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THE CHANGING FRAMEWORK OF INTERNATIONAL MONETARY COOPERATION:

SOME PROBLEMS AND ISSUES

by

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In recent years the Bretton Woods Agreement which has governed international monetary and financial relations since the Second World War has undergone a number of changes. These changes themselves reflect developments in the international economy and the shifts in economic power which have undermined some of the basic premises on which the Bretton Woods system was founded. The present arrangements, however, remain far from settled as countries are still trying to come to terms with a rapidly changing economic and financial environment. It is not our intention in this paper to examine all the various issues of international monetary relations raised by recent developments. Instead what we shall do is to look into the major ways in which the framework of cooperation has changed, particular attention being paid to the exchange rate question and factors directly affecting it. The position of the Less Developed Countries (LDCs) in relation to prevailing exchange rate arrangements will also be briefly examined.

The Bretton Woods System and its Background

The arrangements which formed the basis of international monetary cooperation until 1971 grew directly out of the currency chaos of the 1930's which was a period characterized by competitive devaluations, lack of convertibility, a great variation in exchange rate practices, discriminatory controls over international transactions, capital flight and bi-lateral agreements of various kinds. The fact that these policies proved to be largely self defeating pointed to the need for an agreed set of rules which could guide the conduct of monetary relations among countries. To this end the International Monetary Fund (IMF) was set up in 1944. That a major objective of the IMF arrangements was to prevent the emergence of the 'beggar-my-neighbour' type of policies of the 1930's are clearly to be seen in purposes of the IMF which include, among others the promotion of exchange stability, the maintenance of orderly exchange arrangements among members, the avoidance of competitive exchange depreciation, and assistance in the establishment of a multi-lateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

It was realised at the time that these objectives could not be achieved if attention was focussed solely on international payments. The IMF was conceived as part of a larger system which

included the International Bank for Reconstruction and Development (IBRD), which would provide long term financial assistance and the International Trade Organization (ITO), which would concern itself with the removal of trade restrictions such as tariffs and quotas within a multi-lateral non-discriminatory framework.[1] The ITO never became operational but the General Agreement on Tariffs and Trade (GATT) (which was intended to be a temporary arrangement) has survived to pursue some of the objectives of the former organization which was more embracing in scope.

Since both exchange controls and import restrictions have the same effects in practice this has necessitated a certain amount of collaboration between the IMF and GATT. The structure and approach of both organizations, however, differ in many respects. Generally the GATT is a much looser arrangement, not only relying on negotiations among its members for attainment of its objectives, but permitting the imposition of restrictions for balance of payments purposes under several of its articles. This applies even to countries which are no longer under the protection of the transitional provisions contained in Article xiv of the Fund's Charter.[2]

As far as developing countries[3] are concerned besides the general exceptions available to all members,[4] Article xviii gives special consideration to their conditions. This Article permits such countries "to take protective and other measures affecting imports"

if these are necessary "to implement programmes and policies of economic development designed to raise the general standard of living of their people... " It is worthwhile to note here that while the GATT recognises the need for countries in certain circumstances to employ trade restrictions, it directs no special attention to the export problems facing poor countries. It is also worth pointing out that there is a degree of inconsistency between the authorisation to "take protective and other measures affecting imports" and the reciprocity rule which requires contracting parties to match concessions in tariff negotiations. Not being in a position to conform to this latter requirement developing countries generally have benefitted relatively little from the GATT negotiations.

Despite the obligatory (legal) nature of both the IMF and GATT, the "exceptions' provisions of these agreements make possible the operation of a wide range of restrictions and controls in practice. GATT in particular with the difficulties inherent in in its negotiating procedures has managed to attain only limited success in removing such barriers to trade, which fall within the scope of its objectives. Recent events have shown that both the IMF and GATT lack authority to enforce policies in certain critical areas impinging directly on the adjustment process. For example, as Tew has pointed out, "there is nothing in either the GATT or the IMF Agreement to prevent surplus countries from retaining protective tariffs however much they may be warned off other types of restrictions".[5]

Exchange Rates under the Bretton Woods System

The major arrangements introduced by the IMF Agreement of 1944 centred around exchange rate policies. Under Article iv members were required to declare par values of their currency in terms of gold or the U.S. dollar. These par values could not vary by more than one percent[6] on either side of parity (in case of spot exchange transactions)[7] without permission of the IMF.

