

A New Facility for the IMF?<sup>1</sup>

by

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This paper offers an assessment of the interests of developing countries in the proposal to create what is being referred to as a short-term financing facility within the IMF. (The label leaves something to be desired, inasmuch as the more distinctive feature of such a facility would probably be that it should be fast-disbursing rather than that it lend on short maturities.) The paper starts by discussing the purpose of such a facility, summarizes the sort of proposals that have been advanced regarding its mode of operation, and then turns to the main purpose of the paper, which is to evaluate pros and cons.

#### Purpose of the Proposal

Under conditions of high capital mobility, countries that receive capital inflows are vulnerable to swings of sentiment in the capital markets. If expectations were always rational, in the technical sense of being based upon the best possible forecasts of fundamentals using available information, and were independent of the opinions of other market participants, then there would be no case for having the official sector second-guess the conclusions of the market. But to the extent that markets are prone to speculative swings of mood (the phenomenon that

justifies the quip that a country is creditworthy as long as others are lending to it), it may be useful to have an official presence in the market. Note that there is a convincing institutional reason that can explain why markets may behave in a herd manner rather than act on longer-term, rational considerations, in that the managers of mutual funds are rewarded on a quarterly basis by comparison with their peers: a manager who missed out on the Mexican boom would have been penalized for it, while he would not necessarily have suffered from the Mexican collapse provided that his peers were caught as well.

One conception of what a new facility should attempt to do is to provide a backstop to resist speculative pressures that are not justified by the fundamentals. However, it may be argued that this would give it an unnecessarily broad brief, since the Fund's existing facilities are capable of handling many of the cases in which capital moves in what is judged to be a perverse direction. If one asks under what situations the Fund's existing arrangements are clearly inadequate, it is to deal with those cases where the need is for action so immediate that the normal operations of the Fund could not be effective. There are two, and only two, types of situation where this holds: (a) where a country is trying to defend an exchange rate peg; and (b) where a country is so illiquid that without international help it will have no alternative but to default. In both of those situations help has to be immediate if it is to be of any use at all.

Enthusiasts for floating exchange rates naturally oppose the idea of giving countries extra help in defending pegged exchange rates. It follows that they would seek to restrict the scope of any new facility to helping indebted "emergent borrowers". Others seek to limit the scope of a new facility to countries which pose a systemic threat, on the grounds that a case for international action can be justified only if there is some type of international spillover. In practice this would tend to restrict the availability of the facility to large countries.

Hence there are a variety of purposes that might be served by a new facility. At the broadest level, it might be charged with helping countries to finance, and therefore ride out, capital flows that were judged to be unjustified by the fundamentals and therefore destabilizing. A more restricted mandate would limit it to occasions when immediate access was vital, either to defend a pegged exchange rate or to avoid a default. A still more restricted mandate would preclude use of the facility to defend an exchange rate peg. A further limit to the mandate would involve restricting access to countries whose default was judged to pose a systemic threat. Most of the discussion that follows focuses on the broad version of the proposal.

Given that the IMF was conceived with the aim of providing a lender of last resort, it is a natural candidate for the role of providing a backstop facility to deal with disequilibrating capital flows. Of course, the original purpose of the IMF was to

lend to cover deficits in the current account, and Article VI specifically precluded lending to finance a capital outflow. But this Article has for long been something of a dead letter: at the very least, many of the current account deficits for which the Fund has lent have been amplified by capital outflows ("capital flight"). It is many years, if indeed it ever occurred, since the Fund exercised the right given to it by Article VI, Section 1(a), to "request a member to exercise controls to prevent...use of the general resources of the Fund" to meet a large or sustained outflow of capital. For some years now the Fund's policy has rather been to encourage liberalization of the capital as well as the current account.

### The Proposal

The idea of creating a short-term facility to counter capital flows judged to be speculative and destabilizing harks back to an idea that was discussed during the Committee of Twenty. It was revived by Michel Camdessus in speeches last May and June. Some tentative proposals were laid out in a paper presented to the IMF Executive Board entitled "Short-Term Financing Facility" dated 26 September 1994 (subsequently referred to as "the IMF paper"). It is these proposals that are summarized here. They are presented under five headings: the countries that should have access to such a facility, the terms of access, the level of access, maturity, and the source of finance for the facility.

