

LENDING OPERATIONS OF THE FUND  
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The International Monetary Fund has supervision over the exchange rate and exchange control policies of members and also provides financial assistance to members. The importance of its supervision of exchange rate and exchange control policies is generally recognized; opinions differ, however, on the importance of its lending operations. Mr. Nurkse says, "The main function of the International Monetary Fund will be to create an addition, and quite a substantial addition, to aggregate international liquidity."<sup>1/</sup> Mr. Viner, discussing the original Keynes and White plans, said, "By creating an additional and flexible supply of internationally liquid means of payments both plans would provide needed safeguards against either world or local deflations originating in national balance of payment difficulties. This is the greatest service which the plans would render ...."<sup>2/</sup> This paper examines the contribution which the Fund's lending operations may make to international monetary stability and the avoidance of deflationary and restrictive measures.

Reasonable stability and freedom in international monetary relations is possible only if appropriate measures are taken to achieve balance over a period of time in the international transactions of individual countries. The adoption of suitable exchange rate and exchange control policies is of fundamental importance. But it is perhaps of equal importance, if unnecessary changes in exchange rates, excessive restrictions on current transactions, and domestic deflationary measures are to be

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<sup>1/</sup> Ragnar Nurkse, Conditions of International Monetary Equilibrium, Princeton International Finance Section, "Essays in International Finance," Spring 1945, p. 13.

<sup>2/</sup> Jacob Viner, Two Plans for International Monetary Stabilization, New York Economic National Committee on Monetary Policy, 1943, Reprinted from the Yale Review of Autumn 1943, p. 13.

avoided, that countries have some available means of meeting balance of payments deficits. From this point of view the Fund's lending operations may be considered as important as its supervision of exchange rate and exchange control policies. Although the Fund has the power to object to exchange rate changes and exchange controls on current transactions, it can not do so in practice unless there is some other means of meeting the deficit or correcting the situation.

### The Fund's Lending Operations

The normal financial transactions of the Fund are essentially international lending operations. Unless special permission is granted the total net borrowing privileges of each member are equal to its quota,<sup>1/</sup> or subscription to the Fund, and no more than one quarter of this amount may be obtained in any twelve-month period. The obligation of each member to lend is also equal to its quota. Countries borrowing from the Fund put

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<sup>1/</sup> The provisions of the Fund Agreement run in terms of purchases of currencies from the Fund. Each member may purchase foreign currencies with its own currency until the Fund's holdings of its currency equal 200 per cent of its quota. This means that a member can purchase up to the amount of its quota plus the amount originally subscribed in gold. To the extent that a member obtains foreign currencies up to the amount of its gold subscription it is not obtaining net assistance from the Fund and is not in fact a net borrower from the Fund. If it should withdraw, e.g., it would take back all the Fund's holdings of its currency and would have no further obligation to the Fund.

Although the accumulation of foreign currency balances is essentially an international lending operation, the purchase of foreign currencies with gold is not. However, the Fund's operations in gold may involve lending operations. The gold subscribed by a member may be considered as a loan to the Fund. Also when the Fund uses gold subscribed by members to purchase currencies needed by others a larger proportion of all members' claims on the Fund are now claims on foreign currencies rather than on gold. At this stage the Fund itself becomes the lender. Ordinary gold sales through the Fund may also involve lending operations. When a country sells gold through the Fund to purchase a foreign currency there is no lending whatever if the Fund uses the gold to obtain the currency requested. If the Fund is able to keep the gold, however, and provide the currency from its own holdings, the country whose currency is provided is lending through the Fund.

up equivalent amounts of their own currencies, which they are expected to repurchase from the Fund within a reasonable period of time with gold or with currencies which are in short supply in the Fund. Countries lending through the Fund are countries whose currencies on balance are being made available to other members through the Fund. Such countries obtain equivalent additional privileges to obtain foreign currencies from the Fund.

Transactions of the Fund are limited to those involved in supplying foreign currencies to members in exchange for their own currencies at their request. It has no power to operate on its own initiative, except that it can sell gold or borrow in order to supply the currencies requested. Although the Fund is passive in this sense, its lending operations are not automatic. The Fund can and must exercise discretion in its lending operations. The Fund's resources are not intended to finance large or sustained outflows of capital, relief or reconstruction needs, or war debt settlements. It is probably fortunate that the Fund will not begin lending operations until the end of 1946 since the difficulty of avoiding the financing of relief and reconstruction needs would have been much greater if operations had begun in 1945 or early in 1946. Furthermore, the American and Canadian postwar lending programs, which have taken a heavy burden off the Fund and the Bank, might never have been adopted.

Most important of all, the Fund can and must refuse to lend to a country which is not using the resources made available "in accordance with the purposes of the Fund." One of the stated purposes is, "To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures

destructive of national or international prosperity."<sup>1/</sup> To continue to draw on the Fund to meet a deficit which promises to be chronic, while taking no measures to correct the deficit, would be a waste of the Fund's resources and of the member's borrowing privileges.

