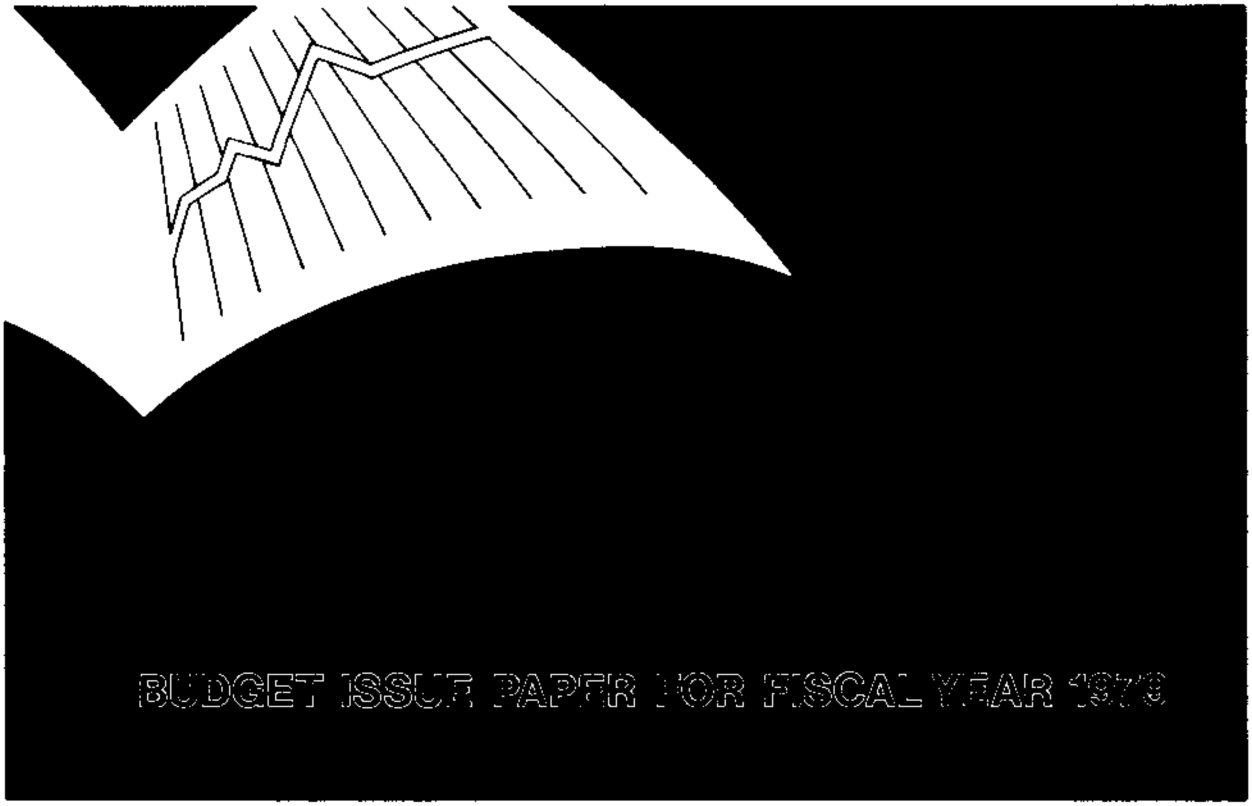
U.S. Participation in the Witteveen Facility: The Need for a New Source of International Finance

MARCH 1978



BUDGET ISSUE PAPER FOR FISCAL YEAR 1979

CONGRESSIONAL BUDGET OFFICE
CONGRESS OF THE UNITED STATES

U.S. PARTICIPATION IN THE WITTEVEEN FACILITY: THE NEED FOR A NEW SOURCE OF INTERNATIONAL FINANCE

The Congress of the United States
Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

PREFACE

Pending before the Congress are proposals to authorize U.S. participation in a new international financial facility operated by the International Monetary Fund (IMF). Participation in this new facility--officially called the Supplementary Financing Facility, but more commonly known as the Witteveen Facility--could require a contribution of some $1.7 billion by the United States in the form of loans to the IMF. Concern has been expressed both over the need for this new facility and over the proper budgetary treatment of U.S. transactions with the IMF.

This budget issue paper was prepared at the request of the Senate Budget Committee. It provides a discussion of the role of the IMF in the international monetary system, a description of the proposed Witteveen Facility, and a discussion of the major arguments for and against U.S. participation in this facility. The paper also outlines the rationales for alternative budgetary treatments of U.S. transactions with the IMF. In keeping with CBO's mandate to provide nonpartisan and objective analysis, this paper offers no recommendations.

This paper was prepared by C.R. Neu of the National Security and International Affairs Division of CBO, under the general supervision of John E. Koehler. The author wishes to acknowledge the assistance of Virginia France and Richard Morgenstern, both of CBO. The manuscript was edited by Robert Faherty and typed for publication by Nancy Swope.

Alice M. Rivlin
Director

March 1978

CONTENTS

		Page
PREFACE		iii
SUMMARY		ix
CHAPTER I.	INTRODUCTION	1
CHAPTER II.	THE INTERNATIONAL FINANCIAL SYSTEM	5
	The Need for International Finance	5
	The Growth of International Financing	8
	The Purposes of International Finance	12
CHAPTER III.	THE ROLE OF THE IMF	15
	The Adequacy of IMF Resources	17
	New Proposal: The Supplementary Financing Facility	19
CHAPTER IV.	THE NEED FOR EXPANDED IMF RESOURCES	23
	The Use of Expanded IMF Resources	24
	The Relevance of IMF Operations to Present Conditions	26
	The Appropriateness of IMF Conditions	30
	The IMF and Commercial Banks	31
	An Alternative to the Witteveen Facility: The Financial Support Fund	35
CHAPTER V.	BUDGETARY TREATMENT OF THE IMF	39
	The Exchange-of-Assets Concept	40
	The Purpose of the Budget	43
	Conclusions	46
APPENDIX A.	THE OPERATIONS OF THE IMF	51
APPENDIX B.	MAJOR GROUPS OF IMF MEMBERS	57

TABLES

Page

TABLE 1. CURRENT ACCOUNT BALANCES FOR SELECTED COUNTRIES AND GROUPS OF COUNTRIES, 1976 11

TABLE 2. CONTRIBUTIONS TO THE WITTEVEEN FACILITY 21

TABLE 3. DEBTS OF SELECTED COUNTRIES TO PRIVATE LENDERS 33

APPENDIX TABLE

Page

TABLE A-1. SCHEDULE OF IMF CHARGES ON TRANSACTIONS 55

SUMMARY

Pending before the Congress is legislation to authorize U.S. participation in the establishment of a special, temporary financing facility of the International Monetary Fund (IMF). The resources for this new facility--officially called the Supplementary Financing Facility, but more commonly known as the Witteveen Facility after the managing director of the IMF, H. Johannes Witteveen--would be borrowed by the IMF from contributing countries and then lent by the Fund to other nations facing large current account deficits. 1/ Besides the United States, thirteen other economically strong nations have agreed to make resources available for the facility.

The total assets of the new facility would be about $10.5 billion, of which about half would be provided by oil-exporting countries and half by the stronger developed countries. The United States would provide $1.7 billion. The resources of the new facility would be available to nations facing balance-of-payments difficulties that are large in relation to their IMF quotas. 2/ Loans made through this facility would have maturities up to seven years and would carry interest rates comparable to those prevailing in private international financial markets.

The proposed establishment of this facility has drawn attention within the United States for a number of reasons. Most obvious of these is the large size of the proposed U.S. contribution.

The second reason is that these proposals have come at a time when the international financial system has been strained by oil

1/ A nation is said to have a current account deficit if its spending for imports of goods and services exceeds its earnings from exports and net transfers into the country.

2/ The quota of a nation represents the amount of its currency that is available to the IMF for lending to other members. To a large degree, the size of a nation's quota determines how much Fund credit is available to that country.

price increases, worldwide recession, and rapid inflation. These events have prompted a general reappraisal of the adequacy of international financial arrangements and of U.S. participation in these arrangements. In the course of this reappraisal, some questions have arisen concerning the appropriateness of IMF operations to current economic conditions.

Finally, it has been the practice in recent years to exclude from the federal budget all U.S. transactions with the IMF. In accordance with this practice, the Administration has not sought an appropriation for U.S. participation in the Witteveen Facility. Some have questioned whether this special budget treatment of transactions with the IMF is still desirable. Whatever decision is made regarding the Witteveen Facility will have implications for future U.S. participation in IMF operations.

THE INTERNATIONAL FINANCIAL SYSTEM

The events of the last four years have led to a dramatic increase in the need for international finance. Increased oil prices and worldwide recession have forced many nations to seek financing to allow time for adjustment to changed economic conditions. Since the establishment of a system of floating exchange rates, some nations have been forced to borrow in order to stabilize their currencies. The requirements of developing countries for external financing remain large, and the continuing expansion of international business has generated new requirements for international finance. Because many transactions go unreported, there is no single, comprehensive measure of the volume of international finance, but all available data suggest a rapid increase.

Just as there is a wide variety of requirements for international financing, there is also a wide variety of institutions and arrangements through which it is provided. Commercial banks, national governments, central banks, the IMF, the multilateral development banks, and private investors all supply international financing, each on terms that are appropriate for particular borrowers in particular circumstances.

Financing provided by each of these agencies is intended to serve particular purposes; nevertheless, there must inevitably be some uncertainty about the ultimate effect of lending from any particular source. Lenders may attach terms and conditions designed to insure that borrowed funds are used only for the intended purposes, but it will always be difficult to say that any international loan was used for one purpose and not some other.

The lending operations of the IMF have expanded greatly in recent years. During IMF fiscal year 1973, the Fund's lending amounted to $1.4 billion; by 1976, it had risen to $7.7 billion. The IMF remains, however, a relatively minor source of international lending. The IMF provided enough credit from 1974 through 1976 to finance only about 7 percent of total worldwide current account deficits. By contrast, 75 percent was financed through private financial markets, and the remaining 18 percent was financed through official lending by governments and the international development banks.

THE ROLE OF THE IMF

Although the IMF provides only a small fraction of total international lending, the Fund plays a unique role in the international financial system. This unique position arises primarily out of the Fund's ability to attach conditions to its lending, requiring that its borrowers adopt specific economic policies that will:

- Lead to reductions in payments imbalances;
- Insure that the borrower's external financial affairs are maintained in good order.

Other international lenders are generally unwilling or unable to impose conditions of this sort, but there is widespread feeling that such conditions are necessary. Adjustment to changing economic conditions can be socially and politically difficult and, without the conditions attached to IMF lending, borrowing nations might be tempted to postpone adjustment or to seek adjustment at the expense of other nations.

The rapid increase in the Fund's lending in recent years has reduced the resources available to it for lending in future years. As of April 30, 1977, the Fund's holdings of usable currencies amounted to only about SDR 4.5 billion. [3] The Fund

[3] The unit of account for nearly all IMF transactions is the special drawing right (SDR). The value of the SDR is determined by a weighted average of the values of 16 major currencies. At the end of 1977, one SDR was worth approximately $1.21.

will obtain additional usable currencies from loan repayments and from a major increase in IMF quotas expected to become effective early in 1978. Nonetheless, many observers have called for the establishment of a special, temporary lending facility financed through borrowing by the Fund to supplement the Fund's resources until a further quota increase can become effective--probably sometime in 1980.

An additional rationale often given for the establishment of a supplementary facility is that many countries facing large current account deficits have only very limited access to Fund credit. This is because the amount of Fund credit available to a country is closely tied to the size of that country's IMF quota. Quotas have not been significantly adjusted for many years, and some countries now have unrealistically low quotas. A new supplementary facility would give increased access to Fund credit to all member countries until new quotas could be negotiated.

The proposed Witteveen Facility has been designed to meet these perceived requirements for expanded IMF resources.

THE NEED FOR EXPANDED IMF RESOURCES

The demand for IMF financing during the next few years will depend on a number of factors--all of which are difficult to predict: the economic policies adopted by member countries, the availability of financing from other sources, and the pace of world recovery from recession. It is not possible to predict that expanded IMF resources will not be required. Neither is it possible, however, to say that the IMF must have expanded resources to meet its commitments.

The countries most likely to benefit from the establishment of the Witteveen Facility are the weaker members of the Organization for Economic Cooperation and Development (OECD)--for example, Spain, Portugal, and Turkey--and the more advanced developing countries. Although the Witteveen Facility is intended to expand access to IMF credit for countries with small quotas, the amounts available to members are still related to quotas, and it is unlikely that the lowest-income developing nations will be able to make much use of the new facility because their quotas are so small. Nor will the Witteveen Facility be a great advantage to the most developed industrial nations. These nations have ready access to credit from other sources.