Responsibility for maintaining the declared rate rested with the national monetary authority of each country, which was required to intervene in the foreign exchange market as the occasion required. Except for a 10 percent margin of change to par values which members could make out of their own initiative, approval for changes generally depended on whether a member's balance of payments was seen to be in a 'fundamental disequilibrium'. This latter term was never defined but theoretically it was supposed to mean "a condition of persistent disequilibrium not amendable to monetary, fiscal and other economic measures, except at the cost of significant un-employment or retarded growth".[8]

The authority of the Fund derives largely from the credit facilities which it makes available to member countries for meeting short term payments problem in the conviction that such assistance will avoid the need for policies which may not only reduce domestic growth and employment, but which may be adopted by other countries as retaliatory measures. Access to the Fund's resources are not

without limit, and the conditions under which credit is granted takes on greater severity with increased or persistent borrowing. Whether initially intended or not the Fund may condition its loans not only on the basis of a particular exchange rate being observed, but on the modification of the whole range of monetary, fiscal and other economic policies which are thought to be affecting the particular country's external balance and performance. The Fund's perceptions, of course, (which are influenced in no small measure by the economic convictions of its dominant members) do not always accord with the priorities of member states, particularly developing members, and this has often been a source of serious conflict.[9]

While the Bretton Woods system concerned itself with current payments, capital transfers were left largely in the hands of national authorities. Initially there was some controversy about the kind of measures that could be adopted for controlling capital movements, particularly with respect to discriminatory currency arrangements or multiple currency practices. The position apparently taken after some deliberation was that these could be used so long as they did not interfere with current payments or hamper the transfer of funds in settlement of commitments.[10] The sections of the IMF Agreement dealing with capital movements are not very precise and provides room for considerable controversy. Initially the Fund seemed to have favoured a highly restrictive approach to capital transfers and this is apparent to some extent in Article IV of the

Agreement which states that a "member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of resources of the Fund". The apparently restrictive position reflected in the wording of this Article appeared to have undergone some change by the mid-1960's when a rather more liberal thinking began to emerge. In its 1964 Annual Report, for example, such restrictions were seen to be "less objectionable" than other exchange restrictions, 'particularly where they are intended to deal with speculative movements'. The report went on to state, however, that 'because of the difficulties and drawbacks attached to such restrictions, it is... preferable to follow, wherever possible, policies aimed at attracting appropriate equilibriating movements of private capital through international coordination of interest rates or similar international action, or to offset undue movements of short term capital through the use of international liquidity".[11]

On the basis of these views it is clear that at this time the IMF was unable to anticipate the degree of capital mobility in the early seventies, which have wrought such havoc with the fixed exchange rate system. Basically, as many people have pointed out, fixed exchange rates free capital movements and independent national monetary policies are not compatible.[12] The problem of control, however, is not a simple one. Capital transfers are responsive to a

wide range of factors which are not easy to distinguish in practice, and since certain forms of capital movement are widely considered to be essential to economic growth and development, controls are not easily recommended. In particular circumstances, however, countries have not hesitated to institute measures (exchange controls, dual exchange markets, etc.) with the aim of influencing capital flows against the backdrop of certain specific objectives related to internal or external developments.

The Changing Context

The Bretton Woods arrangements remained almost wholly intact[13] until 1971 when the U.S. decided to suspend convertibility of the dollar into gold, which was a critical arrangement to the system. Even before this, however, strains in the system had already manifested themselves, and in fact economists were pointing to weaknesses in the arrangements since the late fifties.[14] One of the main points of concern was the dependence on the U.S. balance of payments deficits as a source of international liquidity and the ability of the U.S. to meet its convertibility obligations. To be sure the IMF articles of Agreement do not require the U.S. to sell gold to monetary authorities at a fixed price and this condition is not essential to the maintenance of a par value system. As Mikesell has observed, however, the viability of the gold exchange standard of the kind embraced at Bretton Woods "depends upon the inter-

changeability of the different kinds of reserve assets at par, and the avoidance of massive flights from one reserve asset to another."[15]

The ,onvention adopted by many countries in the post-war years to maintain their parities in terms of the U.S. dollar and to hold reserves in the same currency[16] has its basis in the relative strength of U.S. economy in the early part of the period and the decision by the U.S. government to buy and sell monetary gold at U.S. $35 an ounce. This latter arrangement while providing a reference point for the par value system certainly enhanced the dollar as a reserve asset. The interest earning aspect of dollar reserves as compared to gold, and the inadequacy or un-attractiveness of other reserve assets have also been important factors in this respect.

