Fund are considering expanding quotas, their subscriptions to the Fund, and the main source of its loan funds. The Fund's Interim Committee, responsible for advising the Fund on the international monetary system, recommended, subject to agreement on amending the Fund's Articles of Agreement, that quotas be increased by approximately one-third. It also recommended that the quota share of the major oil-exporting countries be doubled (from 5 to 10 percent) and that the quota share of other developing countries not fall below its present level (about 21 percent).

Under the first recommendation, total quotas would increase from about $36 billion to about $48 billion. The U.S. quota would increase from about $8 billion to about $11 billion, assuming it was raised proportionately. Congressional approval is required for any increase in the U.S. quota.

APPROPRIATENESS AND SIZE OF QUOTA INCREASE

The Treasury supports the quota recommendations of the Interim Committee, provided agreement is reached on a series of amendments to the Fund's Articles of Agreement and on the distribution of individual country quotas, including maintenance of the present U.S. voting share. The Fund should be the "first and central track" in dealing with oil-induced international financial strains and should continue to play the central role in providing multilateral financing for balance-of-payments needs. The Treasury has also stated it does not favor financial "recycling" plans which are independent of measures to help reduce the price of oil.

Tear Sheet. Upon removal, the report cover date should be noted hereon.

Yet IMF financing is not tied to measures to help reduce the price of oil.

IMF credit is made conditional on borrowers' undertaking economic and financial programs to improve their balance of payments without requiring that they directly reduce their dependence on oil imports. To the extent that borrowers improve their payments positions through this type of "conditionality," it will have to be mainly at the expense of deteriorations in the payments positions of other oil-importing countries. At least over the next several years, the ability of the oil-exporting countries as a group to absorb imports will be limited.

The Treasury believes that the Fund's conditionality is appropriate for achieving satisfactory payments relationships among oil-importing countries as well as between the oil-importing and oil-exporting countries. (See p. 13.)

The adoption of floating for the world's major currencies has undoubtedly eased the impact of current large payments imbalances. However, the Fund's conditionality has remained unchanged; besides not dealing directly with the oil price increase, it is still asymmetrical. Member countries that obtain Fund credit must adopt corrective measures, but countries with strong payments positions which would not obtain Fund credit are not required to take measures to reduce their surpluses. There is no assurance that successful implementation of the Fund's conditionality will not be at the expense of some other deficit country rather than of a surplus country. (See p. 14.)

The Treasury indicated that the main factors cited in support of a substantial quota expansion include the (1) increase in scale of the world economy since the

previous quota increase, (2) reduction in the real value of Fund resources as a result of worldwide inflation, and (3) possibility for larger demands for Fund credit in the light of current and near-term major payments imbalances. (See pp. 14 and 15.)

Fund lending (exclusive of the oil facility) averaged $2.2 billion a year during the past decade, with a peak of $4.9 billion in 1974. The Treasury commented that, if current projections of cumulative surpluses of oil-exporting countries are correct ($170 to $250 billion, in 1974 dollars, by the end of the 1970s), the largest annual imbalances between oil-importing and oil-exporting countries have already occurred. (See pp. 10 and 15.)

The Treasury has estimated that the available usable stock of Fund currencies (exclusive of the oil facility) is $12 to $14 billion. In addition, the Fund's gold holdings, valued at the official price of $42.22 an ounce, are presently worth about $6.8 billion. In April 1975, the market price of gold was about $166 an ounce, and it has been predicted that it may be $200 within a year. Agreement has already been reached to abolish the concept of an official international monetary price for gold, and discussions are underway to allow the Fund to dispose of its gold in an orderly manner. Hence, the Fund's usable resources may expand considerably. (See p. 15.)

The above considerations, the floating of the world's major currencies, and the availability of other existing or proposed financing suggest that any proposed Fund quota increase should not be large. (See p. 16.)

DISTRIBUTION OF QUOTA INCREASE

Two main issues to consider in the country distribution of quotas are the (1) political

control of the Fund and (2) balance between the liquidity needs of the Fund and the borrowing needs of its members.

The U.S. quota has declined from 37 percent of total quotas in 1946 to 23 percent in 1974, and its voting power declined from 33 percent of total votes to 21 percent. (Quotas determine votes.)