Although the Witteveen Facility will not provide financing to all the countries that may need it, the special assistance it will provide to the weaker OECD countries may be consistent with U.S. interests. Both Spain and Portugal are facing economic difficulties, and continued economic stability could improve the chances that recent moves toward democracy will succeed in these countries. Similarly, because Turkey is a member of the North Atlantic Treaty Organization (NATO), the United States has an interest in the maintenance of economic and political stability there. More broadly, though, the United States has an interest in the continued smooth operation of the international financial system. To the extent that the Witteveen Facility can help avoid disruptions of this system, it can also serve these broader U.S. interests.

Some observers have argued that the primary problem facing the world economic system today is not the reluctance of some nations to reduce their current account deficits but rather the deliberate efforts of the Organization of Petroleum Exporting Countries (OPEC) and some industrial countries to maintain current account surpluses. The Federal Republic of Germany, Japan, Switzerland, and the United Kingdom are cited as nations actively engaging in currency market interventions and in domestic economic policies designed to encourage exports and discourage imports. Because the IMF is powerless to affect the policies of these nations, these critics say, the Witteveen Facility will provide temporary financial relief for a few nations but will do nothing to eliminate the basic problem.

Other observers, however, argue that currency market interventions are probably of little long-term consequence and that the restrictive fiscal policies adopted by some industrial countries cannot be long pursued. Recovery from recession in most of the industrial countries has been slower than in the United States, and political pressures are likely to develop within these countries for more expansionary policies. Some also see the current account surpluses of the OPEC countries declining in the next few years as these countries increase their imports. Thus, the problems of deliberate policies to run current account surpluses are likely to be only temporary--if, indeed, they exist at all.

Some other critics have opposed the Witteveen Facility on the grounds that it will serve as a "bail-out" for commercial banks that have overextended themselves in their lending to developing countries. Rather than aiding borrowing nations, these critics claim, Witteveen Facility loans will serve only to pay off commercial bank loans. Once the commercial banks have been repaid, it is said, they will not lend again to these nations, and the IMF will be left to bear the risks of this lending.

This view seems to have little merit. It is true that the establishment of a new source of official credit will reduce somewhat the risks of all international lending and thus will benefit commercial banks. But the commercial banks have not shown any desire to reduce their exposure in developing countries. On the contrary, all indications are that, with more financing provided by the IMF, they would increase their lending.

This does raise, however, another objection to expanding the resources of the IMF. In some cases, commercial banks will not lend to a nation until it has agreed to meet IMF conditions. Thus, it is argued that the amount of IMF loans is not important since a nation would be forced to accept this IMF "conditionality" in order to get access to other sources of financing. Supporters of the Witteveen Facility counter with the argument that coordination between the Fund and the private banks is not perfect and that, if the Fund could provide more credit, some nations might seek IMF financing--and thus accept IMF conditions--earlier than they otherwise might.

ALTERNATIVES TO THE WITTEVEEN FACILITY

Because of the difficulties inherent in negotiating multilateral financial agreements, the near-term alternatives to U.S. participation in the Witteveen Facility are few. It is unlikely that the terms of this facility could be renegotiated and, without U.S. participation, it is unlikely that the facility will ever begin operations.

The only alternative arrangement that could be implemented in the near future is the already negotiated Financial Support Fund, more commonly known as the OECD Safety Net. Originally negotiated and proposed to the Congress in 1975, the Safety Net would have had assets of some $25 billion borrowed from private investors and guaranteed by the governments of the OECD countries. These resources would be available to any member of the OECD on terms similar to those prevailing in private financial markets.

The principal advantage of the Safety Net proposal is the large size of the proposed facility and the use of privately supplied funds. Its major disadvantages are that it would not involve directly the governments of the oil-exporting countries and that its resources would not be available to countries that are not members of the OECD.

The Congress failed to act on the Safety Net proposal, and thus the arrangement was never implemented. It is possible that other OECD members would still be in favor of the arrangement if it were accepted by the Congress. Having once abandoned the idea of the Safety Net in favor of the Witteveen Facility, however, some of these nations would face political or administrative difficulties in accommodating themselves to a reversal in the U.S. position regarding the Safety Net.

BUDGETARY TREATMENT OF THE IMF

In 1967, the President's Commission on Budget Concepts recommended that U.S. transactions with the IMF be excluded from the federal budget. The basis for this judgment was the determination that, when dollars were transferred from the U.S. Treasury to the IMF, the United States received in return a claim on the IMF that, for purposes of international payments, is as good as cash. The United States has simply to state that it has a balance-of-payments need of the cash it has transferred to the Fund and this cash is to be returned in the form needed by the United States--most likely in the form of foreign currencies. Thus, transactions with the Fund are simply exchanges of one asset for another, involving no outlays, and there was held to be no reason for these transactions to be included in the federal budget.

Some have questioned this treatment of transactions with the IMF. Arguments to include these transactions in the budget are of three types:

- Dollars supplied by the United States to the IMF and then lent by the Fund to other nations may ultimately be used to purchase real resources from the United States. If this occurs, then transactions with the IMF increase the aggregate demand for U.S. goods and services and ought, therefore, to be included in the budget.

- Dollars supplied to the IMF must be borrowed from private capital markets, increasing the borrowing requirements of the federal government. Since the federal deficit is supposed to provide an estimate of federal borrowing requirements, these transactions should be included in the budget.

- Because transactions with the IMF are not subjected to the established procedures of the budget process, they receive less scrutiny than do other transactions. Congressional oversight of these transactions would be improved if they were included in the budget.

Each of these arguments has some validity but none is completely compelling, and it is possible to raise objections to all of them. The principal objection is that, since dollars are transferred to the Fund only when they are required by the Fund, there is no way of predicting in advance when these transfers might occur. By considering these transfers as outlays, one would be adding a potentially large uncertainty to any year's estimate of outlays.

Ultimately, the choice of how to treat transactions with the IMF will be a matter of judgment. Some kinds of international financial transactions (bilateral loans, contributions to the World Bank) now require appropriation, while others (Federal Reserve currency "swaps") do not. Where one draws the line between on- and off-budget activities is inevitably somewhat arbitrary. The best one can hope for is consistency. Contributions to the Witteveen Facility differ only slightly from quota subscriptions, and whatever budget treatment is chosen for one of these transactions should be applied to both.

CHAPTER I. INTRODUCTION

Events of the last few years have placed serious strains on the international financial system and on the international economy at large. Much attention has been focused on the need and prospects for adjustment to higher oil prices, on the difficulties posed by business cycles in the largest of the industrial countries, on the consequences of rapid inflation, and on the implications of the shift from a regime of fixed exchange rates to one of managed floating rates.

Because of its prominent role in facilitating the workings of international financial arrangements, the International Monetary Fund (IMF) has also been the subject of much discussion. At issue have been the proper role of the IMF in an altered international financial system, the level of Fund assets required to fulfill this role, the relationship of the IMF to other international lenders, and the approach adopted by the IMF in its efforts to promote international financial stability. These issues have become of greater interest since the agreement in August 1977 among 14 economically strong nations (including the United States) to establish a new temporary financing facility within the IMF. The assets of this new facility--officially called the Supplementary Financing Facility, but more commonly known as the Witteveen Facility after the managing director of the IMF, H. Johannes Witteveen--will be about $10.5 billion. The U.S. contribution to this new facility will be about $1.7 billion. [1]

[1] These dollar figures and most other similar figures presented in this paper are only approximate. This is because the unit of account for nearly all IMF transactions is the special drawing right (SDR). The value of the special drawing right is determined by a weighted average of the values of 16 major currencies. As the value of these currencies changes, the value of the dollar relative to the SDR changes also. At the end of 1977, one SDR was worth approximately $1.21. Figures denominated in SDRs are preceded with the letters "SDR"; thus, one thousand SDRs would be written "SDR 1,000."

The establishment of this new facility has aroused interest in the United States for a number of reasons. The most obvious is simply the size of the expected U.S. contribution; in terms of recent U.S. contributions to other international financial agencies, this proposed contribution is quite large. Beyond this, questions have arisen concerning the proper budgetary treatment of U.S. transactions with the IMF. The practice in recent years has been to exclude most of these transactions from the federal budget. U.S. participation in the Witteveen Facility will require Congressional authorization but, unless current practice is altered, U.S. contributions to this new facility will be completely outside the budget/appropriations process and will not appear on the federal budget. This sets the IMF apart from some other international financial institutions supported by U.S. contributions, and some have questioned the special budgetary treatment afforded the IMF.

The proposal for U.S. participation in the Witteveen Facility is somewhat unusual in that the Congress has little freedom in deciding what actions to authorize. The difficulties of negotiating international financial agreements of this sort make it unlikely that changes in the terms of the facility could be effected. For all practical purposes, then, the Congress faces a take-it-or-leave-it situation; it may approve or disapprove U.S. participation, but there is little that can be done to alter the proposed facility.

This proposal also comes at a time of heightened concern in the United States over international lending practices in general. Policies toward both private commercial banks and multilateral development banks are under review, as are the direct international financial activities of the federal government. There is also a widespread feeling that the purposes and operations of the IMF are not sufficiently understood to allow a careful consideration of the pros and cons of proposals for a new facility.

The IMF is perhaps the most visible of the international financial institutions, but it is neither the largest source of international lending nor is it the only international agency through which the U.S. government extends credit to foreign countries. To understand the role of the IMF, it is necessary to place it in the context of other international financial operations. Chapter II contains a brief discussion of the current international financial situation and the kinds of financing provided by various institutions. Chapter III discusses the role of the IMF in the international financial system and describes the proposed Witteveen Facility. Chapter IV addresses the need for expanded IMF resources, presents the principal arguments for and against the establishment of a new facility, and discusses possible alternatives to the proposed facility. Chapter V is a discussion of the budgetary treatment of U.S. transactions with the IMF. It outlines the arguments for and against inclusion of IMF transactions in the federal budget. Appendix A provides more detailed information on the operations of the IMF, and Appendix B lists the major groups of IMF member countries.

CHAPTER II. THE INTERNATIONAL FINANCIAL SYSTEM

THE NEED FOR INTERNATIONAL FINANCE

The international financial system encompasses all those arrangements by which the currency of one country is made available on a temporary basis to governments or to private interests in other countries. Among these arrangements are a wide variety of international transactions: international loans by private commercial banks, deferred payment plans for the purchase of imports, long-term development loans from international agencies, arrangements among central banks to "swap" currencies, the sale of international bonds by governments or businesses, the deposit of funds in foreign banks, and direct investment in foreign business ventures. The purposes for which international financing is required are as diverse as are the means by which this financing is supplied. Indeed, it is largely because of this diversity of purpose that so many channels for international financial flows have been established. Each of these channels is appropriate for meeting particular kinds of financial needs, and the factors that determine the need for one type of international finance may be quite different from those determining the need for other types.

In the last three years, a great deal of attention has focused on the need of some nations for financing in order to maintain their accustomed levels of imports. Because of the dramatic oil price increases of 1974, the oil-importing nations faced a difficult set of policy problems. In the longer run, these countries might hope to reduce their dependence on foreign oil or to reorient their economies to sell more goods abroad. In the near term, however, they had only two choices: reduce imports of foreign goods or borrow sufficient foreign exchange to pay the increased price of oil until more fundamental adjustments could be accomplished. For many nations--developed as well as developing nations--there was little room for import reductions, and the only course available was international borrowing. The principal sources of finance for many of these countries have been the private international credit markets--often spoken of as the eurocurrency (for direct loans) and eurobond (for international bonds) markets. Additional financing for this purpose has been provided by the International Monetary Fund and by national governments, sometimes in some sort of consortium arrangement.

The major recession felt in all industrial countries in 1974 and 1975 added to the financing requirements of some countries. As industrial output in the major industrial countries stagnated, the demand for industrial materials fell sharply. Nations highly dependent on the export of raw materials for their earnings of foreign exchange saw these earnings decline at just the time they were needed to pay higher oil prices. In many cases, the only choice was to borrow foreign exchange.

Requirements for a different sort of international finance arose from the adoption in 1975 of a system of floating exchange rates for major currencies. The flexibility of floating exchange rates allows the international economy to adjust smoothly, rather than in a series of sudden jumps, to changing economic conditions. This same flexibility, however, can give rise to wide fluctuations in exchange rates that do not reflect changes in underlying economic conditions, and these fluctuations can be problematic. Unstable exchange rates increase the risks involved in international transactions and can discourage the flows of international trade and capital that a system of flexible exchange rates is supposed to facilitate. Fluctuations in exchange rates will also change the price of imported goods, and large or sudden price changes of this sort can interfere with national policies to promote price stability. Finally, expectations of changes in exchange rates can cause liquid assets to flow into or out of a country as speculators seek to avoid losses associated with holding a depreciating currency. If these speculative flows are large or frequent, national monetary authorities will be unable to control domestic interest rates or money supplies.