The IMF paper contains no explicit discussion of *which countries would have access to the facility*, but it is clearly addressed to those member countries that have a high level of involvement in the international capital market. It appears to be addressed to the broadest conception of the purposes of such a facility, as discussed above. One can assume that the 49 countries listed in Table 1 of the IMF paper are judged to be potential candidates for access to the facility. These 49 countries comprise 22 industrial countries; 12 Latin American countries (including all 7 of the large countries); Korea and the 5 large ASEAN countries; Egypt, Israel, Jordan, Morocco, Tunisia, and Turkey; Hungary and Poland; and South Africa. Since the paper explicitly cites it as a country that might have used such a facility had it been available in January 1993, it is surprising that the Czech Republic is not included in the list. Another country that is not included but whose growing involvement in the international capital market might well make it a candidate for access is India.

Since the rationale of creating a new facility is to give the Fund the capacity to provide rapid access to funds that could be used to counter speculative disturbances, the *terms of access* are crucial. The IMF paper proposed that a request for the right to borrow under the facility should be made at the time of an Article IV consultation. The Board would approve the availability of a line of credit for a specified period, perhaps 6 months, if after a comprehensive review of the country's

policies it was determined that "(i) the member had a strong record of economic policies and performance and it was suggested that policies would remain appropriate; and (ii) the member was judged not to have a fundamental balance of payments problem."

The IMF paper envisaged two possible procedures under which a drawing might be made under such a line of credit. The first would give the country an automatic right to draw (at least a first tranche), with an immediate report to the Board but no need for Board approval of the drawing. The second procedure would require approval at the time of the request for use of the facility, which "would be approved if in the Fund's assessment: (i) the member's balance of payments problem was short-term; (ii) the member's economic policies had been appropriate since the last Article IV consultation; and (iii) the member was taking appropriate measures to address its short-term balance of payments difficulties." The first approach would provide more confidence to a member that it would be able to use the facility should the need arise and would in that event permit immediate access to the facility, and would therefore have more potential to reassure the markets; but it would expose the Fund to more risk. Conversely, the second approach would better protect the Fund, but at the cost of introducing uncertainty and delay into the process of approving a drawing, especially when the Fund felt that it was necessary for the country to make a policy change before a drawing was appropriate.

The IMF paper suggested that a country for which such a line of credit had been approved might be expected to report regularly a handful of key financial variables to the Fund as long as the line of credit was available. It declared that performance criteria and phased drawings would not be appropriate, but suggested that there might be a role for tranching (i.e., that requests for drawings beyond a certain level could trigger consultations or a review of policies). Periodic consultations would be expected as long as credit was outstanding under the facility.

The IMF paper points out that the *level of access* would need to be commensurate with the size of reserve losses that countries can sustain over short periods if the facility was to make a useful contribution to easing the problem of destabilizing capital flows. It explicitly argues that it would be undesirable for the facility to finance shocks fully, and it assumes that because of Article VI the facility should not be used to finance a large or sustained outflow of capital. (If it had said "large and sustained", or just "sustained", this would have been unexceptionable, but the whole purpose of the facility is to finance large outflows. Indeed, it is difficult to see how such a facility can be reconciled with the present wording of Article VI.) The paper also argues that the facility should play a signalling/catalytic role that would help to reduce the magnitude of the reserve losses that would need to be financed--although the Mexican experience suggests that one should not take it for

granted that Fund programs will be successful in inducing a reflux of private capital. After listing these imponderables, the IMF paper mentions a possible access range between 100 and 300 percent of quota.