By retaining at least 20 percent of the Fund's total votes, the United States can veto changes in the structure of the Fund. The United States is unwilling to let its voting share decline further. (See pp. 16 and 17.)

The quotas of the major oil-exporting countries are substantially below what they should be on the basis of their enhanced economic and financial power. The argument is why not give de jure recognition to what has occurred de facto. A substantial increase in the oil-exporting countries' quotas might also enhance their interest in helping to make the international monetary system function. On the other hand, a substantial increase might make it possible for them to block needed structural changes in the world's economic system.

The Fund's holdings of currencies at the end of December 1974 were about $30 billion, of which only about $12 to $14 billion may be considered usable. These are currencies from countries whose payments positions are relatively strong, mainly major industrial countries and oil-exporting countries. On the other hand, other developing countries may have a greater need for Fund loans because they have limited access to private financial markets. (See pp. 17 and 18.)

There is therefore a need to balance the liquidity needs of the Fund against the borrowing needs of its members.

CHAPTER 1

INTRODUCTION

The International Monetary Fund (IMF), consisting of 126 member countries, is the world's leading international monetary institution. It plays the central role in providing temporary multilateral balance-of-payments financing. IMF loans, excluding those from its oil facility,1/ averaged $2.5 billion a year during the past 3 years.

The main source of IMF loan funds are quotas. At the end of February 1975 total quotas were SDR2/ 29.2 billion, about $36.2 billion, of which the U.S. quota was SDR 6.7 billion, about $8.3 billion.3/ Table 1 compares the size and distribution of quotas in 1975 with 1946, the first year of IMF operation.

Quotas are members' subscriptions to IMF resources. Generally a member pays 25 percent of its quota in gold and the remainder in currency. The Interim Committee, which is composed of Finance Ministers and is responsible for advising the Fund on the international monetary system, recommended eliminating the requirement that a member pay part of its quota in gold.

Quotas determine members' voting strengths, limits on members' borrowing, and amounts that members may obtain of any IMF issue of SDRs, the "paper gold" first issued by the Fund in 1970. Quotas also determine the currency composition of the Fund's own resources.

QUOTA INCREASES

Past increases

There have been three general quota increases since IMF's founding at the end of World War II. Quotas were increased by 50 percent in 1959, 25 percent in 1965, and 25 percent in 1970. Other events that expanded the quotas include the growth of Fund membership from 30 to 126 members, special quota increases for war-recovered Western Europe and Japan, and other smaller quota adjustments.

1/A special fund to assist members to meet the balance-of-payments strains from higher oil import costs.

2/Special Drawing Rights.

3/The average value of the SDR for February 1975 was $1.24.

Table 1

Fund Quotas

	February 28, 1975		October 3, 1946	
	Quota (note a)	Percent of total quotas	Quota	Percent of total quotas
	(millions)		(millions)	
United States	$ 8,308	22.95	$2,750	36.80
United Kingdom	3,472	9.59	1,300	17.40
Germany	1,984	5.48	-	-
France	1,860	5.14	525	7.02
Japan	1,488	4.11	-	-
Canada	1,364	3.77	300	4.01
Italy	1,240	3.43	-	-
India	1,166	3.22	400	5.35
The Netherlands	868	2.40	275	3.68
Australia	825	2.28	-	-
Belgium	806	2.23	225	-
China	682	1.88	550	7.36
Argentina	546	1.51	-	-
Brazil	546	1.51	150	2.01
Spain	490	1.35	-	-
Mexico	459	1.27	90	1.20
Venezuela	409	1.13	-	-
Sweden	403	1.11	-	-
South Africa	397	1.10	100	1.34
Other countries	b/8,882	25.65	c/808	10.82
	$36,195		$7,473	

a/These figures were stated in SDRs. A conversion factor of 1.24 was used to present the figures in dollars.

b/This figure represents 107 countries, about 85 percent of current membership.

c/This figure represents 28 countries, about 72 percent of 1946 membership.