The willingness of other countries to hold U.S. dollars has enabled the U.S. to expand its overseas expenditure and investment by running deficits on its balance of payments. These deficits have been a major source of world reserves in the post-war period. The fact, however, that the system imposed certain constraints on the U.S. particularly in terms of the external value of its currency has led some observers to the view that an 'intolerable burden' was placed on this country.[17] Others, however, feel that a reserve currency country is in a privileged position since it is able to settle foreign deficits by issuing its own currency.[18]

While their may be some truth in both these positions, the fact remains that the system has been associated with a remarkable growth in world trade. Between 1948 and 1971 the value of world trade (excluding trade of the centrally planned economies) is estimated to have grown from US$53.8 billion to US$314.5 billion (or by almost 500% at an average rate of 8% per annum. It is noticeable (from Table I) that the growth of US exports has lagged behind that of other major industrial countries. This country's share of world exports dropped from 23.2% in 1948 to 13.8% in 1971. The relatively poor export performance of the United Kingdom, the other reserve currency country is also very noticeable.

TABLE I

GROWTH OF FOREIGN TRADE OF SELECTED COUNTRIES,
1948 to 1971

US $ '000 million

Countries	1948	1971	% Change	Average Annual Growth %
Total World Exports[1]	53.8	314.5	485	8.0
Canada	3.1	17.6	468	7.8
France	2.1	20.6	881	10.4
Japan	0.3	24.0	7,900	21.0
United Kingdom	6.6	22.4	239	5.4
United States	12.5	43.5	248	5.5
West Germany	0.8	39.8	4,875	18.5

[1]Excluding trade of the centrally planned economies.
Source: U.N. Statistical Yearbook, 1975.

Faced with a dwindling gold stock and an increasing volume of dollars in the hands of foreign central banks, the US government was forced to put an end to the link between the dollar and gold. This was followed by a re-adjustment of exchange rates among major industrial countries under the Smithsonian Agreement, which resulted in a weighted average depreciation of the dollar of 12% against the leading currencies. In February 1973 the dollar was devalued a second time, and a system of floating of major currencies soon followed.

The Reformed International Monetary System

In January 1976, the Interim Committee of the Board of Governors of the IMF met in Jamaica and concluded a number of agreements which were intended to form the basis of a new international monetary system. The Jamaica meeting culminated the work started in 1972 with establishment of the Committee on Reform of the International Monetary System of the IMF Board of Governors (the "Committee of Twenty") whose views were presented in 1974 in an Outline of Reform.

The Jamaica Agreement covered several areas. The main provisions, however, revolved around exchange arrangements and the role of gold in the reformed system. The more important decisions can be summarised as follows:

(1) The quotas of individual members are to be increased.

(2) The compensatory financing facility has been liberalised. Under the new arrangements the Fund will be prepared to authorize drawings up to 75 percent of a member's quota, as against 50 percent under the 1966 decision. Maximum drawings in any one year are raised from 25 percent to 50 percent of quota.

(3) The Fund's holdings of each currency will be usable in the Fund's operations and transactions.

(4) It was agreed that the Interim Committee's consensus on the subject of gold reached at its fourth meeting should be implemented without delay. Three of the main points of that consensus were as follows:

(a) Abolition of the official price for gold;

(b) Elimination of the obligation to use gold in transactions with the Fund;

(c) Sale of one sixth of the Fund's gold for the benefit of developing countries, and restitution of another sixth to members.

These agreements will be supplemented by a set of arrangements which the gGroup of Ten will observe among themselves for two years and to which other member countries of the Fund can subscribe. These arrangements .include, inter alia, the following:

(1) That there be no action to peg the price of gold.

(2) That the total stock of gold now in the hands of the Fund and the monetary authorities of the Group of Ten will not be increased.

With respect to exchange rates a new article iv has been proposed for adoption. This article commits a member to collaborate with the Fund and other members "to assure orderly exchange arrangements and to promote a stable system of exchange rates". Exchange arrangements may include:

(a) the maintenance by a member of a value for its currency in terms of the special drawing right or other denominator, other than gold, selected by the member;

or (b) Cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members;

or (c) other exchange arrangements of a member's choice.