For these reasons, the central banks of various nations sometimes intervene in international currency markets to reduce the fluctuations in exchange rates. In some cases, this intervention is intended only to smooth out sudden or erratic changes in exchange rates (to preserve "orderly market conditions"). In other cases, the central bank endeavors to maintain a constant relationship between its own currency and some other currency or group of currencies. [1] Intervention is accomplished by a

[1] Many developing countries maintain a constant relationship between their currencies and the currency of their major developed trading partner. Others adjust their currencies to a "basket" of developed countries' currencies. Six European countries (Belgium, Denmark, the Federal Republic of

country's buying or selling its own currency as is required to maintain a desired value. If a country's reserves of foreign currencies are inadequate to carry out the necessary purchases of its own currency, there is no choice but to let the currency's value fall or to borrow foreign currency. When a nation faces a short-term need to support its own currency, it can turn to the IMF for loans or to central banks of other countries for "swaps" of currencies. 2/

The increased uncertainty that has accompanied the establishment of a system of floating exchange rates has led many countries to increase their reserves of foreign exchange. Presumably, the desire for increased reserves arises from the perception that currency market interventions are more likely to be required in the new exchange-rate regime. It is also widely felt that the mere existence of sizable reserves of foreign exchange can deter speculative movements, since these reserves enable a nation to maintain a desired exchange rate even in the face of strong pressures for a change. In recent years, total official liquid reserves have risen sharply. At the end of 1970, they stood at approximately $65 billion. By May 1977, they had nearly quadrupled to $232 billion. In many cases, these increased reserves were accumulated through medium-term (five to seven years) borrowing from commercial banks.

Germany, Luxembourg, the Netherlands, and Norway) maintain their currencies at constant values relative to each other, but they allow the group of currencies to float together relative to currencies outside of the group. This arrangement is known as the European "snake."

[2] "Swap" arrangements exist among the central banks of the major industrial countries. When a participating nation finds its currency under very short-term downward pressure--usually as a result of speculative actions--it may, through these arrangements, swap some of its own currency for that of some other country. This foreign currency is then used to buy the domestic currency in world markets, thus supporting its value. When the speculative pressure has ended, the country may use its own currency to reverse the swap of currencies. Such country swaps are for very short duration and generally must be reversed within six months.

International financing is also required to facilitate the economic growth of developing countries. In many of these countries, the level of production is barely sufficient to meet the immediate needs of the population, and few resources are available for the capital formation required to support economic development. Even without the recent upheavals of the international economic structure, developing nations would have needed to borrow large amounts from foreign lenders to buy imported capital equipment, and this need will continue even after successful adjustment to increased oil prices.

The kind of financing required for economic development is of a longer term than that needed for other purposes. Often this financing is provided through the foreign aid programs of developed countries and through international financial institutions such as the World Bank, the Inter-American Development Bank, or the Asian Development Bank. These development loans carry maturities as long as 50 years. Increasingly, developing nations have been supplementing this official development lending with shorter-term loans from commercial banks.

Finally, international finance is required to meet the needs of international business. Financing is required to build plants and equipment, to maintain inventories, to offer deferred payment plans, and so on. These business needs for international finance are met almost exclusively by commercial credit markets.

THE GROWTH OF INTERNATIONAL FINANCING

Because of higher oil prices, worldwide recession, the institution of a system of floating exchange rates, rising expectations in developing countries, and a growing volume of international business, there has been in the past three or four years a dramatic increase in the demand for international finance. In response to this growing demand, supply has increased markedly, and the international flow of financial assets has grown rapidly.

There is no single measure of the volume of international financial flows. This is because many transactions--usually short-term or private transactions--are not reported in any systematic way. The data that are available, however, reflect a rapid rise in the scale of international financial operations.

In the absence of comprehensive information about international financial flows, much attention has focused on the size of the national current account deficits that have been financed in recent years. The current account balance of a country during a particular period is formed by subtracting from the value of the country's exports of goods and services the value of all imported goods and services and adding to this difference the net flow of transfer payments into the country during the period in question. If spending for imports exceeds earnings from exports and net transfers, this result is negative, and the nation is said to have a current account deficit.

When a country has a current account deficit, it must make up the difference between its foreign spending and earnings either by depleting its reserve holdings of foreign currency or by borrowing from international sources. Similarly, a country with a current account surplus must either increase its reserve holdings or lend its surplus to borrowers in other countries. Thus, the current account balance of a country provides a measure of its net financing requirements (if the current account is in deficit) or its net capability for lending (if the current account is in surplus).

Whenever one country has a current account deficit, some other country or group of countries necessarily has an offsetting current account surplus. Worldwide, the total amount of all current account deficits should be exactly balanced by the total of all current account surpluses. This means that at a constant level of reserves there should be exactly enough currency available for international lending as there is need for currency to finance current account deficits. In many cases, countries with current account surpluses do not lend directly to countries with current account deficits. Instead, these financial flows are channeled through various financial intermediaries. Rather than lending directly to nations with large current account deficits, for example, the oil-exporting countries (which have large surpluses) have deposited their excess foreign exchange in commercial banks or lent it to international agencies. These banks and agencies in turn "recycle" these assets by lending them to countries needing to borrow.

In recent years, the size of current account deficits and the resulting requirement for financing them have grown rapidly. In the three years before the increase in oil prices (1971 through 1973), the aggregate deficit of all nations running current account deficits averaged about $15 billion a year. In the three years immediately following the increase in oil prices (1974 through 1976), the average aggregate deficit increased fivefold to about $75 billion a year. 3/

Current account deficits were not confined to one group of countries in 1976 (see Table 1). Both developed and developing countries had deficits in that year. Even some OPEC countries are expected to run deficits in the next year or so. 4/ Neither were surpluses confined to OPEC countries. Four of the major industrial countries had current account surpluses and two others were quite close to balance.

As deficits have grown during the last few years, so have the funds available for financing these deficits. Indeed, this must be so because, without financing, a country could not run a deficit. By far the largest source of new lending has been the commercial credit markets. New publicly announced international loans by banks and new international bond issues reached $61.4 billion in 1976. 5/ This was up sharply from the 1973 level of $29.6 billion. The U.S. Treasury estimates that during the years 1974 through 1976, three-quarters of the aggregate current account deficit was financed through private financial markets. 6/

Development lending by the developed countries and by the multilateral development banks has also grown in recent years, but not as fast as private lending has. The World Bank estimates that in 1975 (the last year for which complete data are

3/ Testimony of Anthony H. Solomon, Undersecretary of Treasury for Monetary Affairs, before the Subcommittee on International Trade, Investment, and Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs (September 20, 1977; processed).

4/ "The International Debt Situation," World Financial Markets (June 1977), p. 2.

5/ "International Credit Market Developments," World Financial Markets (July 1977), p. 1.

6/ Testimony of Anthony H. Solomon before the Subcommittee on International Trade, Investment, and Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs.

TABLE 1. CURRENT ACCOUNT BALANCES FOR SELECTED COUNTRIES AND GROUPS OF COUNTRIES, 1976: IN BILLIONS OF DOLLARS

Countries	Deficit	Surplus
Major Industrialized Countries		
Austria	1.5	
Belgium-Luxembourg	0.4	
Canada	4.2	
Denmark	1.9	
France	6.1	
Germany, Federal Republic of		3.0
Italy	2.8	
Japan		3.7
Netherlands		2.3
Norway	3.7	
Sweden	2.4	
Switzerland		3.5
United Kingdom	2.7	
United States	0.6	
Total	26.3	12.5
Other OECD Countries	12.7	
Oil-Exporting Countries		41.0
Non-Oil Developing Countries	25.8	

SOURCES: OECD Economic Outlook (July 1977), pp. 72-73; International Monetary Fund, Annual Report 1977 (September 1977), p. 15.

available), development lending by nations and international organizations totaled about $15 billion, up from less than $9 billion in 1973. 7/ The U.S. Treasury estimates that lending of this sort from official sources financed about 18 percent of total current account deficits in the years 1974 through 1976.

7/ World Bank, World Debt Tables, vol. I (September 1977), p. 100.

Lending by the IMF has also increased markedly over the past four years. During fiscal year 1973, the Fund's lending amounted to $1.4 billion; by fiscal year 1976, it had risen to $7.7 billion. [8] Despite this rapid increase, the Fund is still a relatively small international lender. The IMF provided enough credit in 1974 through 1976 to finance only about 7 percent of aggregate current account deficits.

THE PURPOSES OF INTERNATIONAL FINANCE

Just as the needs for international financing are numerous and varied, so are the institutions that provide financing. International organizations, national governments, and private institutions all make international loans, with each institution offering financing to meet a particular set of requirements. Some of this financing is intended to facilitate the flows of real resources among countries. The primary purpose of the development loans provided by international development banks and by bilateral foreign aid programs, for example, is to allow borrowing nations to import real resources--usually capital equipment and technical expertise--that are necessary for their economic development.

At the other extreme are lending arrangements intended to be purely financial in nature, with nothing other than financial assets changing hands. The purest example of this sort of arrangement is found in the very short-term "swap" arrangements among the central banks of industrial countries. Currencies are swapped only to allow a nation to stabilize its own currency by currency market interventions. Only currencies are bought and sold as a direct result of these transactions, and no real resources are exchanged.

In between these extremes are a wide variety of other transactions intended to serve particular purposes. Financing from a particular source may in fact have different effects in different circumstances. In some cases, for example, IMF loans temporarily support the purchase of imports until economic adjustments can be

[8] International Monetary Fund, *Annual Report 1977* (September 1977), p. 51. IMF fiscal years run from May 1 to April 30. Unless otherwise noted, in this paper the term "fiscal year" refers to IMF fiscal years.

accomplished. In other cases, they increase the foreign exchange holdings of a country to deter speculative actions. Commercial bank loans sometimes support particular industrialization projects, but frequently they simply provide foreign governments with foreign exchange for whatever purposes the borrowers desire.

International lenders often attempt to control the uses to which their loans are put by attaching conditions to loans, by lending only in particular circumstances or to particular borrowers, or by adjusting the terms of loans to make them particularly appropriate for certain purposes. For example, the long maturities attached to loans from the multilateral development banks and the requirement that loans from these banks be used to finance specific projects approved by the lender make these loans highly suitable for financing economic development. In contrast, loans from commercial banks usually carry no binding conditions on how they are used, and the usual maturities of five to seven years for these loans mean that they must be repaid before major development projects can be completed. Thus, commercial bank loans may be more attractive for financing temporary shortfalls in foreign exchange earnings or for increasing reserves of foreign exchange rather than for financing economic development. Similarly, the maturities (three to seven years) of IMF lending and the requirement that borrowing nations take steps to eliminate current account deficits are usually thought to make IMF lending inappropriate for financing economic development.

Despite the diverse purposes and policies of the various international lenders, however, the distinctions among the effects of various international loans are necessarily blurred. Whatever their intent, all international financial agencies do the same thing: they make the currency of one country temporarily available to another country. Currency from one source is indistinguishable from currency from another source, and it will serve equally well for any purpose regardless of its source. Governments may be borrowing from the IMF to stabilize a currency at the same time they are borrowing from the World Bank to build an oil refinery or a steel mill. There is no guarantee that the steel mill would not have been built without the World Bank loan. It could be that the ultimate effect of this loan was to provide general balance-of-payments support, since the steel mill would have been built in any case. Similarly, an IMF loan might provide sufficient balance-of-payments support for the government to contemplate using some of its foreign exchange earnings to build a new steel mill. The situation would be further complicated if the government were also borrowing in private capital markets to support a desired level of imports or if the private firm operating the new steel mill were selling international bonds or receiving direct investment from abroad. Wealthy citizens in the borrowing country may even be lending out their private assets to other countries as they make deposits in foreign banks or buy foreign government securities.

The result of all these transactions is a complex flow of financial resources. Trying to trace the effect of any particular type of loan is very difficult. It is impossible to know what would have happened in the absence of a particular loan, and thus it is impossible to know what effect that loan had. One may readily identify loans from particular sources as being designed to have a particular effect, but there is necessarily an element of fiction in any statement that a particular loan in fact achieved a particular purpose.

CHAPTER III. THE ROLE OF THE IMF

Although the IMF provides only a small fraction of total international lending, the Fund plays a unique role in the international financial system. Since its establishment in 1947, the Fund has been the primary institution responsible for the maintenance of a smoothly operating international monetary system. Through the years, the actions required of the Fund to fulfill this responsibility have changed as the nature of the international financial system has changed. Today the IMF is no longer responsible for the management of a system of fixed exchange rates. [1] Instead, its major function is to encourage member nations to adopt policies that will facilitate the international flow of trade and capital and to avoid actions that would restrict these flows.