In the late 1940s and early 1950s, European recovery and world trade growth were largely financed by the Marshall Plan and by U.S. balance-of-payments deficits. This tempered the demand for IMF assistance. Accelerating world trade and a shift from recovery to development financing gradually increased the demand for IMF resources. Moreover, the need for the currencies of a recovered Europe and Japan necessitated the enlargement of their shares in both absolute and relative terms. Large short-term capital movements also began to influence currency values, increasing the need for balance-of-payments support. These factors appear to be the chief justifications for the three general quota increases.

IMF is required to make a general review of quotas at least every 5 years, and the Interim Committee has recommended that this be shortened to 3 years.

Proposed increase

The Interim Committee recommended in January 1975 that, subject to satisfactory amendment of IMF Articles of Agreement, quotas be increased by approximately one-third. It also recommended that the quota share of the major oil-exporting countries be doubled (from 5 to 10 percent) and that the quota share of other developing countries not fall below its present level (about 21 percent).

Under the first recommendation, total quotas would increase to SDR 39 billion, about $48 billion. The U.S. quota would increase to about $11 billion, assuming a proportionate increase.

The U.S. Treasury supports the Interim Committee's recommendations provided that agreement can be reached on the distribution of individual country quotas, including maintenance of the present U.S. voting share (20.8 percent), and on a series of amendments to the IMF Articles of Agreement. The U.S. Government considers proposed amendments dealing with four subjects particularly important.

1. Legitimization of floating exchange rates. The floating exchange rates for the dollar and other major currencies are in technical violation of IMF Articles.

2. Reduction of the monetary role of gold. The concept of an official international monetary price for gold should be eliminated. The Fund should not be obligated to accept gold from members nor

should members be obligated to use gold in transactions with the Fund. The various restrictions that distinguish gold from other commodities should be eliminated, subject to transitional arrangements. The Fund should be allowed to dispose of its gold in an orderly manner.

3. Usability of currency subscriptions. Members may now prevent the use of their currencies for IMF loans, although they may be in strong balance-of-payments positions.

4. Establishment of an IMF Council. The council would be a permanent decisionmaking body to oversee the operations and evolution of the international monetary system, replacing the Interim Committee which has only advisory powers.

The package of quotas and amendments were to be considered by the Interim Committee in June 1975. When agreement is reached, proposed legislation to increase the U.S. quota and to implement amendments to IMF Articles will be submitted for congressional approval.

We believe the question of quota increases should be considered against the background of the current oil-induced financial strains which have radically altered the world payments structure and the longer term development of the international monetary system.

CHAPTER 2

EVOLUTION OF INTERNATIONAL MONETARY SYSTEM

CREATION AND PURPOSES OF IMF

The Articles of Agreement that established IMF in 1944 sought to create an international monetary system based on rules for international cooperation. The chaotic monetary conditions of the 1930s were to be avoided; the Fund was intended to promote exchange stability, freedom of trade and payments, and high levels of income and employment.

The Articles of Agreement provided for establishing fixed exchange rates for currencies. Changes in these rates could only be made when a country's balance of payments was in "fundamental disequilibrium."1/ Changes of more than 10 percent had to be approved by IMF. The principal intention was that exchange rates should be adjusted infrequently. For other balance-of-payments problems, a country was expected to use its own reserves (liquid assets for international use), temporary IMF financing, and corrective economic policies. The Articles also provided for abolishing (1) exchange restrictions on current international transactions (i.e., payments for trade, services, amortization of loans, income from investment, and family remittances) and (2) discriminatory and multiple exchange rates. They also provided for convertibility among currencies for current international transactions.

The exchange system set up by the Articles of Agreement is known as the par value system. Each IMF member established a relationship, called the par value, between its currency and gold or the dollar. The par value of most currencies was defined in terms of dollars, while the par value of the dollar was defined in terms of gold.

Except for those opting to buy or sell gold freely, at par value within margins prescribed by IMF (one-quarter of 1 percent plus handling charges) with other member monetary authorities, countries were obligated to keep their exchange rates within a 1 percent margin of the par values of their currencies. Most countries adopted the method of buying

---

1/No attempt was made to define fundamental disequilibrium but it was clearly intended to exclude ephemeral balance-of-payments difficulties due to temporary factors.

and selling dollars against their currencies to keep them within their prescribed par value margins. Only the United States chose to maintain the par value of its currency by freely buying and selling gold, until 1971.