The par value system has not been completely abandoned. At some future date the "Fund may determine, by an eight-five per-cent majority of the total voting power, that international economic

conditions permit the introduction of a widespread system of exchange arrangements based on stable but adjustable par values".

The Fund's role under the new Article iv is to "oversee the international monetary system in order to ensure its effective operation... " In accordance with this function it "shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies".

At this point there are two questions to which we need to address ourselves if we are to see the present arrangements in perspective. The first question is how have the decisions taken in Jamaica affected the Bretton Woods system; and the second is to what extent do they fall short of what are widely considered to be desirable changes in the context of the observable trends in the international economy.

Let us take the first question. Under the Bretton Woods Articles monetary authorities were forbidden from buying gold at a price higher than the official one. The Jamaica Agreement by abolishing the official price for gold and eliminating all obligation to use gold in transactions with the Fund considerably reduces the central role which gold has played in the monetary system since 1944. One

effect of the abolition of the official price of gold may be to make gold less attractive as a reserve asset, since there may be considerable fluctuation in its value. In view of this, and in the light of the uncertainty which has come to surround the future role of this commodity it is surprising that the reform paid so little attention to the problem of reserve creation and composition. In the Outline of Reform (cited earlier) it was stated that SDR would become the principal reserve asset though it did not give any hint as to how this was going to be achieved.

As regards exchange rates the Jamaica meeting merely legalised what was a de facto and irretrievable situation. It had little choice. Member countries are no longer required to peg their currencies either to gold or the U.S. dollar. Under the new Article members are given much greater freedom in their exchange rate policies. Those so desiring can let their currencies float subject to their own intervention and to the restraints of the IMF, which latter are yet to be properly articulated. Countries who wish to peg can do so in relation to another currency, a basket of several currencies (including the SDR basket) or by mutual pegging. Changes in the peg can apparently be made as frequently and in as large amounts as are considered desirable. There are no limits, too, on the margins within which countries may wish to operate. It is worth noting that the decisions commit members to help promote "a stable system of exchange rates" and not "a system of stable exchange rates". Should conditions permit

the introduction of "exchange arrangements based on stable but adjustable par values", it is clear that this could only be done with the consent of the developed countries who have the necessary voting power in the Fund, to provide a 85 percent majority. The United States with about 20 percent of the voting power has been given an effective veto.

It needs to be pointed out that the decision by the IMF to legalise the system of managed floating among major currencies does not automatically solve the problem of international adjustment. Certainly it is better able to deal with the difficulties posed by large and volatile capital movements which now characterize the international financial system, and for which no rules have been yet devised. A crucial question on the efficiency of managed floating hinges on the problem of management. This is all the more significant in view of the fact that a system of floating rates is less amenable to international supervisory control than the parity arrangements.

Though the agreements concluded in Jamaica ignored many of the proposals contained in the Outline of Reform, some of which had broad support from a wide spectrum of governments and academics, many people still see the decisions as being of significant importance. Johannes Witteveen the Fund's Managing Director felt that the discussions provided "complete agreement on the far reaching amendments". Jean-Pierre Fourcade, the French Minister of Finance and Economy saw the outcome as marking the beginning of a new political and monetary

era. The U.S. Treasury Secretary William E. Simon compared the results of the Interim Committee negotiations with the 1945 agreement at Bretton Woods, which established the Fund.[19] Many academic economists,[20] however, have expressed great disappointment over the limited scope of the reform that has been undertaken. In particular they lament the lack of attention that has been given to such key issues as an effective adjustment mechanism, a framework for dealing with disequilibrating capital flows, international control and management of international liquidity, the composition of reserves and asset settlement. Another important issue receiving relatively little attention was the flow of resources to developing countries. Since SDRs were created there have been proposals that they should be linked to development assistance in some form or another. These proposals have so far not proved acceptable to the rich countries even though, as Triffin has pointed out, that of the SDR 100 billion growth of world reserves over the five years 1970-74 about 97 percent was invested in the developed countries - mostly the United States.[21]