The principal instrument available for the discharge of these duties is lending by the Fund to its member nations. This lending is designed to aid countries facing current account deficits and whose currencies are under downward pressure. The rationale behind this design is that a country that finds itself in such a situation may have no recourse but to impose restrictive trade policies or severely contractionary domestic economic policies, or to allow the value of its currency to fall abruptly. Such actions would reduce the exports of other nations, which in turn might respond by trade restrictions and devaluations of their own. By such a chain of events, a temporary disturbance in a few countries could lead to a general adoption of restrictive trade policies or a round of competitive devaluations that would harm all nations. Permanent changes in the world economy could bring about similar results if countries responded by adopting restrictive trade policies rather than by making necessary internal economic adjustments. By providing financing, the Fund can allow countries in temporary difficulty to avoid restrictive policies and give those facing more permanent problems time to adjust in ways that will not be harmful to other nations.

[1] Under the proposed amendments to the Fund's Articles of Agreement, the Fund will undertake "surveillance" of members' exchange-rate policies. What actions the Fund will be able to take to affect these policies is unclear.

There is, however, an important additional element in the operations of the IMF. This is the "conditionality" of Fund lending--the ability of the Fund to require that its borrowers adopt economic policies that will lead to reductions in payments imbalances and will insure that the borrower's external financial arrangements are maintained in good order. Financing is necessary for deliberate adjustment to changing circumstances, but because this adjustment can be politically and socially painful for many nations, there is also a need for some institution that will, in addition to supplying financing, insist on the adoption of policies that will lead to adjustment. Through the conditions associated with its loans, the IMF encourages adjustment that will not be accomplished at the expense of other nations, and it is this conditionality that sets the Fund apart from other international lenders.

Some other international lenders impose conditions on borrowers, but none for the same purposes as the IMF does. The multilateral development banks, for example, require that the funds they lend be used for specific development projects. Bilateral loans from governments often carry conditions about how borrowed funds are to be used or about where they must be spent. Only the IMF regularly requires that policies be adopted that will facilitate the smooth operation of the international financial system.

Private lenders--who provide the largest fraction of international lending--have been loathe to involve themselves in the internal affairs of borrowing nations, for both political and business reasons. Most international banks have a variety of financial interests in potential borrowing countries, and these interests make it important for the banks to maintain good relations with the host governments. Involvement in domestic economic policy could threaten these relations. Further, it is difficult for any one bank to impose stringent conditions on a borrower because the opportunity often exists for the borrower to take his business elsewhere. If conditions imposed by banks are to be effective, most of the major international banks must stand behind the conditions. Finally, few banks have the staff or the data necessary to determine what measures are required to correct payments imbalances in particular nations.

Similarly, governments are often unwilling to appear to be dictating internal economic policies when making loans to other governments. Borrowing nations may also find it politically difficult to accept conditions--even reasonable ones--that are imposed by foreign governments. As a result, bilateral loans rarely carry conditions that encourage economic adjustment.

The IMF is particularly well suited for providing conditional financing. Because the Fund is an international body with no direct interests other than maintaining order in the international financial system, borrowing nations are more willing to accept conditions imposed by the IMF than those imposed by commercial banks or other governments. In fact, governments often welcome IMF conditions because these conditions often provide a justification for politically difficult measures. It is also difficult for a nation to avoid IMF conditions by turning elsewhere for financing; commercial banks have in general been wary of lending to nations with large borrowing needs that have not first submitted to Fund conditions. The Fund is also better supplied with information than are the commercial banks. To receive a loan from the Fund, a nation must report data relevant to its present and prospective economic situation. Some of these data are not available to private lenders, and the Fund is generally regarded as having better information on the prospects of particular countries than other lenders have.

A further distinction between the IMF and other international lenders is found in the circumstances under which the Fund will make loans. In theory, IMF loans are made only for the purpose of financing (and eventually eliminating) a balance-of-payments problem. The Fund does not lend to finance specific projects for economic development as do the international development banks and the foreign aid programs of some developed countries. Neither does the Fund lend to support general programs of development as commercial banks sometimes do. In practice, however, this distinction may be more apparent than real, since many developing countries receive financing from a variety of sources, and it is impossible to identify what purpose is being served by any particular loan.

THE ADEQUACY OF IMF RESOURCES

As the requirements for international financing have risen, so have the lending activities of the IMF. During fiscal years 1972 through 1974, total yearly drawings from the Fund averaged SDR 1.4 billion (about $1.6 billion at that time). During the next three years, average drawings jumped to SDR 5.5 billion (about $6.5 billion) a year. This rapid increase in Fund lending has reduced the resources available to the Fund for future lending. Although total Fund holdings of currencies are quite large--more than SDR 32 billion ($38 billion)--only a fraction of these holdings can be used for making loans to members. Many nations whose currency is held by the Fund are themselves running large current account deficits or have reserve assets that are inadequate to maintain orderly markets for their currencies. Fund lending of these currencies might only exacerbate the difficulties of the deficit nations supplying the currency.

The determination of which currencies are usable at a given time is based on the Fund's judgment of the strength of member countries' current account and reserve positions. The Fund does not make public which currencies it considers usable at any given time, but it does publish its total holdings of usable currencies. In the last three years, these holdings have steadily declined. At the end of fiscal year 1975, they were SDR 10 billion; by the end of fiscal year 1977, they had been reduced to about SDR 4.5 billion. Further usable currencies will be added to the Fund's holdings as a result of loan repayments, and an additional SDR 5 or SDR 6 billion ($6 or $7 billion) will be added when the quota increase approved in 1976 under the Sixth General Review of Quotas enters into force. This quota increase is being ratified now by member countries and is expected to make additional resources available to the Fund in early 1978. 2/ The Fund also has some SDR 2.5 billion available to it for use in particular circumstances through the General Arrangements to Borrow (GAB). 3/ A Seventh General Review of Quotas is now

2/ A nation's quota represents the amount of its currency that is available to the Fund for lending to other member countries.

3/ In the early 1960s, it was feared that balance-of-payments support for the largest of the industrial countries would require financing in excess of the Fund's ability to provide it. To meet this potential need, special arrangements were made between the Fund and 11 major industrial nations (Belgium, Canada, France, the Federal Republic of Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States). Under these arrangements, called the General Arrangements to Borrow (GAB), the Fund may borrow up to certain limits from any of these nations for the purpose of making loans to some other members of the group. Total resources available under the GAB are about SDR 6.6 billion, but usable currencies remaining to be drawn amount to only about SDR 2.5 billion.

underway and is expected to be completed in February 1978 but, because the process of approval and ratification by member nations is expected to be quite lengthy, the increased quotas resulting from this review will probably not become effective until sometime in 1980. In the meantime, many observers--and the Fund itself--view IMF resources as being inadequate to support continued operations of the Fund at current levels. Until the larger quotas are available, it is argued, some additional temporary resources will be required.

Interest in a temporary expansion of IMF resources has also grown out of concern that private financing may not be available to some countries in the next few years. Since 1974, commercial banks have lent heavily to a small number of the wealthier developing countries and the weaker developed nations. With such large loans already outstanding, the private banks may be unwilling to increase their exposure to risk in these same countries. Thus, if any of the countries that have borrowed heavily in the last three years should need financing in the next few years, private financing may be unavailable, even though commercial banks will not have any shortage of loanable funds.

With private financial sources closed to them, these countries will have to turn to the IMF. Unfortunately, many of the countries that have had the largest need for financing in the past are also those whose economies and whose potential need for financing have grown faster than their quotas in the Fund. Because the amount of Fund credit available to a country is closely related to the size of its quota, many of these countries will have only very limited access to Fund credit. There is a widespread feeling that, in the near future, quotas of some countries will have to be realigned to reflect new economic realities. This cannot happen, however, until the Seventh General Review of Quotas enters into force. Negotiating new quotas is a difficult and time-consuming process, and success is by no means guaranteed. Some argue that a supplementary financing facility is needed to allow nations with unrealistically small quotas increased access to Fund resources until such time as quotas can be realigned.

NEW PROPOSAL: THE SUPPLEMENTARY FINANCING FACILITY

To meet the perceived requirement for a temporary increase in Fund resources, the executive directors of the IMF have established a Supplementary Financing Facility. This new facility is more commonly called the Witteveen Facility after the managing director of the Fund, H. Johannes Witteveen. If it is finally approved by the legislatures of the participating countries, the facility will provide an additional SDR 8.7 billion (about $10.5 billion) for IMF operations.

The resources for the Witteveen Facility will be lent to the IMF by nations with relatively strong economies. The Fund will then lend these resources to countries in need of financing. Fourteen countries have agreed (subject to legislative approval in some countries) to make resources available for this facility. Initially, the Fund will pay contributing countries a yearly interest rate of 7 percent on Fund borrowings from these countries. Subsequent adjustments will be made in this rate to keep it slightly above the average interest rate on U.S. Treasury securities with five years remaining to maturity. Roughly half of the resources for the Witteveen Facility will be supplied by oil-exporting countries, and half will be supplied by the stronger industrial countries. Table 2 shows the amounts each of the participants has agreed to furnish.

During 1974 and 1975, the IMF operated a temporary supplemental lending facility--the Oil Facility--that was in some respects similar to the proposed Witteveen Facility. The resources for the Oil Facility were borrowed by the Fund from oil-exporting and industrialized nations in the same way the resources for the Witteveen Facility are to be borrowed. (The group of nations contributing to the Oil Facility was not identical to the group that has promised to support the Witteveen Facility, although many of the same nations did participate. The United States did not contribute to the Oil Facility.) The interest rate structure of the Oil Facility was also similar to that planned for the Witteveen Facility: interest rates paid by the Fund to its creditors and by Oil Facility borrowers to the Fund were close to market rates of interest.

The major differences between the Oil Facility and the Witteveen Facility are the purposes of lending through these facilities and the conditions associated with them. The Oil Facility was intended to provide financing for member countries whose balance-of-payments positions suffered because of increased oil prices. The Oil Facility was seen as a temporary measure to help some countries during an unusually difficult period and, as such, it provided nearly unconditional financing. In contrast, the Witteveen Facility is intended to encourage adjustment to what are apparently permanent changes in the world economy. Witteveen

TABLE 2. CONTRIBUTIONS TO THE WITTEVEEN FACILITY: IN MILLIONS OF SDRs

Country	Contribution
Belgium	150
Canada	200
Germany, Federal Republic of	1,050
Iran	685
Japan	900
Kuwait	400
Netherlands	100
Nigeria	220
Qatar	100
Saudi Arabia	2,150
Switzerland (Swiss National Bank) [a]	650
United Arab Emirates	150
United States	1,450
Venezuela	500
Total	8,705

[a] The Swiss National Bank rather than the government of Switzerland will participate in the Witteveen Facility.

Facility lending will be available only to nations facing imbalances of payments that are large in relation to their Fund quotas. This lending will be available only in conjunction with drawings from the permanent facilities of the Fund and will therefore carry the same conditions as do drawings from these permanent facilities. Member countries will be able to draw on Witteveen Facility resources on a roughly matching basis with credit tranche or extended facility drawings. [4] The maximum amount available to a country through the Witteveen Facility will be 102.5 percent of the member's quota if the drawings are in conjunction with

[4] For a description of these permanent IMF facilities, see Appendix A.

credit tranche drawings and 140 percent of quota if they are in conjunction with extended finance facility drawings. In special circumstances (as yet undefined), the IMF can allow larger drawings on the Witteveen Facility.

The Fund may approve financing through the Witteveen Facility for a period of two years after the effective date of the agreement to establish the new facility. Once a loan is approved by the Fund, the borrowing nation may draw the approved amount over a period as long as three years. Loans made through the facility will have a maximum term of seven years. Borrowers will pay the Fund a "market-related" rate of interest--a rate determined by the costs of borrowing borne by the Fund. Interest charges will be èqual to the rate of interest paid by the Fund to its creditors plus 0.2 percent a year for the first 3-1/2 years of a loan and 0.325 percent thereafter. Initially, the Fund will pay its creditors 7 percent a year.

CHAPTER IV. THE NEED FOR EXPANDED IMF RESOURCES

Without question, the resources of the IMF have been heavily utilized in the last three years and, as a result, the resources available for use in the future have declined. What is not clear--and cannot be clear--is what future demands will be placed on the Fund's resources. The need for Fund lending will depend on factors that are very difficult to predict. Perhaps the most important of these are the policies adopted by individual member countries. In many countries, the principal obstacles to adjustment and the reduction of imbalances in international payments are political, not economic, and predictions of politically acceptable rates of adjustment are by necessity highly uncertain.