IMF RECORD THROUGH 1970

It is generally agreed that the international monetary system, in which IMF was supposed to play the central role, worked well through the late 1950s. Postwar economic recovery was achieved. The average annual rate of growth in developed countries' gross national product (GNP) was about 4 percent, and the average annual growth rate of world trade was about 6 percent in the 1950s. There was no widespread unemployment as there had been in the prewar period. Restrictions on international trade were substantially reduced. The European currencies were made convertible, which gave rise to substantial international capital flows.

The extent to which the smooth functioning of the international monetary system can be attributed to the Fund is problematical. Although the Fund may have contributed, the success was fundamentally based on the strength of the U.S. economy and U.S. willingness to assume the leadership role in the free world. The United States provided support for reconstruction and defense, markets for foreign production, and the international currency needed to finance world trade.

The dollar became the leading world currency early in the postwar period. It was widely used for international transactions and for intervention in exchange markets to support par values. Countries knew that the United States stood ready to freely convert their dollar holdings into gold upon demand.

Economic progress accelerated during the 1960s. The average annual growth rate of developed countries' GNP increased to about 5 percent and the average annual growth rate of world trade increased to 8 percent. GNP growth rates of the developing countries also increased.

However, the international monetary system was subject to increasing strains. Payments imbalances among major countries became huge. The United States experienced growing balance-of-payments deficits, while Europe and Japan accumulated large surpluses. Movements of short-term capital intensified, and countries found it increasingly difficult to cope with them. A series of foreign exchange market crises occurred.

IMF was powerless to alleviate these strains. It could not compel the major countries to correct their imbalances by means of adjusting exchange rates or adopting appropriate domestic policy measures. It only requires a member in a weak balance-of-payments position to adopt corrective balance-of-payments programs and policies if the member seeks to borrow in excess of its IMF gold tranche position (equivalent to the gold portion of its quota, adjusted for purchases and repurchases and for sales of its currency by IMF 1/). The United States has never borrowed beyond its gold tranche position. Moreover, the central position of the dollar in the entire system severely limited the extent to which the United States could take corrective action. Countries with balance-of-payments surpluses, which would not need IMF financial assistance, are not required to adopt appropriate policies and programs.

BREAKDOWN OF INTERNATIONAL MONETARY SYSTEM

There was a feeling that major exchange rate adjustments would soon occur. The dollar had long been overvalued. The U.S. trade surplus had steadily dwindled and some expected that a trade deficit might emerge.

The U.S. trade balance did in fact become negative in the second quarter of 1971, and this reinforced expectations of major changes in exchange rates. In May 1971 two massive dollar outflows began: one was an increased outflow of short-term funds from U.S. residents to residents of other countries; the other was a large conversion of dollars into other currencies by banks and businesses abroad. So serious were these capital flows that foreign exchange markets were closed by international agreement from May 5 to 9, 1971. On May 10 it was announced that the German mark and the Dutch guilder would float and the Swiss franc would be revalued; but exchange market turbulence continued in anticipation of more drastic changes.

On August 15 the United States announced that it would not continue to buy and sell gold. In effect, this knocked

---

1/IMF loans take the form of foreign exchange transactions. A borrowing member purchases foreign exchange from IMF with payment of an equivalent amount of its own money (this is also called a "drawing"). The member is expected to "repurchase" its currency within 3 to 5 years with gold, foreign exchange acceptable to IMF, or SDRs.

out the underpinnings of the par value system, because the predominant intervention currency and the world's major reserve currency was no longer convertible.

In December 1971 new exchange rates were established for nine major currencies.1/ Convertibility into gold was not resumed. A temporary arrangement of "central rates," which could be substituted for par values, was introduced for IMF members, under which intervention margins were widened to 2 and 1/4 percent.

The December 1971 rates were short-lived. In June 1972, after a massive speculative attack on the pound, the United Kingdom decided to float its currency, as did the 16 other countries whose currencies were pegged to the pound. In January and February 1973 most of the remaining major currencies were floated, and the U.S. dollar was devalued for the second time in 14 months. The floats are referred to as "managed" or "dirty" because national monetary authorities have intervened through buying and selling in foreign exchange markets. Almost all the developing countries decided to maintain relatively stable rates for their currencies vis-a-vis a single currency, usually the dollar, the pound, or the French franc.