That would have given Mexico access to an IMF loan of a maximum of \$7.8 billion, the figure that the Fund initially volunteered. That figure was subsequently supplemented by a further \$10 billion, in an impressive display of the Fund's ability to escape from its customary constraints when it judges the case to be compelling enough. But even that total of \$17.8 billion was little over a third of the total package that Mexico was judged to need. Thus the Mexican case would suggest that any useful facility will need to allow for the possibility of access on a substantially larger scale than the Fund was anticipating last September. Similarly, 300 percent of quota would be fairly modest in comparison to the exchange market pressures that developed in the ERM during its 1992-93 crisis: the Bundesbank has stated that DM 188 billion (some \$129 billion) was spent in defending ERM parities in the second half of 1992, a period during which the parities of six countries (Denmark, Ireland, Italy, Portugal, Spain, and the UK) with total IMF quotas of some \$23 billion came under attack. There were, of course, other sources of funds used in intervention besides drawings on the Bundesbank.

The IMF paper proposed that the maturity of the loans under the facility would be short. A basic maturity of three months

was suggested, with the possibility of rolling over for a further three months. Of course, it was recognized that a problem might turn out to be less transitory than had originally been anticipated: the IMF paper suggested that this could be met by funding via a standby or extended arrangement. (However, it was emphasized that the facility should not be used to provide bridging finance where the need for longer term financing was apparent from the outset.)

Once again, the experience with Mexico must make one doubt whether such a short-term facility would meet the need. What Mexico needed was the ability to fund a large volume of short-term into medium-term debt, which required at least the possibility of medium-term support.

So far as the financing of the facility is concerned, the paper suggested that this might be provided from the Fund's normal resources, including the possibility of activating the General Arrangements to Borrow (GAB), provided that access under the facility were within the existing limits on annual access for stand-by and extended arrangements. Since the Mexican precedent has suggested that a useful facility would require access much above those limits, however, it seems likely that the Fund would have to develop an alternative source of financing should the proposal materialize.

## Evaluation

Clearly members of the G-24 will need to evaluate their interests differently depending on whether or not they could expect to be eligible to draw from such a facility in the next few years. I shall consider first the interests of those countries that could expect to be eligible (see preceding section for a list of these), and subsequently of other countries.

### (a) *Interests of Potential Participants*

The dominant consideration for potential participants would presumably be whether an IMF facility of the type proposed would work. It would clearly have a limited role: it could not be expected to save a country that has a serious balance of payments problem (as Roberto Frenkel points out in his letter already discussed in the G-24), and indeed its availability to a country in that situation could make things worse rather than better. This is because aid is a two-edged sword: while it can be enormously valuable in giving adjustment measures time to take effect, thus mitigating the need that would otherwise arise to resort to unnecessarily savage deflationary actions, it can also provide an unfortunate opportunity to delay adjustment if it is provided before adequate measures have been adopted. Similarly, if a country were given access to the facility when its balance of payments position was unsustainable and before it had implemented adequate adjustment measures, the facility could simply provide it with the leeway to perpetuate the unsustainable

for rather longer, intensifying the ultimate pain when adjustment could no longer be delayed. Thus a key requirement for the facility to function effectively is that the Fund be able to diagnose whether or not the balance of payments position is sustainable.

Unfortunately, as Frenkel also notes, it is clear that the Fund's recent analysis has not been up to the mark. Many economists outside the Fund were on record as being concerned about the unsustainability of Mexico's policies in 1993-94, and the threat posed by rising US interest rates, yet apparently the IMF was complacent about the size of the current account deficit that had developed, despite an anemic growth rate, and the absence of any reason for expecting that the deficit would decline substantially without a real devaluation. The only obvious reason for imagining Mexico's policy stance to have been sustainable was the belief that its fiscal accounts were in surplus coupled with acceptance of the "Lawson thesis" that current account deficits do not matter if they are the counterpart to a deficit by the private rather than the public sector. But both elements of that argument were wrong. The Lawson thesis is erroneous in emphasizing the public/private counterpart to a deficit rather than whether it is being used to finance investment rather than consumption. (Note that the thesis has failed every time it has been advanced: in Chile in 1981, Britain in 1988, and Mexico in 1994.) Second, it turned out that Mexico actually had a less solid fiscal position than

appeared, since public sector capital spending had been moved off-budget into the Development Bank several years ago when it was so compressed that no one noticed, but it had grown again to 4.1 percent of GDP by 1994, without the IMF objecting.