The need for Fund financing will depend also on the availability of financing from other sources. Here, too, economic factors may be of only secondary importance. No one expects commercial banks to run short of loanable funds in the next few years. If financing should become unavailable to some countries, it will be because banks decide not to increase their exposure further in these countries. Predicting the decisions of major banks about their loan portfolios is no easier than predicting government policies. Other major uncertainties are future decisions by OPEC on oil prices, the rate of recovery of industrial economies from the recession of 1975, and the prices of primary commodities exported by developing countries.

It would seem, then, that statements that the IMF must have expanded resources to meet its commitments are not justified. At the same time, it is not possible to identify trends in the world economy that will make expanded Fund resources unnecessary. The best that can be done is to identify those situations in which additional Fund resources might be useful. How likely it is that any of these situations might arise necessarily remains a matter of political and economic judgment.

A number of other issues have arisen that are not related directly to the need for expanded IMF resources but, instead, involve questions about whether the Witteveen Facility is the appropriate mechanism to provide additional international finance. The remainder of this chapter provides a brief discussion of the more prominent of these issues.

THE USE OF EXPANDED IMF RESOURCES

The most likely beneficiaries of the new IMF facility are the smaller and weaker developed countries of the OECD and the most advanced of the less developed countries (LDCs). A number of these countries--for example, Spain, Portugal, and Turkey--have been experiencing serious payments imbalances in the last year. These imbalances have been the result of higher oil prices and of falling demand for LDC exports brought on by world recession. Because the political situation is precarious in some of these countries, strong measures to reduce imports and restrictive fiscal policies to reduce overall demand have proved difficult to enact. Complete adjustment will most likely have to be postponed until the governments responsible for directing adjustment are more firmly in control. In the meantime, these nations will need financing to keep their economic and political structures functioning. Some of these countries have borrowed heavily in the past, and this fact, together with the uncertain political outlook, may reduce the willingness of private banks to extend further credits to these countries. (At present, this seems to be the case with Turkey. [1]) These countries may have no place to turn but to the Fund.

Although the amounts available through the Witteveen Facility would be small in comparison with the potential financing requirements of these countries, the existence of the new facility could have some important benefits. If the amount a country could borrow from the Fund were increased, then nations might be more willing to submit to IMF conditions and thus improve their chances of obtaining financing from private lenders. On the other hand, it might be argued that the size of IMF lending is not really important since in practice many nations must seek IMF financing, no matter what its amount, as a mark of creditworthiness in order to gain access to commercial credit markets. Proponents of this latter view point to the recent events in Peru. The government at first rejected IMF conditions, choosing instead to seek financing from private lenders. When private lenders proved unwilling to extend credit without a guarantee that the government would adopt

[1] For a more detailed account of the financial situation in Turkey, see Pamela Clarke, "Will the Banks and the Fund Make an Example of Turkey?" Euromoney (September 1977), pp. 16-23.

what the banks considered prudent economic policies, Peru was forced to go back to the IMF and submit to Fund conditions in order to establish its creditworthiness.

It would seem that the Witteveen Facility will do little to aid any but the richest developing countries. This is principally because lending through the Witteveen Facility will be related to the quotas of members, and these countries have very small quotas. Even after the quota increases expected in 1978, the 57 middle- and lower-income LDCs that are members of the IMF will have combined quotas of only about SDR 4.2 billion. 2/ Except in exceptional cases, Witteveen Facility lending will be restricted to an amount roughly equal to a country's quota, so that, even if all of the middle- and lower-income LDCs made full use of the new facility, they would use less than half of its total resources. Although these countries have small quotas, their needs for financing are considerable. The World Bank estimates that in 1977 these nations required some SDR 4.4 billion just to make service payments on the loans they have outstanding already.

Neither will the Witteveen Facility provide significantly increased financing for the most advanced industrial countries. The 10 largest industrial members of the IMF (in conjunction with Switzerland, which is not a member) already have special financing arrangements with the IMF. Because a drawing by any one of these larger countries would seriously deplete Fund resources, the General Arrangements to Borrow (GAB) were established in the early 1960s. Under these arrangements, the IMF may borrow from any participating member to acquire the resources to make a loan to another participating member. It was through the GAB that the IMF was able to offer a $3.9 billion standby arrangement to the United Kingdom in January 1976. At present, about $3 billion in usable currencies is available through the GAB, and it appears unlikely that the extra resources provided by the Witteveen Facility will be needed in the near term to finance loans to the major industrial countries.

It would seem, then, that the establishment of the Witteveen Facility would enable the IMF to extend assistance principally to the weaker developed nations and the strongest of the developing countries. This distribution of potential benefits may be desirable, since there is widespread agreement that the principal

2/ For a list of these countries, see Appendix B.

need of the poorer LDCs is long-term development financing of a type not supplied by the IMF and since most industrialized countries have ready access to private credit markets.

This distribution may also be very much in accord with U.S. interests, since the United States has much to gain by encouraging political and economic stability in the countries most likely to take advantage of Witteveen Facility lending. In Spain and Portugal, the prospects for continued democratic government would presumably be improved by economic stability, and Turkey's position as a North Atlantic Treaty Organization (NATO) ally makes its political and economic stability important to the United States. The United States, of course, has a broader interest in promoting a stable and smoothly operating international monetary system. To the extent that the Witteveen Facility will prevent disruptions of this system, it will serve these broader interests.

THE RELEVANCE OF IMF OPERATIONS TO PRESENT CONDITIONS

Some observers have opposed the Witteveen Facility on the grounds that it does little to address what they see as the principal problem facing the international financial system: deliberate attempts on the part of some nations to maintain large current account surpluses. Adjustment to changing economic conditions is a reciprocal process; if some nations are to reduce their current account deficits, other nations must necessarily reduce their surpluses. As long as the OPEC nations and some of the larger industrial nations continue to run large current account surpluses, no amount of adjustment on the part of deficit countries can reduce the need for current account financing. Indeed, if surplus countries persist in policies to maintain their surpluses at the same time that deficit nations are seeking to reduce their deficits, the result will be a reduction in the volume of world trade--an outcome undesirable to all nations.

Unfortunately, the IMF cannot easily affect the economic policies of surplus nations. It can impose conditions only on those deficit nations that seek financial assistance from the Fund. If surplus nations--which need no assistance--engage in restrictive trade policies or other policies designed to promote their own exports at the expense of those of other countries, the Fund can do little. Some observers contend that it is exactly such policies on the part of stronger nations that are inhibiting the worldwide process of adjustment.

The countries most often cited as engaging in such policies are the economically strong industrial countries. In the last year, West Germany, Japan, Switzerland, and the United Kingdom have all intervened heavily in international currency markets. The central banks of these countries have been buying dollars, thereby supporting the value of the dollar and limiting the appreciation of their own currencies. These countries have argued that these interventions were necessary to preserve "orderly market conditions," but some have seen these activities as efforts to maintain the competitive position of their exports by limiting price increases resulting from the appreciation of their currencies. Recovery from recession has been disappointing in all these countries, and all depend heavily on exports to provide stimulus to their domestic economies. Thus, maintaining a favorable competitive position and a high level of exports are important policy objectives for these countries.

Three of the countries that have been most active in currency market interventions--Japan, West Germany, and Switzerland--are running large current account surpluses, and the fourth--the United Kingdom--is expected to have a steadily improving current account position as exports of North Sea oil begin. By restricting the appreciation of their currencies, these nations may be hindering the process of adjustment. Ideally, the currencies of surplus countries should appreciate sufficiently to reduce their surpluses and restore international payments balance.

In addition, all of these countries have been following relatively restrictive fiscal policies designed to reduce inflation. These policies have had the effect of restraining demand for imports and thus further strengthening the current account positions of these countries. In recent months, both Japan and West Germany have announced somewhat more expansionary policies, but few observers see these rather modest actions as leading to marked increases in the rate of economic growth.

Unquestionably, an expansion of IMF resources would provide welcome relief for some deficit countries, but if the view of the present situation outlined here is accurate, this expansion of resources cannot be seen as offering a solution to the more serious problems underlying international payments imbalances. At best, it will allow more time for other international arrangements to be implemented to solve these problems. At worst, it may delay the recognition of these underlying problems and make their solution more difficult in the future.

Another view of the current situation is possible, however. It may not be possible for industrial democracies to pursue for very long policies designed to hold down imports. Recovery from the recession of 1974 and 1975 has been disappointing in most industrial countries other than the United States. In a number of these countries, unemployment rates are very high--at least by historical standards--and there is growing domestic pressure for these countries to adopt more expansionary policies. More expansionary policies would bring about an increase in demand for imports.

Neither, it is argued, can these countries continue to stimulate demand for their exports through manipulation of exchange rates. The example of the Bank of England's efforts to restrain the rise in the value of the British pound suggests that even massive currency market intervention may bring about only modest changes in exchange rates. [3] The expansion of the money supply that would be required for a central bank to affect significantly the value of its currency would be likely to produce exactly the inflationary pressures that restrictive fiscal policies were intended to avoid. One might expect, then, to see a

[3] On October 31, 1977, the Bank of England announced that it would cease the currency market interventions designed to keep the value of the British pound from rising. The value of the pound had been held down by very large purchases of foreign currencies by the Bank of England. During the first 10 months of 1977, British official reserves of foreign currencies increased from $4.13 billion to $20.21 billion, with $3.04 billion being accumulated in the month of October alone. The Bank of England was forced to end its currency market intervention because these massive inflows of foreign currencies reflected a very rapid increase in the domestic money supply that many feared would add to inflationary pressures. In the days following this announcement, the pound moved up in value relative to the U.S. dollar to a rate that presumably reflects the free market rate of the pound. After an initial rise of about 3.8 percent relative to the dollar, the pound seemed to stabilize at a rate of about 1.4 percent higher than had prevailed when the Bank of England was intervening. Thus, it seems that even massive interventions can affect exchange rates--particularly exchange rates relative to the dollar--only slightly.

decrease in the current account surpluses of some industrial nations during the next two or three years.

There is also some prospect for reductions in the current account surpluses of oil-exporting countries. Morgan Guaranty Trust Company has projected that the total OPEC current account surplus in 1980 will be less than one-third its size in 1977--a reduction from about $34 billion to a little more than $10 billion. 4/ These reductions in OPEC surpluses are expected to come about both as a result of conservation measures in oil-consuming countries and because of increased imports into OPEC nations.

Thus, there is some reason to think that current payments imbalances are a temporary phenomenon that may disappear in the next two or three years. If this is the case, then the temporary resources provided by the Witteveen Facility may be extremely useful both in providing financing during the period of adjustment and in imposing the conditions on borrowing countries necessary to insure that this adjustment does, in fact, take place.

Unfortunately, there is no easy way to determine which of these two descriptions of the current situation is closer to the truth. Much will depend on the political forces at work in the industrialized nations: how strongly the governments of these countries are urged to adopt more expansionary policies and whether they can resist pressure to adopt restrictive trade policies. Of equal importance will be the ability of governments in both the developed and the developing countries to pursue programs that will restrain the growth of oil imports without at the same time reducing total output. No amount of analysis can settle these issues. If one were sanguine about the prospects for economic recovery in the industrialized world and about the chances for reduced dependence on imported oil in all countries, then the Witteveen Facility might be seen as an important element in the process of adjustment. If, on the other hand, one were to see present payments surpluses in some countries as reflections of an attempt by these countries to stimulate their economies at the expense of their trading partners, then one would have to conclude that the Witteveen Facility would be of little help in resolving the problems facing the international economy.

4/ "The International Debt Situation," World Financial Markets (June 1977), p. 2.

THE APPROPRIATENESS OF IMF CONDITIONS

Some objections to the Witteveen Facility and to IMF operations in general have been raised on the grounds that the conditions imposed by the IMF are not always well suited to solving the problems facing borrowing countries. [5] Fund conditions are widely seen as being quite conservative in nature and placing a heavy emphasis on monetary policy. Typically, Fund conditions are concerned with the rate of credit expansion, the size of the government deficit, exchange-rate policies, trade policies, levels of foreign borrowing, and the maintenance of "adequate" reserves of foreign exchange. The focus of Fund conditions is usually on the short term; conditions are designed to stabilize the external payments of a borrowing nation within two or three years. Seldom is direct consideration given to such matters as the composition of government spending, the choice between investment and consumption (either public or private), government price and wage policies, or how the current payments difficulties relate to the longer-term economic goals of the borrowing country.

There are good reasons for the Fund's reticence to go beyond these areas traditionally included among its conditions. A definite focus on the short-term situation reduces the chance that the Fund will be seen as a source of long-term development finance. By restricting itself to relatively technical matters of monetary and exchange-rate policies, the Fund is able to avoid more politically charged issues of resource allocation within an economy.