MOVEMENT TOWARD REFORM

During the 1946-71 period, one major reform of the international monetary system was adopted. SDRs were established to make international liquidity independent of gold and balance-of-payments deficits of reserve currency countries, principally the United States. In 1967 provision was made for the Fund to create SDRs which would be accepted by member countries as reserves and would be used in international settlements.

A unique feature of SDRs is that they are created on paper. SDRs are not issued in the form of any certificate, and SDR transactions are carried as entries on the IMF books. When members are allocated SDRs, they are given credits on IMF's books in a special drawing account. When members part with SDRs, their accounts are debited.

1/Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. The Canadian dollar continued to float.

There have been three issues of SDRs, 1970, 1971, and 1972, totaling $9.3 billion (defined in terms of the pre-devaluation value of the dollar). SDRs are allocated to participating countries on the basis of quotas. As of May 1975, 117 members participated out of a total IMF membership of 126.

Most neglected in the pre-1971 period was the adjustment problem; i.e., how countries could cope with balance-of-payment deficits or surpluses. The U.S. reform plan made public at the IMF annual meeting in September 1972 focused on this problem. Under this plan, the need for adjustment would be based on the level and trend of each country's reserves. Continuous movements in a country's reserves in either direction would be an indicator of disequilibrium in its balance of payments and adjustment to either increase or reduce its reserves would be required. The adjustment could be through (1) domestic monetary and fiscal policies, (2) exchange rate changes, or (3) some combination of these.

The Committee of 20, established by IMF at the meeting for the purpose of proposing a reform plan, considered the U.S. plan and alternatives at successive meetings. Many countries had doubts about the use of reserves as an indicator of adjustment. Important areas of agreement emerged, such as (1) "an exchange rate system based on stable but adjustable par values and with floating rates * * * in particular situations," (2) the need for "an effective and symmetrical adjustment process," and (3) that SDRs should become the principal reserve asset.

However, in 1974 the work on reform was cut short by two related events, the oil crisis and massive worldwide inflation. The sharp increases in the price of oil fundamentally altered the world payments system.

The Committee of 20 proposed, and IMF Executive Board adopted, certain guidelines for floating currencies to avoid competitive depreciation and to maintain "exchange stability" and "orderly exchange arrangements." Countries were encouraged to keep their rates within "target zones."

The IMF Board of Governors, at the September 1974 annual meeting, dissolved the Committee of 20 and created the Interim Committee, consisting of 20 Governors, to meet usually three to four times a year and to advise and report to it. The Interim Committee is to (1) supervise the management and adaptation of the international monetary system, (2) consider proposals by the Executive Board to amend the

Articles of Agreement, and (3) deal with sudden disturbances that might threaten the international monetary system.

In its first major meeting in January 1975, in addition to the quota increase, the Interim Committee recommended an enlarged oil facility (see ch. 3).

OIL PRICE INCREASES

Oil prices have more than quintupled since October 1973. This has led to a financial problem which has been characterized as "unprecedented" by the Treasury, although in its view the problem is also "temporary and transitional." Large financial surpluses are being accumulated in countries having small capital markets and limited abilities for spending their newly acquired wealth on goods and services, at least over the next several years.

The balance-of-payments surpluses of oil-exporting countries rose from $5 billion in 1973 to an estimated $60 billion in 1974. These were matched by corresponding deficits of oil-importing countries, the bulk of which were concentrated in the industrial countries. It is estimated that balance-of-payments deficits of oil-importing countries will be $50 to $55 billion in 1975, divided about evenly between developed and developing countries. According to the Treasury, current projections are that the cumulative deficits 1/ will amount to $170 to $250 billion (in 1974 dollars) before they disappear at the end of this decade.

1/It is impossible to delineate the oil deficit of any oil-importing country. Subtracting net oil payments from the current account balance is insufficient for arriving at the oil deficit; other elements which should but cannot be included because of difficulties of estimation relate to the further consequences of higher oil prices. These include induced debt service payments, effects of oil price increases on prices of other energy products and of products produced with oil, effects of oil price increases on competitive positions, larger exports to oil-producing countries. However, as the current accounts of Organization for Economic Cooperation and Development (OECD) countries shifted dramatically from small surpluses to enormous deficits between 1973 and 1974 and the price of oil quintupled during this time, it is reasonable to conclude that most of the overall current account deficit may be thought of as oil-induced.