Like the Bretton Woods Agreement the Jamaica reforms seemed to have been dominated by the developed countries. In fact the decisions with respect to gold and exchange rates are clearly a compromise between the views of the United States and France respectively- hence the particular satisfaction emanating from these two sources. The structure of the IMF, of course, gives a dominant position to the richer countries who control the decision making process. This to a

extent explains the almost total lack of attention paid by the Jamaica reform to the needs of developing countries, which are now well documented. It has been suggested that to the extent that the arrangements permit the industrial countries to improve their payments position, developing countries will benefit via financial aid and access to commodity and capital markets. It is also often pointed out that the reformed system will permit developing countries the same freedom with exchange rates allowed the industrial countries. It is worth noting, however, that under the new arrangements the basis of the IMF's authority is by no means removed. Floating exchange rates (and particularly the managed system that is prevailing) do not eliminate the need for reserves and IMF assistance. In fact a country pursuing a policy of pegging its currency to that of a developed country which is floating, may find itself with an increased need for reserves. If the peg is ~~to~~ a basket of currencies, the need ~~may~~ even be larger.

The LDCs and the Question of Exchange Rates

Though the question of exchange rates is one that concerns both developed and developing countries, discussions taking place both within and outside the IMF have until recent years largely excluded the latter group. It was not until after the Smithsonian Agreement that developing nations began to demand on active part in international monetary reform. They sought and got representation on the

Committee of Twenty which produced an Outline of Reform, which many believed would have formed the basis of a new monetary system.

One of the major criticisms levelled against the par value system was that it was too rigid in the sense that rates were not altered sufficiently quickly in response to changes in domestic conditions, and as a result the process of international adjustment was affected. It is important to note here that while the par value system did indeed come to be characterized by an excessive amount of rigidity, it has been argued by some observers that this was not due to the "constraints of the international regime but to the inherent characteristics of the national decision-making process on parities".[22] Changes in exchange rates which were supposed to be economic decisions aimed at facilitating the process of adjustment came to acquire deep political significance. The result was that desirable changes were often delayed and it was not until the situation assumed crisis proportions that a decision to adjust was taken. One of the anomalies of the Bretton Woods system was that while pressure could be brought on a country experiencing payments problems to adjust its exchange rates downwards and to institute what are thought to be 'correctional' domestic policies, there was nothing in the arrangements which could force surplus countries the take action aimed at achieving an equilibrium position. This situation was not helped by the fact that the United States which held a key role in the system could not change its exchange rate without throwing international

monetary relations into deep apprehension and disarray.

The par value system clearly did not function as the framers intended, and as a result it became very crisis prone, particularly in recent years with the huge movements in speculative funds. Some of the proposals put forward from time to time to overcome this rigidity include a wider band around which par values can fluctuate and more frequent adjustments of exchange rates to take account of domestic cost price changes vis-a-vis those of other countries. Though many academic economists have often strongly advocated floating rates as a more effective adjustment mechanism, this system has never had strong official appeal. In the Outline of Reform cited earlier, for example, the main features of international monetary reform were seen to include, inter alia "an effective and symmetrical adjustment process, including better functioning of the exchange rate mechanism, with the exchange rate regime based on stable but adjustable par values". Floating rates were recognised as providing a useful technique only in "particular situations".

As indicated earlier the reform undertaken in Jamaica does not lay down any specific regime which a country must follow. As worded the amendment to Article IV permits a wide range of options. In practice the system varies from one country to another. The most prevalent one that has emerged among the developed countries is that of managed floating. Under this system exchange rates are not left entirely to market forces as they would be under a pure float.

Monetary authorities intervene to keep fluctuations within acceptable limits. In this respect reserves still has a functional role to play, as indeed they also do in the financing of imbalances in the external accounts. The process of real adjustment to changes in the exchange rates is not instantaneous even under a floating rate system.

There are differences among the developing countries about what the ideal exchange rate system should be. A large cross section seems to prefer or system of fixed rates among the developed countries and a freedom on their part to operate with more flexible arrangements. Some are inclined to favour the old system of fixed rates for all countries, but with more flexible procedures for changing parities.[23]

In terms of exchange rate policies there is no doubt that the attitudes of developing countries are still significantly influenced by tradition in which the domestic currency was pegged to that of the 'mother' country with which the bulk of economic transactions was carried out. Even with changing circumstances the LDCs generally have shown a certain reluctance to depart from a system that does not permit a great deal of fluctuation in the exchange rates of the developed countries vis-a-vis their own currencies. Their concern over a more flexible system among industrial countries arises from a number of areas among which are:[24]

(1) it would increase uncertainty about real export earnings, import prices, and foreign exchange reserve values;

(2) it would lead to greater commodity price fluctuations;

(3) it would encourage the formation of currency blocs and might inhibit the diversification of LDC trade from traditional trading pattners;

(4) it would raise problems for reserve and debt management.