Some have argued, however, that this narrowly focused, politically neutral orientation is becoming increasingly irrelevant to the problems confronting deficit countries. The adjustments that need to be made are by their nature long term and involve some important restructuring of economies. The transition to an economy less dependent on imported oil will in many countries require major new investment and perhaps significant redistributions of resources among individuals, among industries, and between the private and public sectors of the economy. Unless the Fund addresses these issues directly, it is argued, Fund conditionality will have only a minimal effect on the

[5] For a concise discussion of these issues, see the testimony of Professor Richard S. Eckaus before the Joint Economic Committee (April 21, 1977; processed).

pace of adjustment. In spite of the technical nature of Fund conditions, these conditions already have political content. Monetary policies and exchange-rate policies do affect the distribution of resources within an economy and can in part determine the rate and character of economic development. As long as the Fund is already involved in such political issues, critics ask, why should it not extend its concern to include a wider set of relevant economic issues?

THE IMF AND COMMERCIAL BANKS

It is sometimes argued that the principal beneficiaries of new official lending facilities are likely to be private commercial banks that have lent to deficit countries in the past. In this view, commercial banks are seen as having overextended themselves in their international lending--lending more (particularly to developing nations) than the borrowing nations can realistically be expected to repay or refinance within the maturity of the loans. In some cases, the banks may find themselves with no choices other than to accept rescheduling or postponement of repayments or to make further loans to allow the borrowing nation to continue to make payments on previous loans. If the latter course is chosen, the rescheduling of repayments is simply postponed. [6]

Commercial banks could extricate themselves from this kind of situation without losses if loans from new sources became available. These new loans would allow debtor countries to repay commercial banks, which could then reduce their exposure to risks of nonrepayment by refusing to make further loans. Thus, it is

[6] The recent financial arrangements between Zaire and its private creditors are an example of this kind of dilemma. In 1976, Zaire fell into arrears on its international loan repayments. Zaire's official creditors (foreign governments and international institutions) agreed to a rescheduling of debt, but private creditors refused to accept such a rescheduling, preferring instead to provide a new package of loans and to require that Zaire continue to meet its obligations under the terms of the old loans. The effect of this action was much the same as rescheduling; in either case, the commercial banks would be postponing repayment of their original loan.

sometimes said that the establishment of a new official credit facility is likely to provide no new financing for countries in need of support for programs of economic adjustment. Instead, it would simply reduce the risks borne by private banks.

Commercial banks would unquestionably benefit from the establishment of the Witteveen Facility--both because it would provide an additional source of credit for a nation that found itself hard-pressed to meet its financial obligations and because the conditions attached to Witteveen Facility loans are intended to insure the short- and medium-term creditworthiness of borrowing nations. But there is little reason to think that financing from the Witteveen Facility would encourage commercial banks to reduce their commitments to a borrowing country. One reason for this is the small size of the proposed Witteveen Facility compared with the size of private international debt outstanding.

The nations that are most often cited as uncertain credit risks and as potential users of the Witteveen Facility are the relatively advanced developing countries and the weaker OECD countries. These are also the nations that account for most of the sovereign lending (that is, lending directly to governments or government agencies in borrowing countries) by private creditors. At the end of 1975 (the latest year for which complete data are available), the total public debt owed to private lenders by the higher- and upper-middle-income developing nations was some $41 billion. [7] Since 1975, this debt has continued to grow and may have reached some $50 billion by the end of 1976. By comparison, the total resources of the Witteveen Facility will be only about $10 billion.

The amounts available to individual countries through the Witteveen Facility are also small relative to the size of their debts to private lenders. Table 3 lists the total disbursed public debt owed to private lenders at the end of 1975 by selected OECD countries and by some of the higher-income LDCs. Also given

[7] These classifications of developing countries are established by the World Bank. Included in these two categories are most of the more developed LDCs, as well as some of the weaker OECD countries. For a complete listing of these countries, see World Bank, World Debt Tables, vol. I (September 1977), p. 58. The $41 billion includes disbursed debt only; see p. 142.

TABLE 3. DEBTS OF SELECTED COUNTRIES TO PRIVATE LENDERS: IN MILLIONS OF DOLLARS

	Total Disbursed Public Debt Owed to Private Lenders December 31, 1975	IMF Quota	Debt/Quota (percent)
Weaker OECD Countries			
Greece	2,058	160	1,286
Portugal	438	136	323
Spain	2,272	458	496
Turkey	191	175	109
Yugoslavia a/	404	240	168
Higher-Income LDCs			
Argentina	1,741	510	341
Brazil	7,604	510	1,490
Chile	1,425	183	777
Colombia	639	182	351
Costa Rica	173	37	466
Dominican Republic	158	50	317
Guyana	83	23	358
Jamaica	460	61	748
Korea, Republic of	2,696	92	2,905
Malaysia	655	216	304
Mexico	8,910	429	2,076
Nicaragua	342	31	1,092
Panama	449	42	1,075
Paraguay	47	22	211
Peru	1,754	143	1,229
Syria	151	58	260
Zambia	434	88	492

SOURCE: World Bank, World Debt Tables, vol. I (September 1977), pp. 142-143.

a/ Yugoslavia is not a member of the OECD but is associated with some of the work of the OECD.

is each country's quota in the IMF and the ratio of debt to private lenders to quota. In most cases, the maximum amount that any country could draw under the Witteveen Facility would be roughly equal to its quota. Table 3 shows that for many countries drawings from the new facility would allow the retirement of only a small fraction of the debts owed to private lenders. It would seem unlikely, then, that a facility as small as the Witteveen Facility would in itself allow any major reduction in private international lending.

More important, however, is the fact that private banks have shown little inclination to reduce their international loans outstanding. In recent years, international lending has accounted for a growing share of the earnings of commercial banks, 8/ and these banks have suffered much lower loss rates on their international lending (particularly sovereign lending) than they have on their domestic lending. 9/ This does not guarantee, of course, that losses will not increase in the future. What it does indicate, though, is that international lending has been highly profitable for private lenders, and there is no reason for them to reduce their international lending unless for some reasons the risks involved were to increase significantly.

The establishment of a new lending facility would reduce the risks of foreign lending and would, if anything, increase the willingness of commercial banks to make foreign loans. The prevailing view among commercial bankers is that official lending (particularly IMF lending) and private lending are complements rather than substitutes. 10/ The extension of an IMF loan is widely seen as a certification of creditworthiness for the

8/ In 1976, international lending accounted for nearly half of the earnings of 13 large U.S. international banks. See International Debt, the Banks, and U.S. Foreign Policy, Hearings, Subcommittee on Foreign Economic Policy, Senate Committee on Foreign Relations, 95:1 (August 1977), p. 11.

9/ Bank for International Settlements, Forty-Seventh Annual Report, 1st April 1976 - 31st March 1977 (Basle: June 1977), p. 102.

10/ For a banker's view of this subject, see Irving S. Friedman, The Emerging Role of Private Banks in the Developing World (New York: Citicorp, 1977), pp. 52-53.

borrowing country, and the acceptance of IMF conditions by the borrowing country provides tangible evidence that the borrower has adopted economic and financial policies that will allow repayment of foreign debts. In some cases (notably Peru and Turkey in recent months), commercial banks have refused to make additional loans until the borrowing country has concluded a loan agreement with the IMF.

While there seems little reason to think that new IMF lending facilities will serve as a "bail-out" for private lenders, the complementarity of official and private lending does raise some questions about the need for additional Fund resources. To the extent that the Fund serves as a certifier of creditworthiness, it has the power to impose conditions on deficit nations, even if the financing provided by the Fund itself is minimal. If nations cannot obtain access to private financial markets without Fund certification, they will accept Fund conditions no matter how much or how little the Fund may provide. If the certification role is the principal source of the Fund's effectiveness, then the need for additional resources is questionable.

But the coordination between the Fund and commercial banks is not perfect. Banks do make loans to countries that are not subject to IMF conditions. In most cases, there is no question that the countries are creditworthy, and there is no need for IMF conditions to insure this. There may, however, be cases in which a country might not approach the IMF for financing because of the fear that such an approach would be seen as an indication that the country was in difficulty. In situations like this, nations might be more likely to turn to the Fund if the Fund could provide more credit. The wider involvement of the Fund in international lending that would result is sometimes seen as reducing the risk for all parties involved and strengthening the international financial structure. There remains, however, considerable disagreement about whether larger lines of credit will encourage wider use of Fund facilities and whether this wider use of Fund credit will, in fact, lead to greater international financial stability.

AN ALTERNATIVE TO THE WITTEVEEN FACILITY: THE FINANCIAL SUPPORT FUND

Because of the difficulties inherent in negotiating multilateral financial arrangements, the near-term alternatives to participation in the Witteveen Facility are few. It is unlikely that the terms of the Witteveen Facility could be renegotiated. The United States is in very much a "take it or leave it" situation with respect to this facility, and it is widely believed that without U.S. participation the new facility will never begin operations. Neither is it likely that any new multilateral agreement could be worked out in the near future; negotiations on the establishment of the Witteveen Facility began more than a year ago, and there is no prospect that, having rejected this arrangement, the United States could soon obtain agreement on another. The United States could attempt to make credit available in special circumstances through bilateral arrangements (as with the pending loan to Portugal) or in cooperation with other nations (as was the case in the loan to the United Kingdom managed by the Bank for International Settlements in 1977). The ad hoc nature of these arrangements, however, prevents their being a dependable source of financing on known terms for deficit countries.

It would seem that there is only one practical alternative for establishing a multilateral credit facility that could begin operations in the course of a few months. This facility is the Financial Support Fund, more commonly called the OECD Safety Net. U.S. participation in this facility was first proposed to the Congress by President Ford in 1975. Hearings were held before the Banking Committee and the International Relations Committee of the House and before the Banking Committee and the Foreign Relations Committee of the Senate. This last committee reported the authorizing legislation favorably, but no further action was taken. At the moment, it seems unlikely that the Safety Net proposal will be revived, but failure to reach agreement on establishing the Witteveen Facility could lead to renewed interest in the Safety Net.

As originally proposed, the Safety Net would have been operated by the OECD for the use of its members only; developing nations would have had no access to the Safety Net. The Safety Net was to have had resources totaling $25 billion. These funds would have been raised principally from borrowing by the OECD in private capital markets. Each participating nation would have had the option either of lending directly to the Safety Net or of furnishing guarantees for OECD borrowing. The United States would have chosen the guarantee approach to furnish its $6.9 billion share of the Safety Net's resources. Actual outlays from the United States would be required only in the event of default by some borrower from the Safety Net that made it impossible for the OECD to meet its obligations to its own private creditors. No oil-producing nations would have supplied funds or guarantees for the Safety Net.

Safety Net lending would carry market-related interest rates, and the maximum term of the loans would be seven years. In order to be eligible for a loan, a nation would need to have made "fullest appropriate" use of other sources of finance (the IMF, private banks, and its own reserves) and would have had to adopt specific economic policies to relieve its financing problems. Borrowers would have been required not only to adjust their domestic and international economic policies, but also to join in cooperative efforts with other nations to promote energy conservation and production.

Since the Safety Net was first negotiated in 1975, a sufficient number of other OECD nations have approved participation to initiate operations. The OECD has not done so, however--apparently for lack of U.S. support. It is possible that a reversal of the U.S. position regarding the Safety Net would allow this facility to begin operations. Such a reversal, however, could cause political and administrative difficulties from some OECD members that abandoned the idea of the Safety Net in favor of the Witteveen Facility principally because of the United States' refusal to participate in the Safety Net. It is by no means certain that these nations would be willing to accommodate themselves to another shift in U.S. policy.

The Safety Net offers some potential advantages over the Witteveen Facility. The most obvious is the much larger size of the proposed Safety Net: $25 billion compared with only $10 billion for the Witteveen Facility. (The original target for Witteveen Facility resources was SDR 15 billion--about $18 billion--but the final amount was reduced, reportedly because of reluctance by some oil-producing countries to make commitments for larger amounts.)

But the Safety Net has disadvantages, too. The most troublesome is that some of the nations most likely to need additional international credit in the next few years--the higher-income developing nations--would not have access to the resources of the Safety Net. Neither would the Safety Net make direct use of the reserves of the oil-exporting nations. These resources might be utilized indirectly as OPEC countries purchase bonds issued by the OECD to finance the Safety Net, but it would be the members of the OECD, not the bond holders, who would bear the risks associated with the Safety Net's loans. The risks of Witteveen Facility loans will be borne by all members of the IMF.