However, rumors suggest that the IMF has learned from the Mexican debacle that current account deficits do matter. While any rule of prudence limiting the size of current account deficits judged sustainable is bound to be somewhat arbitrary, it would be better to have an arbitrary limit of (say) 3 percent of GDP than to have no specific limit at all. There should be some scope for making such a rule a little more sophisticated than a flat limit applicable to all countries, e.g. by allowing a larger current account deficit where it is financed by inflows of direct investment, by allowing a higher limit for a country with a rapid underlying rate of growth, and/or by allowing a larger deficit for a country with a low stock of debt or a high level of exports relative to GDP. But one should certainly demand that the IMF incorporate some reasonable limits on current account deficits into its judgments about sustainability before giving it the authority to approve automatic access to lines of credit to meet a speculative outflow. Unless and until a country had adopted adjustment measures designed to reduce the deficit to the sustainable range, a country with an excessive deficit should be ineligible. Mexico should not have been pre-approved in 1994 when its current account deficit was unsustainable and there were no policy measures in place to reduce it.

Within the limited range of cases for which such a facility might be relevant, its usefulness would depend on the answers to the following questions:

- (1) Would it be possible to provide funds fast enough to nip a crisis in the bud?
- (2) Would the facility be large enough?
- (3) Would the maturity of loans be long enough to nurture the reestablishment of confidence?

The question of the *speed* with which funds are provided is crucial. In order to be useful, a special facility would need to be able to provide funds considerably more rapidly than has been traditional. The suggestion in the IMF paper was that this could be accomplished by preestablishing at the time of an Article IV consultation access, or potential access, to a line of credit, provided that the Fund were satisfied that the country's policies merited support. Subsequent access to that line of credit in the event of need might be automatic or might require Fund approval.

Automatic access would clearly be an advantage in terms of permitting timely access when market pressures develop. Indeed, in the cases that some argue provide the only rationale for creating a new facility, where speed is crucial if assistance is to be of any use at all, automatic access would seem to be essential. This is because it seems inevitable that a requirement that the Fund approve a drawing on a line of credit would involve a significant delay before a drawing were possible. Admittedly there is no very obvious reason why IMF procedures

need be as slow as they are, and the speed with which the Fund moved in the Mexican case reinforces one's doubts as to whether it would not be possible to do better. Macroeconomic management is by now pretty familiar intellectual terrain. On the other hand, the Managing Director's commitment of the Fund in advance of consultations with the Executive Board provoked strong protests from some of the European countries. It would seem difficult to envisage a drawing taking place in much less than a month from the time a country recognizes that it faces a need unless that right is automatic. And a delay of a month gives a lot of time for financial markets to magnify a crisis.

It will be objected that a requirement of prior authorization would impose great demands on the Fund's analytical capacity to judge whether or not a country's policies are sustainable. Had the Fund erred by giving Mexico an automatic right to draw prior to 20 December 1994, it is entirely likely that the crisis would have been postponed a few weeks and would subsequently have proved even more intractable because the inherited stock of indebtedness would have been bigger. In fact, however, the difference in analytical requirements is quite limited. If the Fund had to make a quick decision at the time that a country needed to draw, it would still need to make judgments about whether policies were adequate and the balance of payments was sustainable: it would simply avoid the potential embarrassment of seeing a country that it had declared to be sound being judged by the markets to be risky without having the

chance to think again before it provided support. But if one believes that the Fund is capable of making sound judgments, and leading rather than following the markets, then it is really not obvious that it will be in a markedly better position to make such judgments at the time the country needs to draw than a few months before. Provided that the country is required to provide key financial statistics to the Fund that give assurance that its policy stance is indeed that which was endorsed at the time the line of credit was approved, the risks in automatic access ought not to be significantly greater than those involved in a decision at the time a drawing is made. It would be a tragedy if the Fund's blindness to the unsustainability of Mexico's policies, which easily could be and hopefully already has been remedied, were to preclude the facility being designed in such a way as to be useful.