Approximately $37 billion of the oil-exporting countries' surpluses in 1974 was invested in highly liquid financial instruments in the United States, United Kingdom and Eurocurrency markets (primarily banks in Europe which accept deposits of dollars and other nondomestic currencies) and in the British and United States money markets. About $6 billion went into United States Government securities, and about $3.5 billion into British Government securities. Some $27.5 billion was deposited with banks, including $4.5 billion in the United States, $2.5 billion in the United Kingdom, and $20.5 billion in Eurocurrency deposits. The bulk of the Eurocurrency deposits was in dollars. Bonds issued by international financial institutions or loans to IMF under the oil facility accounted for $4.2 billion. Another $2.5 billion has been transferred as grants or loans to developing countries. The remaining increase has been diffused among such other items as private securities and real estate.

Although the surpluses of the oil-exporting countries must be invested in the oil-importing countries as a group, there is no assurance that such surpluses will be directed toward individual oil-importing countries to cover their financing needs on reasonable terms. To meet such needs, attention has been given to increasing the use of IMF resources and to other "recycling" proposals.

CHAPTER 3

NEED FOR A QUOTA INCREASE

APPROPRIATENESS AND SIZE

As previously indicated, the Treasury supports the quota recommendations of the Interim Committee, provided that agreement can be reached on the distribution of individual country quotas, including maintenance of the present U.S. voting share, and on a series of amendments to the IMF Articles of Agreement. IMF should be the "first and central track" in dealing with oil-induced international financial strains and should continue to play the central role in providing multilateral financing for balance-of-payments needs. The Treasury has also stated it does not favor financial recycling plans which are independent of measures to help reduce oil prices.

Chairman Burns of the Federal Reserve System recently made a case against recycling without appropriate measures to bring down the price of oil, stating that:

> "But preoccupation with 'recycling' techniques has had the unfortunate effect of diverting attention from the fundamental need to bring down the price of oil. Unless that is done it is extremely doubtful whether the financial problems released by the huge increase of the price of oil will prove manageable. As a practical matter 'recycling' simply means that oil importing countries will slip more and more deeply into debt. Piling debt on top of debt--or speaking more realistically, piling dubious debt on top of good debt--neither can nor should go on indefinitely."

Yet IMF financing is not tied to measures to help reduce the price of oil.

This was a major consideration in the U.S. proposal for a "safety net" financing facility of $25 billion among the OECD countries which is tied to their undertaking measures to reduce their dependence on oil imports. The Treasury said that:

> "The Government has stated that this initiative has been suggested outside the IMF, in part because of the magnitude of the possible transfer

requirements among the major industrial countries during the next few years, and in part because the need for a financial mechanism complementary to cooperation in energy makes it desirable that the arrangement be established within the general framework of the OECD, which provides the central forum for such cooperation among the developed countries. The Government does not believe that it is necessary to graft this essentially transitory, insurance arrangement onto the IMF's permanent liquidity structure."

IMF credit, through its ordinary loans, is made conditional upon borrowers' undertaking economic and financial programs to improve their balance of payments without requiring that they directly reduce their dependence on oil imports. To the extent that borrowers improve their balance of payments through this type of "conditionality," it will have to be mainly at the expense of the balance of payments of other oil-importing countries. It must be remembered that the potential expansion of exports to oil-exporting countries as a group will be limited, at least over the next several years, because their abilities to effectively use enlarged imports of goods and services are limited.

The Treasury believes that IMF's conditionality is appropriate and desirable for achieving satisfactory payments relationships among oil-importing countries as well as between oil-importing and oil-exporting country groups. In the Treasury's opinion, it becomes increasingly inappropriate to focus simply on oil deficits and oil relationships and more relevant to consider financing needs in the light of a country's overall payments situation.