CHAPTER V. BUDGETARY TREATMENT OF THE IMF

In 1967, the President's Commission on Budget Concepts recommended that "subscriptions, drawings, and other transactions reflecting net changes in the U.S. position with the International Monetary Fund should be excluded from budget receipts and expenditures." 1/ The view of the commission was that transactions with the IMF were exchanges of assets with no budgetary impact. The IMF, the commission noted, was "like a bank in which funds are deposited and from which funds in the form of needed foreign currencies may be withdrawn." 2/

In 1968, the U.S. Treasury adopted this exchange-of-assets approach to transactions with the IMF. As a result, transactions to increase the size of the U.S. quota in the Fund and transactions to maintain the value of the U.S. quota no longer appear on the budget. Also excluded from the budget are loans made by the United States to the IMF under the General Arrangements to Borrow. (Such loans have been made recently to help the Fund finance a large loan to the United Kingdom.) If the United States should ever choose to borrow from the IMF, this transaction also would be off-budget. Two kinds of transactions with the IMF do appear on-budget, but not within the International Affairs budget function. These are the remuneration (interest) paid to the United States by the IMF whenever the Fund lends dollars to other members and the charges that would be paid by the United States if it were to borrow from the Fund.

Despite this practice of excluding most transactions with the IMF from the budget, appropriations were sought in 1970 for an increase in the U.S. quota in the IMF and in 1972 and 1973 for U.S. payments to the Fund to maintain the value of the U.S. quota. In none of these cases did appropriations result in any actual outlays. In 1975, the United States again made a maintenance-of-value payment to the IMF, but this time no appropriation was sought. Neither was an appropriation sought for

1/ *Report of the President's Commission on Budget Concepts* (October 1967), p. 31.

2/ Ibid.

the quota increase approved in 1977. In every case, Congressional authorization was required before payments could be made.

Because U.S. dealings with the IMF involve large sums of money, questions arise from time to time about the most desirable budgetary treatment for these transactions. Most recently, these questions have been raised with respect to the Witteveen Facility. In accordance with recent budgetary practice, no appropriation was sought when legislation authorizing U.S. participation was first introduced. Since then, however, there has been growing sentiment within the Congress that such financial transactions should be subject to the budget/appropriations process, and apparently an appropriation will ultimately be required for the U.S. commitment to the Witteveen Facility.

There is no simple answer to whether or not U.S. dealings with the IMF should be on-budget. It is clear that U.S. dealings with the IMF are, in some respects, different from other financial transactions, but it is not immediately clear that these differences should qualify the IMF for special treatment within the U.S. budget or that the current special treatment is appropriate. Arguments for and against the current treatment of IMF transactions may be advanced, but they are not conclusive. The remainder of this chapter will outline briefly the major points of these arguments.

THE EXCHANGE-OF-ASSETS CONCEPT

The present practice of excluding most transactions with the IMF from the budget is based on the view that in these transactions the United States is not making any budgetary outlays. Instead, it is transferring one kind of monetary asset to the Fund in exchange for another kind of monetary asset that will serve as well as the former for purposes of international payments. To see how this exchange takes place, it is useful to trace through a series of transactions with the Fund. Membership in the IMF requires that the United States make available to the Fund an amount of dollars--the U.S. quota in the Fund--for the Fund's use in its activities. [3] Making these dollars available

[3] Until now, one-quarter of the quota was to be provided in gold and the remainder in dollars. After the ratification of the Second Amendment to the Articles of Agreement of the IMF (expected in early 1978), gold will no longer form a part of a member's quota subscriptions.

to the Fund does not, however, require an outlay from the U.S. Treasury. When the quota of the United States is increased, the United States provides to the Fund not dollars, but rather a letter of credit for the required number of dollars. This letter allows the Fund to draw these dollars from the U.S. Treasury whenever the Fund has need for them. IMF quotas are fixed in SDRs rather than in dollars, and consequently it is necessary from time to time to adjust the number of dollars that the Fund may draw to account for changes in the value of the dollar relative to the SDR. These adjustments are known as maintenance-of-value payments, and in these transactions as well, no dollars change hands; only the amount of the letter of credit held by the Fund is changed.

No dollars are transferred to the IMF until the Fund has a need for dollars to lend to other members. The Fund then draws on its letter of credit and dollars are transferred. Whenever the Fund has drawn dollars in this way, the United States receives in exchange a claim on the IMF for a similar amount. The United States has simply to state that it has a balance-of-payments need for the amount of currency it has transferred to the Fund, and the Fund must return these amounts in the form needed by the United States--most likely foreign currencies. The Fund has no power to challenge this statement and must return its drawings when requested. It is this liquidity of the U.S. claim on the IMF that gives rise to the analogy between the IMF and a commercial bank. Dollars are deposited with either the IMF or a bank, but they must be returned at the discretion of the depositor.

Also like a private bank, the IMF pays interest on its drawings from the United States. The rate of interest paid by the Fund on most of its drawing, however, is below the cost to the United States of borrowing the funds it provides to the IMF. For example, in fiscal year 1976, the Fund paid an average rate of remuneration of 3.6 percent. In fiscal year 1977, this average rate rose to 3.85 percent. [4] During this same period, the cost of borrowing for the United States (as measured by the interest rate of six-month Treasury bills) fluctuated around 5 percent, and for the year ending June 30, 1977, the net cost to the United States of providing dollars to the IMF was around $30 million.

[4] International Monetary Fund, Annual Report 1977 (September 1977), p. 63.

This cost does not appear explicitly in the budget. The costs of U.S. borrowing appear as part of interest payments on the national debt, and remuneration received from the Fund is included in the budget under miscellaneous receipts. Nowhere is there a net cost of U.S. participation in the IMF. This cost is similar to a tax expenditure in that if either tax expenditures or the costs associated with foregone interest are omitted from the appropriate functional categories of the budgets, a misleading picture of federal spending will result.

U.S. transactions with the IMF through the Witteveen Facility would operate in a similar manner. The United States would undertake to make dollars available to the Fund when they were needed for the Fund's activities. When the Fund drew on these dollars, the United States would receive a liquid claim on the IMF and interest on the dollars borrowed by the Fund. The only difference between the drawings on the U.S. quota described above and Witteveen Facility drawings is that the interest rate paid by the Fund on the latter would be higher, to be set initially at 7 percent. In the case of the Witteveen Facility, interest payments by the Fund to the United States would fully cover the costs of U.S. participation.

For the last 10 years, the accepted view has been to consider as the equivalent of money the claim on the Fund that is received when it draws on the letters of credit provided by the United States. Thus, there has been no reason to consider these transactions as involving outlays. There is a logic to this treatment, but it must be recognized as fundamentally arbitrary. Many transactions of the federal government result in an exchange of assets. What distinguishes transactions with the IMF from, say, the acquisition of surplus agricultural products by the federal government is the liquidity of the asset received in exchange for cash. The claim on the IMF is highly liquid and, as a result, no appropriation is required to acquire this asset. Surplus grain is nonliquid, and its acquisition requires an appropriation. Problems may arise with government transactions that lie in between. Just how liquid must the asset received in exchange for cash be for the cash not to require an appropriation? Should federal loan programs be exempted from the need for appropriation since the federal government receives a claim on borrowers? Matters would be simplified if some criterion other than the liquidity of the assets exchanged could be used to determine which transactions should be on- or off-budget.

THE PURPOSE OF THE BUDGET

There are three principal reasons why a particular transaction of the U.S. government might be included in the budget. If all of these reasons apply to a particular transaction, then the case is presumably strong for including it in the budget. If one or more do not apply, the case is weakened. These three reasons are:

- That the transaction represents a transfer of real resources and, therefore, affects the level of aggregate demand in the United States or the allocation of real resources among competing uses;
- That the transaction will have an effect on U.S. financial markets by resulting in net government lending or borrowing;
- That Congressional and Executive oversight of the transaction would be facilitated by its inclusion in the budget.

A consideration of how each of these reasons applies to transactions with the Fund will illuminate more fully the problems inherent in choosing an appropriate budgetary treatment for these transactions.

The Transfer of Real Resources

If a loan from the IMF allows a borrowing nation to import goods or services from the United States that it could not have imported without this loan, then real resources are being transferred from the United States to the borrowing country. If, on the other hand, Fund resources are used purely for financial transactions--to stabilize the currency of the borrowing nation, for example--then no real resources are transferred. As was discussed above, there is no way of knowing for sure to which of these purposes Fund lending will be put. Indeed, it is likely that both happen to some extent. If U.S. participation in the IMF does result in additional claims on real U.S. resources by foreign countries, aggregate demand in the United States is increased and resources are diverted from domestic uses as a result of government action. To the extent that this is true, there would seem to be valid reasons for including transactions with the IMF on the budget.

Unfortunately, no conclusive analysis of the effects of IMF lending has been performed, and no firm answers can be given on this score. It seems likely that the effects of IMF lending on the demand for real resources in the United States will lie somewhere between the effects of lending through Federal Reserve swap arrangements, which are usually thought to have no impact on demand for real resources and do not require any appropriation, and lending by the World Bank, which has definite resource transfer effects and does require appropriation. There is a spectrum of government financial activities--some involving more transfers of real resources than others. Even if it were known for certain what the effects of IMF lending were, there would still remain an arbitrary decision to be made about what level of resource transfers is sufficient to justify inclusion of all or part of particular transactions in the budget.

Effects on Domestic Financial Markets

The projected federal budget deficit in any year provides an estimate of the amount of borrowing that the federal government will seek in private financial markets that year. The amount of this borrowing has important implications for interest rates and the desired growth of the money supply, and it would seem desirable for the budget deficit to give as accurate an estimate of federal borrowing needs as possible. When the United States is called upon to provide dollars to the IMF, these dollars must be borrowed in private financial markets. To the extent that budget deficits are supposed to reflect total federal financing requirements, transactions with the IMF should presumably be included.

It can be argued, however, that the uncertainties surrounding federal financing arrangements are already so great that the inclusion or exclusion of IMF transactions will make little difference. During U.S. fiscal year 1977, the United States provided $0.8 billion to the IMF that was not reflected in the budget. But during that same fiscal year, federal expenditures and thus federal financing needs were $16 billion less than anticipated in the Second Concurrent Resolution on the Budget for that year because of spending shortfalls throughout the government. Once again, the budgetary treatment of the IMF is a matter of judgment. Is inclusion in the budget of all transactions that may require federal borrowing a useful policy, when the uncertainty about the financing needed to accomplish even those activities now included is so large?

Congressional Oversight

Oversight of an institution like the IMF has always been problematic. There is general recognition that, within the limits of its Articles of Agreement, the Fund should be allowed to pursue its activities unhindered by the demands of member governments. It is, after all, an international organization that was established to serve international interests, not those of particular nations. Representatives of the United States have a voice in the day-to-day operations of the Fund, but it is only on special occasions--for example, when the Articles of Agreement are to be amended, when quotas are to be increased, or when a new credit facility is to be established--that the Congress must involve itself directly in the affairs of the IMF.

On these occasions, it is important that the Congress have a clear understanding of what the IMF is, how it operates, and what the major issues are that surround the pending decisions. Unfortunately, the desired level of understanding is not always easy to attain. In part, this is because Fund operations are often quite complex, and the Congress has no direct access to all of the documents and deliberations of the Fund. But it can also be argued that, because the Fund's operations are not reviewed regularly as part of the budget process, less attention is focused on it than on other agencies and institutions that must undergo this regular scrutiny. Because there is no regular review of Fund activities, this argument continues, an adequate system for collecting and considering information about IMF activities has not been developed. Some feel that a more thorough consideration of the options available for dealings with the IMF would result if the well-established procedures of the budget process were exercised in these matters.

While this idea may initially seem appealing, there are some difficulties inherent in it. The principal problem arises from the unpredictability of IMF operations. The budget process is designed principally to give the Congress control over the costs of carrying out programs in any year. Unfortunately, no reliable estimate of the costs of U.S. participation in the Fund can be given in advance. There is no way to predict accurately how much lending members of the Fund will seek in a given year and how many dollars the Fund will have to draw from the United States to finance this lending. Neither is there any way of knowing for sure when member countries will repay IMF loans and when the Fund will reduce its outstanding borrowings from the United States.

Thus, while it may be desirable for the Congress to keep a close watch over IMF activities, it is not clear that the budget process is the best mechanism for this oversight. Inevitably, estimates of outlays (if transfers of funds from the Treasury to the IMF were considered outlays) would prove inaccurate, and the integrity of the entire budget process might suffer as a result. This does not mean that the budget process would not provide a useful structure for debate over matters relating to the IMF. It very well might. But whether the value of this structure is sufficient to compensate for the difficulties inherent in applying the budget process to the IMF is finally a matter of judgment.