The second question is that of the size of the facility. The Mexican experience made it transparently clear that in order to address this type of need the resources to be made available have to be much larger than those which have traditionally been provided by the Fund, or that were envisaged by the Fund paper of last September. The additional resources that would be needed might come from several sources: from an expansion in the size of the Fund's regular resources; from an expansion in the size of commitments to the GAB, and/or an increase in the number of countries that contribute to the GAB; from an alternative GAB-like facility that might be created for this specific purpose; or

from a decision to borrow in the financial markets, as recently suggested by Lamberto Dini. It would make little difference to borrowers as to where the funds came from, except insofar as potential participants might be expected to contribute relatively more under some proposals than others, with the presumption being that they would contribute the most if the facility were financed by a tailor-made GAB-like arrangement. But even this would not be a matter of much consequence to them, since the borrowings would doubtless remain liquid and the IMF pays market interest rates on its borrowing comparable to what a country can earn by holding reserves in other forms.

The final question is that of maturity. It has already been argued that the Mexican experience shows that the initial Fund proposal of a short-term facility would not be very useful. A longer-term facility could, of course, have a requirement for early repayment keyed to the reflow of reserves, so that the average expected maturity might be quite short, but any facility that has an unconditional requirement of repayment in a very short time frame seems unlikely to be able to help restore confidence except in the easy cases where this awaits some exogenous event (like the approval of NAFTA in November 1993).

*(b) Interests of Nonparticipants*

The interests of countries that would not participate in the new facility involve largely different issues. Of course, a facility that permitted countries that borrowed from it to ride out

unjustified speculative pressures would also have some spillover benefits for nonparticipants, inasmuch as avoidance of unnecessary deflationary adjustment in those countries would help to maintain higher demand for imports (and thus of exports from other developing countries). But there are at least two other issues that seem likely to be of greater significance to those that would not themselves expect to participate.

The first of these issues is whether the new facility would crowd out other lending activities of the Fund. Clearly this is much more likely if it were financed from the Fund's regular resources than if special arrangements were made to borrow from some other source, either the GAB, the potential participants in the facility in a separate GAB-like arrangement, or the market. This would be of special importance if the maturity were much longer than envisaged by the IMF paper, which was argued above to be essential if the facility is to be effective. Thus other developing countries would seem to have a very clear interest in ensuring that if such a facility comes into being it is provided with its own distinctive source of finance rather than that it draws on the Fund's regular resources, and that it be financed in a way that does not require nonparticipating developing countries to contribute.

The other issue that surely impinges on nonparticipants is whether the creation of such a facility might provide a mechanism for reinvigorating the Fund. It is a weakness of the Fund that since the mid-1970s it has provided rather little in the way of

services that its major shareholders find of any direct value: they have not borrowed from it, nor has there been any effective Fund input into producing mutual consistency among their macroeconomic policies. The main benefits that they perceive themselves to derive from their participation in the Fund are to have an institution to deal cooperatively with systemic problems like debt and the transition and to provide a collective international response to countries that require international support in order to get back on their feet. Having the Fund meet a systemic need for a backstop facility to stabilize the process of investment in emergent markets, or even more to help fulfill agreed exchange rate commitments on the part of industrial countries, might help maintain their support for the institution. Such support would seem to be in the interest of developing countries, inasmuch as they are now the borrowers from the Fund and the recipients of its technical assistance.

The adoption of a backstop facility might even provide an occasion for extending the scope of effective surveillance beyond the countries that borrow from the Fund. This is because it would introduce the Fund into the business of asking whether its members' policies are sustainable even when they are not seeking to borrow immediately. Essentially the same principles that are needed to evaluate whether a country can safely be given access to a line of credit could be used to evaluate the policies of the major industrial countries. It might therefore be a relatively small additional step to introduce effective surveillance over

the countries of major systemic significance, with the hope that might offer of improving their macroeconomic management.