It is difficult to understand how IMF's conditionality will help to improve the payments positions of the oil-importing countries vis-a-vis the oil-exporting countries over the next several years. The Treasury has acknowledged that the oil countries' "capacity to spend those surpluses on real goods and services is, at least temporarily, restricted." Its reference to the inappropriateness of focusing on oil deficits and oil relationships is apparently related to IMF's oil facility and is, therefore, not germane to our criticism of IMF's conditionality.

The Treasury's comment on the appropriateness and desirability of IMF's conditionality for achieving adequate

payments relationships among oil-importing countries, 1/ as well as between oil-importing and oil-exporting countries, raises the fundamental question of IMF's role in helping countries to deal with payments imbalances; i.e., the adjustment problem. As pointed out in chapter 2, failure to adequately resolve the adjustment problem contributed to the downfall of the pre-1971 international monetary system.

The adoption of floating for the world's major currencies has undoubtedly helped to ease the impact of current large payments imbalances. However, IMF's conditionality has remained unchanged. It is still asymmetrical. Member countries which have weak payments positions and which obtain credit from IMF must adopt corrective measures. On the other hand, countries with strong payments positions, which would not obtain IMF credit, are not required to undertake measures to reduce their surpluses. There is no assurance that successful implementation of corrective payments measures by one deficit country will not be at the expense of some other deficit country rather than of a surplus country.

The Treasury Department has indicated that the main factors cited in support of a substantial increase in IMF quotas include the:

1/In regard to payments imbalances among oil-importing countries, the Morgan Guaranty Trust Company in "World Financial Markets," Feb. 19, 1975, observed: "Germany's huge surplus and Japan's near equilibrium (despite its oil imports of $20 billion), due in large part to their low economic growth policies, are placing a heavy burden on the economies and balances of payments of their trade partners. Reducing the current-account imbalances among the OECD countries clearly deserves a much higher degree of urgency than it has been accorded to date. The persistent, large current-account imbalances among the industrial countries is nearly as important a problem as the gap between the oil-exporting and oil-importing countries--particularly now that prospects for narrowing this gap have improved. In the context of this latter, still sizable gap, the prospective increase this year in the United States' modest current-account deficit will contribute to a more equitable sharing of this burden among oil-importing countries."

1. Enormous increase in the scale of the world economy and international transactions since the last review of, and increase in, IMF quotas. World income increased by some 70 percent during 1967-72 1/, while world trade and current account transactions nearly doubled. In addition, the scope for international capital flows has increased rapidly, with widespread easing of controls on capital transactions and improved capital markets worldwide.

2. Reduced real value of IMF resources over the past several years because of worldwide inflation. Consumer prices in OECD countries, for example, have risen by some 40 percent since IMF quotas were last increased.

3. Possibility of larger demands for use of IMF resources over the next few years in the light of current major imbalances in world payments, which are expected to continue for several years, although such demands may be moderated by the greater degree of exchange rate flexibility now prevailing.

The increase in the scale of the world economy and the decline in the real value of the Fund's resources do not imply *per se* that IMF resources are inadequate. Its lending, exclusive of the oil facility, averaged $2.2 billion a year during the past decade, with a peak of $4.9 billion in 1974. The Treasury has commented that, if current projections of the cumulative oil surpluses of the oil-exporting countries are correct, the largest annual imbalances between the oil-importing and oil-exporting countries have already occurred.

The Treasury has estimated that the available usable stock of IMF currencies is $12 to $14 billion, exclusive of the oil facility. IMF gold holdings, valued at the official price of $42.22 an ounce, are presently worth about $6.8 billion. The market price of gold was about $166 an ounce on April 29, 1975, and it has been predicted that within a year the price may be about $200 an ounce. It has already been agreed that the concept of an official international monetary price for gold should be abolished, and discussions are underway to allow IMF to dispose of its gold in an orderly manner. Hence, IMF's usable resources may expand considerably.

1/1972 is the latest year for which full data is available.

IMF is also presently arranging to borrow from major oil-exporting countries and other countries in strong payments positions for its 1975 oil facility. To assist members to meet the balance-of-payments strains from higher oil import costs, IMF established an oil-lending facility in 1974, amounting to about $3.6 billion, financed primarily from loans from oil-exporting countries. The Interim Committee agreed the 1975 oil facility should be SDR 5 billion, about $6.2 billion; SDR 450 million, about $.6 billion, is available from the 1974 oil facility.