CONCLUSIONS

It would seem, then, that there is no clear answer to whether or not U.S. participation in the Witteveen Facility--or in any activity of the IMF--should require appropriations. Arguments can be made on both sides, and none is conclusive. The IMF is one of a number of ways that the United States makes international financing available to other countries. In some cases, this financing requires appropriations (U.S. contributions to the World Bank, for example), while in others, it does not (Federal Reserve swap arrangements). In some cases, the same financing seems to require appropriations in one context but not in another. For example, the Treasury Department argues that no appropriation should be required for the Witteveen Facility. Yet recently, the United States negotiated a bilateral loan to Portugal--a likely user of the Witteveen Facility--on terms similar to those anticipated for Witteveen Facility lending. This bilateral loan required an appropriation, and the question arises whether simply channeling a loan through the IMF removes the need for appropriation. 5/

5/ The principal distinction between a U.S. bilateral loan to Portugal and a loan to the Witteveen Facility for the same purpose lies in the type of claim the United States receives in return for its transferred cash. In the latter case, the U.S. claim on the IMF is highly liquid and can be redeemed at any time. In the former case, the claim is on Portugal and could be redeemed only at the full term of the loan.

Ultimately, any decision that a particular kind of lending does or does not require appropriation must be arbitrary. The various international lending arrangements differ from one another in degree, not kind, and there is no clear place to draw a line between those that require appropriation and those that do not. At the very least, consistency in treatment is desirable. The budgetary and economic differences between lending from the Witteveen Facility and lending from the general account of the IMF are minor, and there seems to be no reason to treat U.S. contributions to the Witteveen Facility very differently from the payment of the U.S. quota in the Fund. Thus, however the Congress decides to treat the Witteveen Facility, it is making at least an implicit choice about all IMF transactions.

APPENDIXES

APPENDIX A. THE OPERATIONS OF THE IMF

Membership in the IMF requires that a nation make available to the Fund a subscription of currency equal in amount to a quota assigned by the Fund. Quotas are determined by the size of the member's economy and the extent of its international trade and, with minor exceptions, the size of a nation's quota determines how much it can borrow from the Fund. [1] Three-quarters of a nation's subscription is paid in its own currency, and the remaining quarter is paid in gold. [2]

To borrow from the Fund, a member "purchases" some of the currencies held by the Fund in exchange for its own currency. To repay a loan, the member "repurchases" its own currency with foreign currency. (Because of this exchange of currencies, it is common to speak of IMF transactions as purchases and repurchases rather than as loans and repayments, although there is no real distinction.) A member may borrow an amount equal to one-quarter of its quota--this is the so-called gold or reserve tranche--on the basis of a simple representation to the Fund that it needs this loan to support its balance of payments. Further borrowing from the Fund is divided into four parts--known as credit tranches--with the member able to draw amounts

[1] At present, the only Fund lending that is not related to quotas is the relatively small amount (SDR 32 million) to date provided through the Trust Fund. In the past, Oil Facility loans were available without regard to quota.

[2] The Second Amendment to the Articles of Agreement of the IMF eliminates the requirement for payment of any part of quotas in gold and prohibits the Fund from accepting gold. This amendment is not yet in force; it is expected that a sufficient number of Fund members will have accepted the proposed amendment for it to enter into force in early 1978.

equal to one-quarter of its quota under each credit tranche. [3] The Fund reviews each request for credit tranche drawings and may refuse the drawing if it is not deemed consistent with the purposes of the Fund. As a nation draws on successive credit tranches, the conditions attached to these drawings become progressively more stringent.

The gold and credit tranches are the principal permanent lending facilities of the IMF and, for most of the Fund's history, tranche drawings have been the largest source of Fund credit. In fiscal year 1977, purchases of SDR 2.5 billion were made in the gold and credit tranches. In addition to these tranches, the Fund has established special facilities--either temporary or permanent--to meet particular requirements.

The best known of the special facilities is the Oil Facility, established for one year of operation in April 1974 and subsequently extended for another year. The Oil Facility was intended to provide relief for countries facing serious balance-of-payments problems arising from increased oil prices. Oil Facility lending was directed primarily at financing temporary deficits rather than at forcing deficit nations to adjust. As a result, the conditions attached to Oil Facility lending were much less stringent than those attached to other Fund lending.

Resources for lending through the Oil Facility were borrowed by the Fund from 16 oil-exporting and developed countries. The IMF then lent these funds to the ultimate borrowers. During the two years of its operation, the Oil Facility was the largest source of IMF lending, providing SDR 6.9 billion in financing. The United States did not participate in the Oil Facility either as a lender or as a borrower.

The largest of the permanent special facilities is the Compensatory Financing Facility. It is designed to provide balance-of-payments support to countries--particularly countries that are heavily dependent on the export of primary commodities--

[3] As a temporary measure, each credit tranche was widened to 36.25 percent of quota in January 1976. These widened tranches will remain in effect until the entrance into force (probably in early 1978) of the Second Amendment to the Articles of Agreement and the increase in quotas that will accompany this acceptance.

suffering a temporary shortfall in export earnings. In fiscal year 1977, purchases under this facility totaled SDR 1.8 billion.

Three other special facilities--the Extended Financing Facility, the Buffer Stock Facility, and, most recently, the Trust Fund--provide small amounts of financing. In fiscal year 1977, these facilities accounted for SDR 222 million.

THE DISTRIBUTION OF IMF LENDING

The IMF is not equally important to all nations in need of finance. While private capital markets are the largest source of international finance, all countries do not have access to commercial bank loans or to international bond markets. The poorest of the developing countries do not appear to private lenders to be good credit risks and, as a result, they have not been able to borrow from private sources. It is estimated that only about 21 percent of all new private international lending went to non-oil LDCs in 1976. 4/ Of the lending that did go to developing countries, most went to the higher-income LDCs. In 1975 (the latest year for which data are available), these higher-income countries accounted for 86 percent of all private loan commitments to non-oil LDCs. 5/ A rough estimate, then, of the fraction of private lending going to middle- and low-income LDCs is about 3 percent.

Because little private lending was available to the poorer LDCs, these countries were forced to seek financing elsewhere--either through bilateral loans from other governments or from the international development banks. The IMF has not been a major source of financing for these countries. Because their quotas are small, the amount of Fund credit available to them is limited. In fiscal year 1977, only 16 percent of all Fund lending went to these countries. 6/

4/ "The International Debt Situation," World Financial Markets (July 1977), p. 1.

5/ World Bank, World Debt Tables, vol. I (September 1977), pp. 146-147.

6/ International Monetary Fund, Annual Report 1977 (September 1977), p. 88.

THE TERMS OF IMF LENDING

The terms of IMF lending do not serve to set the Fund apart from other sources of international finance. In some respects, IMF terms are harsher and in other respects easier than terms attached to other loans.

IMF loans bear only slightly shorter maturities than do most commercial bank loans. Tranche drawings, compensatory financing, and buffer stock drawings from the IMF all have maximum maturities of five years. For Extended Financing Facility drawings, maturities are as long as eight years and for Oil Facility drawings, as long as seven years. The bulk of Fund loans have maturities in the three- to five-year range. This compares with the five- to seven-year maturities now common for commercial bank loans.

Other lending arrangements have maturities much longer and much shorter. Loans from the international development banks have maturities ranging from 15 to 50 years, and bilateral loans from the developed countries of the Development Assistance Committee (DAC) of the OECD had an average maturity of 33 years in 1975. [7] On the other end of the scale of maturities are central bank swap arrangements that normally carry a six-month maturity.

Interest rates charged by the Fund on its loans also occupy a middle ground. Drawings from the gold tranche carry no interest charges at all. Drawings from the credit tranches have variable interest rates depending on how long the drawing is outstanding. These rates begin at 4.375 percent and go up to 6.375 percent. Interest charges on some other facilities are slightly higher, reaching 7.875 percent for drawings under the Oil Facility in 1975. All drawings are subject to a one-time service charge of 0.5 percent. Table A-1 shows interest charges on various types of IMF lending. In fiscal year 1977, the average interest charged on all loans outstanding, other than from the Oil Facility, was 4.25 percent. The average rate on all Fund loans was just under 6 percent. [8]

[7] Organization for Economic Cooperation and Development, Development Cooperation, 1976 Review (Paris: November 1976), p. 158.

[8] International Monetary Fund, Annual Report 1977, p. 62. Average rates are lower than current rates because some

TABLE A-1. SCHEDULE OF IMF CHARGES ON TRANSACTIONS: PERCENT PAYABLE PER YEAR ON FUND HOLDINGS IN EXCESS OF QUOTA

Maturity Term	Tranche, Compensatory, and Buffer Stock Drawings	Extended Facility Drawings	1974 Oil Facility Drawings	1975 Oil Facility Drawings
Service Charge a/	0.5	0.5	0.5	0.5
Up to 1 Year	4.375	4.375	6.875	7.625
1 to 2 Years	4.875	4.875	6.875	7.625
2 to 3 Years	5.375	5.375	6.875	7.625
3 to 4 Years	5.875	5.875	7.000	7.750
4 to 5 Years	6.375	6.375	7.125	7.875
5 to 6 Years	---	6.875	7.125	7.875
6 to 7 Years	---	6.875	7.125	7.875
7 to 8 Years	---	6.875	---	---

SOURCE: International Monetary Fund, Annual Report 1977 (September 1977), p. 97.

a/ Payable only once.

These interest charges are generally lower than those imposed by the international development banks or by commercial banks. World Bank loans (representative of nonconcessional loans made by the international development banks) approved in fiscal year 1977 carried interest rates ranging from 8.2 to 8.9 percent. 9/ Commercial banks usually charge a variable interest rate that is determined by adding a fixed percentage "spread" to the prevailing London interbank offer rate (LIBOR) on six-month eurodollar deposits. Throughout the first half of 1977, LIBOR ranged from

earlier drawings were made at lower rates. For a brief description of changes in IMF charges, see "Fund's Resources are Drawn by Members to Meet a Wide Range of Payments Needs," IMF Survey (December 12, 1977), pp. 381-85.

9/ World Bank, Annual Report 1977 (June 1977), p. 88.

about 5.5 to 6.5 percent. Typical spreads were from 1.25 to 2.25 percentage points, with the lower spreads going to developed countries and the higher spreads to developing countries. This means that commercial banks were charging between 6.75 and 8.5 percent for foreign loans.

Concessional lending by the international development banks and by developed nations carried interest rates lower than some IMF loans. The International Development Association (IDA) charged only 0.75 percent on its loans approved in fiscal year 1977. In 1974 (the last year for which data are complete), the developed countries of the DAC charged an average of 2.6 percent on their loans to developing nations. [10]

[10] Organization for Economic Cooperation and Development, , Development Cooperation, 1976 Review, p. 231.

APPENDIX B. MAJOR GROUPS OF IMF MEMBERS

INDUSTRIALIZED COUNTRIES

Australia
Austria
Belgium
Canada
Denmark
Finland
France
Germany, Federal Republic of
Greece
Iceland
Ireland
Italy
Japan
Luxembourg
Netherlands
New Zealand
Norway
Portugal
Spain
Sweden
Turkey
United Kingdom
United States

HIGHER-INCOME LDCs

Argentina
Barbados
Brazil
Chile
China, Republic of
Colombia
Costa Rica
Cyprus
Dominican Republic
Fiji
Gabon
Guatemala
Guyana
Jamaica
Lebanon
Malaysia
Malta
Mauritius
Mexico
Nicaragua
Panama
Paraguay
Peru
Romania
Singapore
Syria
Trinidad & Tobago
Tunisia
Uruguay
Yugoslavia
Zambia

MIDDLE-INCOME LDCs

Bolivia
Botswana
Cameroon
Central African Republic
Congo, People's Republic of
Egypt
El Salvador
Equatorial Guinea
Ghana
Grenada
Guinea-Bissau
Honduras
Ivory Coast
Jordan
Kenya
Korea, Republic of
Liberia
Mauritania
Morocco
Papua New Guinea
Philippines
Senegal
Swaziland
Thailand
Togo
Uganda
Western Samoa

LOWER-INCOME LDCs

Afghanistan
Bangladesh
Benin
Burma
Burundi
Cambodia
Chad
Ethiopia
Gambia
Guinea
Haiti
India
Laos
Lesotho
Madagascar
Malawi
Mali
Nepal
Niger
Pakistan
Rwanda
Sierra Leone
Somalia
Sri Lanka
Sudan
Tanzania
Upper Volta
Vietnam
Yemen Arab Republic
Yemen, People's Democratic Republic
Zaire

OIL-EXPORTING COUNTRIES

Algeria
Ecuador
Indonesia
Iran
Iraq
Kuwait
Libya
Nigeria
Oman
Qatar
Saudia Arabia
United Arab Emirates
Venezuela

OTHER

Bahamas
Bahrain
Israel
South Africa