If there is felt to be a need for backstop finance and the Fund is not chosen as the vehicle for providing it, one would assume that the BIS or the G-7 would be called on to fulfill that role. (However, the BIS has in the past provided only bridging finance, so that its acceptance of this role would be a major departure.) In either event developing countries would be deprived of any input into the determination of how much help is provided and on what conditions. Individual countries that sought help would have to negotiate bilaterally with the G-7 or the BIS, neither of which have any developing country participation, such as one hopes provides a relatively sympathetic environment within the Fund.

### Conclusions

The role envisaged for a backstop facility of the character discussed in this paper is necessarily limited, to cases where the balance of payments position is sustainable but not so solid as to preclude the emergence of speculative pressures in response to unexpected developments. This will typically mean countries with current account deficits in the range of 1 percent to perhaps 4 percent of GDP, or with larger deficits but where remedial adjustment measures have already been implemented and the Fund is satisfied that the deficit is in the course of declining to a sustainable level. If the facility were also used

to provide resources to help defend pegged exchange rates, it would similarly be crucial to develop and utilize techniques for estimating equilibrium exchange rates, and avoid lending to defend disequilibrium rates. (Given the uncertainty involved in this estimation, this would imply restricting support to countries operating with a wide band for their exchange rates.)

Quite a large number of developing countries, including many of the larger ones, might be eligible to draw on such a facility. Their interest is primarily in judging whether such a facility could work. This depends upon the IMF learning the lesson of the Mexican crisis, that large current account deficits are presumptively dangerous, and showing greater awareness of that in the future than it has done in the immediate past. It also requires that any facility be automatically available once a line of credit has been approved, upon the finance made available being on a scale substantially greater than the Fund has been providing in recent years, and upon maturities being decidedly longer than was envisaged in the Fund proposals of September 1994.

The interests of the remaining developing countries, those that still have little access to the international capital market and that accordingly are unlikely to be candidates for drawing on any such facility for the foreseeable future, are different. They certainly have a strong interest in ensuring that, if such a facility is developed, it has its own source of financing and does not lead to a squeeze on the funds available to them under

the Fund's existing facilities. Provided that condition is met, however, it might be advantageous to them to have such a facility developed within the context of the Fund, since this would help to keep the IMF alive and might help to increase its role in areas such as surveillance of the larger countries. The larger scale on which such a facility would have to operate in order to be effective might even create precedents to which nonparticipants could subsequently appeal in arguing for larger access limits under the Fund's existing facilities.

However, even if one does not take the traditional concerns about moral hazard very seriously,<sup>2</sup> it may seem unlikely that the industrial countries will be willing to endorse the conditions that I have suggested would be essential in order to allow such a facility to operate effectively. Most problems of capital flows can probably be addressed through the Fund's existing facilities, and it may be judged an over-reaction to create a new facility to deal with the occasional case where a threat of default could arise in the absence of immediate disbursement. Perhaps it would be better to think of some other way of containing that particular threat.

The most promising alternative approach would seem to be that being urged by Jeffrey Sachs, who has recently been developing proposals for giving the Fund a duty and a capacity to respond to debt difficulties by operating an international

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<sup>2</sup> What country would deliberately risk getting itself into a situation like that in which Mexico now finds itself because of a belief that this would entitle it to some bailout finance?

analogue to the Chapter 11 proceedings in the U.S. bankruptcy code ("The IMF and Economies in Crisis", mimeo). To prevent a government that has decided it wants to reform being pushed into a vicious circle, in which the erosion of the state's fiscal capacity emasculates its ability to supply basic services which in turn undermines the willingness of the populace to respect the authority of the state and pay their taxes, Sachs argues that it needs the same elements as in a financial restructuring under Chapter 11 of the U.S. bankruptcy code. These involve "a debt service standstill at the outset of reforms; fresh working capital during restructuring, so that critical governmental functions don't collapse; and (usually) some debt reduction at the culmination of reforms, to help reestablish the government's solvency".