(5) it would require the development of forward exchange markets which would be difficult to establish in LDCs.

Without wishing to go into an exhaustive discussion of these points there are a few observations which are worth making with respect to what appears to be de facto as distinct from legal constraints facing LDCs in the formulation of exchange rate policies within the prevailing context. The first point to note is that LDCs generally depend heavily on foreign trade. The ability to guage the availability of foreign exchange from their exports is considered to be an important pre-requisite to long term planning. While this is a point that cannot be ignored many observers are quick to point out that foreign exchange earnings in developing countries (which rely on a narrow range of primary exports) tend to fluctuate more in response to supply and demand factors than the exchange rate changes.[25] They often further point out that apprehensions stemming from this source should be seen against the possible advantages flowing from the operation of a more flexible system among the developed countries.

To the extent that the latter are able to deal more effectively with their external positions, the less likely are they to resort to protective measures affecting the exports of developing nations.

The concern over greater fluctuations in commodity prices stems from the practice by which the prices of certain products are quoted in U.S dollars or sterling and the expectation that under a flexible exchange rate system these two currencies are likely to float downwards. Recent events, particularly those surrounding the 1973-74 commodity boom, have shown that the factors influencing product prices can outweigh the downward pull on receipts occuring through depreciating currencies.

As far as the formation of currency blocs are concerned there is no evidence so far that the tendency in this direction is significantly stronger under a flexible exchange rate regime. A major consideration underlying this particular concern is the fact that a country on the periphery usually have to link the stability of its currency to that of the currency of the centre country "with which it maintains its principal trade and financial relations".[26] Fluctuations in the centre currency are seen to impose severe constraints on the periphery country in a number of areas, chief among which is often listed the need to diversify the pattern of foreign trade, which is often very highly concentrated. As pointed out later there are other options open to an LDC besides pegging to a major currency.

For obvious reasons poor countries tend to be particularly sensitive to real losses in their reserves. The problem is by no means a new one. Even under the fixed exchange rate system losses could be suffered, as indeed happened in the latter half of the sixties and early seventies with the devaluations of the pound and the dollar. Even before floating became a reality many countries were already diversifying their foreign reserves portfolio (among available assets) in a manner consistent with their foreign trade and foreign debt commitments. Floating among major currencies, however, does raise some new questions for LDCs in terms of the level and management of foreign reserves.

Another of the arguments often advanced against flexible rates for developed countries is that LDCs would be faced with the task of developing forward exchange markets. Experience has shown that in a situation where transactions are largely carried out in foreign currencies, forward markets are not necessary. "To the extent that LDC traders wished to hedge against new relative movements of these currencies, they could do so through established forward exchange markets in the financial centres of industrial countries."[27]

Some Concluding Comments

It is clear that because the rigid Bretton Woods system managed to prevail for some twenty-five years, many people have come to view this system as being a natural one. The fact that this period

has been associated with a tremendous increase in world commerce has served to strengthen this belief. Despite this, it remains true, however, that exchange rates are inherently unstable since the basic conditions underlying them are always susceptible to change - hence the reason why many people are surprised that the fixed system lasted for so long. The conditions that would make possible a system of perpetually fixed rates do not hold in practice in the same way as it is difficult to conceive of a situation where rates are allowed to float freely in response to market forces. Cline has therefore rightly argued that the choice is not "between permanently fixed exchange rates and flexible rates but between fixed rates with infrequent but large disruptive exchange rate re-alignments and a system with more frequent but smaller rate changes".[28]

It is clear from the experience we have had so far with floating system that exchange rates among the developed countries are going to change more frequently than in the past. The fluctuations, however, are likely to be held within certain limits. Faced with this situation developing countries have a number of options open to them, each with its own advantages and disadvantages. They can peg their currencies to a major currency, a basket of currencies or a relation to the SDR. Pegging to a major foreign currency may carry with it a greater degree of certainty in terms of the country's foreign transactions and commitments. A major disadvantage of this

arrangement, however, is that it deprives the country of control over the effective exchange rates of its currency vis-a-vis other currencies.[29] Pegging to a basket of currencies itself is not free from problems of its own. The fact that this system may require the diversification of reserves calls for "expertise and skill in the management of the foreign-exchange port-folio in order to hedge against losses."[30] The options available to developing countries are clearly not unlimited. The particular arrangement chosen will have to depend on a careful weighing of the benefits against the costs both from a short and long term perspective, and against the background of the particular circumstances of each country. Political factors may have a bearing on the option chosen, as could such a question as economic integration.