To supplement IMF and other sources of financing, OECD countries recently agreed (but their legislatures have not as yet approved) to establish a Financial Support Fund of $25 billion for helping OECD members deal with their energy-related financing needs. The Support Fund is authorized to make loans for 2 years from the date of entry into force of the underlying agreement. The Support Fund agreement evolved from the U.S. "safety net" proposal and a similar proposal by the Secretary General of OECD.

The United States has also proposed establishment of a Trust Fund managed by IMF to provide balance-of-payments assistance on concessional terms to the poorest countries, which are most severely affected by oil price increases. The Trust Fund would be financed by contributions from oil-exporting countries and others and by using a portion of IMF gold.

A special lending facility of SDR 5.6 billion, about $7.9 billion, called the General Arrangements to Borrow, is available for meeting extraordinary financing needs of the 10 major countries that established it. The General Arrangements to Borrow were recently renewed for a 5-year period.

The above considerations, as well as the existence of floating for major currencies, suggest that any proposed IMF quota increase should not be large.

DISTRIBUTION

Two main issues to consider in the country distribution of quotas are the (1) political control of IMF and (2) balance between IMF liquidity needs and members' borrowing needs.

The U.S. quota has declined from 37 percent of total quotas in 1946 to 23 percent in 1974. Its voting power declined from 33 percent of the votes in 1946 to 21 percent in 1974. As one observer recently put it: "At Bretton Woods the U.S. got what it wanted; today it can only block what it does not like."

By retaining at least 20 percent of the votes, the United States can veto changes in IMF structure because a four-fifth's majority is required to amend IMF Articles of Agreement. The Treasury pointed out that the United States had taken less than its share in previous quota increases and the Treasury is unwilling to let its voting share decline further.

The principal argument in favor of substantially increasing the quotas of the major oil-exporting countries from 5 percent is their enhanced economic and financial power. Why not give de jure recognition to what has occurred de facto? A substantial increase in the quotas of the major oil-producing countries might also enhance their interest in helping to make the international monetary system function.

On the other hand, a substantial increase in the quota share of major oil-exporting countries would make it possible for them to block structural changes in the world economic system. A 20 percent quota would give them the same voting position as the United States. Even the doubling of their quotas would make it easier for them to block important actions by "persuading" other countries to join them. The power of major oil-exporting countries to convince other countries of the rightness of their positions has clearly increased as a result of the Arab countries' oil embargo and the oil price increase.

IMF holdings of currencies at the end of December 1974 were about $30 billion. Only about $12 to $14 billion may be considered usable for IMF loans; these are currencies from countries whose payments positions are relatively strong, the major industrial countries and oil-exporting countries. Hence, consideration of IMF's liquidity needs would tend to distribute the quota increase in favor of such countries.

On the other hand, the non-oil-exporting developing countries may have a greater need for IMF loans than would other countries. Although their balance-of-payments deficits for 1975 are estimated to be about the same as those of the industrial countries, their need to borrow from IMF

may be much greater; they have only limited access to private financing markets. This consideration would tend to distribute the quota increase in favor of these countries.

Therefore, the liquidity needs of IMF need to be balanced against the borrowing needs of its members when considering a quota increase. Of course, the larger the quota increase, the less urgent it is to pay close attention to this balance. However, as previously indicated, there are arguments against a large quota increase.

Copies of GAO reports are available to the general public at a cost of $1.00 a copy. There is no charge for reports furnished to Members of Congress and congressional committee staff members; officials of Federal, State, local, and foreign governments; members of the press; college libraries, faculty members, and students; and non-profit organizations.

Requesters entitled to reports without charge should address their requests to:

U.S. General Accounting Office
Distribution Section, Room 4522
441 G Street, NW.
Washington, D.C. 20548

Requesters who are required to pay for reports should send their requests with checks or money orders to:

U.S. General Accounting Office
Distribution Section
P.O. Box 1020
Washington, D.C. 20013

Checks or money orders should be made payable to the U.S. General Accounting Office. Stamps or Superintendent of Documents coupons will not be accepted. Please do not send cash.

To expedite filling your order, use the report number in the lower left corner of the front cover.

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS

Library
Room 7056