It can be argued that the IMF already has the legal authority to impose a debt service standstill, by invoking the provisions of the IMF's Article VI. The fresh working capital during restructuring is already in principle provided by the Fund's lending programs (although, Sachs argues, typically on too modest a scale). Extensive debt reconstruction, involving both debt reduction and a stretching of maturities, was negotiated for a number of countries under the Brady Plan, albeit without the assurance that a legal basis would have provided for enforcing acceptance by recalcitrant creditors. Thus the idea of turning the IMF into an agency responsible for administering bankruptcy-style proceedings where countries find themselves impossibly

illiquid does not appear entirely fanciful. Moreover, market knowledge that this was likely to happen if a country overborrowed might provide a useful discipline discouraging the markets from pouring excessive funds into emergent markets as has tended to happen in recent years.

Addendum to "A New Facility for the IMF?"

In his speech to the Social Summit in Copenhagen on 7 March 1995, the Managing Director of the IMF mentioned study of "the role the SDR could play in putting in place a last-resort financial safety net for the world". A Reuters report of 21 March 1995 on forthcoming Executive Board discussions on increases of IMF resources stated that "Camdessus has suggested resurrecting a Japanese proposal made a few years ago to set up a new IMF loan facility of up to \$30 billion to help countries facing liquidity crises", which suggests that this proposal is being pursued within the Fund.

The intellectual antecedents of the idea go much further back than a Japanese proposal of a few years ago. In the 1970s the then Research Director of the Fund, Jacques Polak, pointed out the simplification in the Fund's operations that could be effectuated if the General Account were to operate exclusively in SDRs. Before that, the proposals of Robert Triffin to reform the IMF so as to allow it to increase liquidity (in *Gold and the Dollar Crisis*, 1959) had envisaged this being done partly by open market operations in which the Fund would buy securities in the money markets of major members and partly by allowing the Fund to extend loans to countries that needed to borrow from it. Earlier still, the Keynes Plan for an International Clearing Union had envisaged that bancor would be created automatically as credits on the books of surplus countries as deficit countries drew on their credit lines. So the basic idea goes back a long way.

Given that the world has a fiduciary reserve asset created by the IMF, nothing could be more natural, or technically more simple, than to use it to finance lender of last resort activities by a backstop facility of the character discussed in the main paper. This way of financing the facility might also overcome the main objection that was identified to such a facility from the standpoint of G-24 members, namely the danger that it would crowd out the normal lending activities of the IMF by competing for the limited pool of the Fund's financial resources. On the contrary, a decision to finance a new facility by the creation of additional SDRs might lead on in due course to a funding of all the Fund's lending by SDR creation, with the possibility this would offer of expansion in the resources available for other activities. (Of course, the fear of this effect may induce the financially conservative members of the Fund to oppose the proposal.)

The question arises as to whether the proposal is consistent with the Fund's Articles of Agreement. The principle for allocating SDRs that is enshrined in Article XVIII, Section 2(b), reads:

The rates at which allocations are to be made shall be expressed as percentages of quotas on the date of each decision to allocate...The percentages shall be the same for all participants.

No alternative basis for allocation is provided for in the Articles. It is therefore clear that a facility of indeterminate size would not be compatible with Article XVIII. What might be legal would be to create once-for-all a \$30 billion facility by

having every member, or all the members that would be eligible to draw, assign their share of an allocation to the facility.

Obviously those G-24 members that do not expect to draw would have an interest in ensuring that only countries that did expect to draw would be required to assign their share of the allocation: under such a formula they might even receive an allocation that otherwise would not happen.

This formulation recalls the many ingenious proposals that have been advanced over the years for enabling deserving groups of countries to receive new SDR allocations in the absence of a general allocation. The basic idea has always been that some countries should pass on their new allocations to the group that it was desired to favor. None of these proposals has ever won approval: they require not only the willingness of 85 percent of the Fund voting power to approve an allocation, but unanimous consent on the part of the members expected to assign their allocations.

The alternative to achieving such unanimity would be to amend the Fund's Articles, which is an equally daunting task.