NOTES

1. It was also intended (as is the GATT) to provide a body of rules to govern commercial relations among contracting parties, while acting at the same time as a forum for the resolution of conflicts arising from trading policies.

2. Section 2 of Article XIV provides that members may "maintain and adopt to changing circumstances... restrictions on payments and transfers for current international transactions. Members shall, however, have continuous regard in their foreign exchange policies to the purposes of the Fund; and, as soon as conditions permit, they shall take all possible measures to develop such commercial and financial arrangements with other members as will facilitate international payments and the maintenance of exchange stability...."

3. The term 'developing countries' is not clearly defined in the GATT Agreement. One writer has pointed out that the "special facilities accorded to a contracting party in the interest of its economic development were paralleled by identical facilities for use by any contracting party engaged in postwar reconstruction. See J.W. Evans, The Kennedy Round in American Trade Policy: The Twilight of the GATT? (Cambridge: Harvard University, 1971), p. 114.

4. Particularly Articles XIX, XX, XII and XIV.

5. See Brian Tew, International Monetary Cooperation, 1945 to 1970 (London: Hutchinson University Library, 1970), p. 100.

6. This was the case for all countries until 1971 when the major industrial nations signed the Smithsonian Agreement which permitted a band of ± 2.25%.

7. In the case of other exchange transactions the margin permitted could not exceed the margin for spot transactions by more than what the Fund considered reasonable.

8. See R.F. Mikesell, Financing World Trade (New York: Thomas Y. Crowell Company, 1969), p. 54.

9. For an interesting discussion on this subject see Cheryl Payer, "The IMF and the Third World", in Steve Weissman et al. The Trojan Horse (Palo Alto: Ramparts Press, 1974). See also The Debt Trap (Penguin Books, 1974), by the same author.

10. See J. Keith Horsefield, The International Monetary Fund 1945-1965 (Washington: IMF, 1969), pp. 403-404.

11. Quoted in Brian Tew, International Monetary Cooperation, 1956 to 1970 (London: Hutchinson University Library, 1970) pp. 104-105.

12. See, for example, Conrad J. Oort's presentation in Steps to International Monetary Order (Federation of Bankers Associations of Japan, Tokyo, 1974).

13. The first major amendment to the Agreement was made in 1969 with the creation of Special Drawing Rights (SDRs).

14. See, for example, Robert Triffin, Europe and the Money Muddle, (Yale University Press, 1957), See also his Gold and the Dollar Crisis, (New Haven: Yale University Press, 1960).

15. Mikesell, op. cit., p. 64.

16. Sterling has also served a similar function for some countries with close economic and political ties to Britain. Sterling's role in this respect, however, has been considerably less significant than that of the U.S. dollar.

17. See Peter G. Peterson's Report, A Foreign Economic Perspective (Washington 1971).

18. France has been a leading proponent of this view.

19. IMF Survey, Jan. 19. 1976.

20. See, for example, Fritz Machlup, "Between Outline and Outcome the Reform was Lost", in Edward M. Bernstein et al. Reflections on Jamaica (Essays in International Finance, Princeton Univ. 1976)

21. See R. Triffin, "Jamaica: "Major Revision" or Fiasco", in Reflections, op. cit.

22. Oort, op. cit., p. 27.

23. See CIAP, Latin American and the Reform of the International Monetary System, (Washington, D.C.: 1972), p. 24.

24. William R. Cline, International Monetary Reform and the Developing Countries, (Washington D.C.: The Brookings Institution, 1976), p. 14.

25. See for example, Cline, op. cit., p. 22.

26. CIAP, op. cit., p. 49.

27. Cline, *op. cit.*, p. 32.

28. *Ibid.*, pp. 14-15.

29. See Nurul Islam in Reflections, *op. cit.*

30. *Ibid.*