The Fund's supply of a particular currency, furthermore, may fall short of the amount which members exercising their normal borrowing privileges may request. The Fund must try to maintain a balance in its holdings of various currencies if it is to continue to be able to meet the requests of members. For this reason it must bear in mind the prospects that the borrowing country will be able in due course to repurchase amounts of its own currency paid into the Fund. Even from this very limited point of view, then, the Fund must satisfy itself that a borrowing country is adopting corrective measures so that it will be in a position to repay the Fund. If the Fund's resources were much larger and its ability to supply any particular currency were sufficient to meet all possible demands a compromise similar to that in the original Keynes plan might have been adopted. Only after a country had exhausted half of its borrowing privileges could certain corrective measures, including a change in exchange rates or control of capital movements, be required as a condition of further borrowing. Other internal measures could be recommended at this stage but could not be required unless a member had been borrowing up to 3/4 of its quota for at least a year. As a practical matter, there may be a range within which

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<sup>1/</sup> Some writers have argued that the phrase "in accordance with the purposes of the Fund" is much too vague in view of the fact that there are possible inconsistencies as between the various stated purposes. It would seem that the purpose quoted above which is the only one referring specifically to use of the Fund's resources is the directly relevant one, and, reasonably interpreted, excludes such extreme possibilities as that the Fund should be used to whatever extent is necessary to maintain exchange rates unchanged, or should be used to give the borrower time to correct the disequilibrium provided that it does so in the quickest possible way.

even the Fund, in its more vulnerable position, will exercise little discretion, but this range should be small.

Conditional Borrowing Privileges and International Liquidity

Will a country's ability to borrow from the Fund help to avoid measures "destructive of national and international prosperity" and lead to the adoption of more constructive corrective measures? Of course the Fund may refuse to approve certain measures and suggest drawing on the Fund temporarily instead. But there are restrictive and deflationary measures over which the Fund has no actual control. The important question is whether member countries themselves will be inclined to avoid restrictive measures in general because of their ability to draw on the Fund. One view is that the ability to borrow from the Fund will have little or no effect on the policies of any country unless it is an automatic right to borrow rather than a conditional borrowing privilege. Mr. Nurkse says that "conditional liquidity is not liquidity at all."<sup>1/</sup> And Mr. Williams says, "I have never sympathized with the idea that the way to protect the Fund is to make it operate like a bank. Critics of this general line of suggestion seem to me quite right in maintaining that this type of restriction on the use of the Fund will only undermine its usefulness. If the Fund is to operate as a common pool of foreign exchange resources, equivalent to gold, there must be the same freedom of access that pertains to gold itself."<sup>2/</sup> The implication is that a country will not postpone restrictive measures or adopt offsetting policies on the assumption that it may be able to borrow, but would if it were sure it could borrow. If this is true the lending operations of the Fund will be of little importance since the Fund must exercise discretion.

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<sup>1/</sup> Op. cit., p. 17.

<sup>2/</sup> John H. Williams, The Bretton Woods Agreements; Address before the Academy of Political Science, April 4, 1945, p. 42.

It seems likely, however, that monetary authorities will be able to act with increased confidence if they can reach a general understanding with the Fund on the circumstances under which Fund assistance will be forthcoming. Certain situations in which the Fund clearly should not continue lending can perhaps be defined at once. A member experiencing a rapid inflation should not continue to borrow unless drastic steps are being taken to curb the inflation. A country which has a substantial and continuing deficit because it is undergoing a rapid process of development or reconstruction should finance such a deficit by long-term borrowing rather than through the Fund. Again, continued use of the Fund is obviously unwise if costs and prices are seriously out of line with those abroad and a change in exchange rates is necessary. The principal feature of the understanding reached, however, must be not a ruling out of extreme or specific cases but a recognition that the Fund is intended to give only temporary assistance and that other ways must be found of meeting and correcting deficits which promise to become chronic. Members should be able to borrow for a time in order to plan corrective measures, and, if possible, to meet the deficit until such measures take effect.

Will the ability to borrow from the Fund do little more than take the place of private international short-term capital movements? Before 1914 such movements, sensitive to interest rate differentials, served a useful function, at least in relatively undisturbed conditions and for certain countries. Even if the Fund merely takes the place of such private capital movements, therefore, it will be of considerable importance since the prospects of such private capital movements in the future are extremely limited. It seems likely, however, that the Fund will be more useful than private capital movements in preventing restrictive measures. Many countries

have been unable to attract private capital and private capital in any case is subject to sudden withdrawal. Although controls may be used to prevent withdrawal such measures tend to restrict future capital inflows. In general, it is necessary, also, to raise interest rates to attract foreign capital. By contrast all members will be able to borrow from the Fund, no rise in interest rates will be involved, and the Fund can not withdraw its support suddenly.<sup>1/</sup>

#### Cost of Borrowing from the Fund

The attitude of countries toward borrowing from the Fund will be affected by the cost of borrowing. A service charge of  $3/4$  of 1 per cent<sup>2/</sup> must be paid on all amounts of foreign currencies obtained from the Fund. This is more than it costs to ship gold between most countries, which means that members are not likely to use the Fund to meet small day to day deficits. Such needs will be met by use of gold and foreign exchange reserves, perhaps through national stabilization funds. The charge would not be excessive if the funds were needed to meet a seasonal deficit, and the Fund may be used for this purpose. But the deficits of uncertain duration are those the Fund is really intended to help meet, and in such cases the service charge may be considered as a reasonable initial borrowing cost and should not be a serious deterrent to use of the Fund.

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<sup>1/</sup> The Fund can refuse to lend additional support but it cannot suddenly require repayment of past borrowings. If a member's reserves increase in a given year, and exceed its quota, it must use half the increase to repay the Fund at the end of the year, but in such circumstances the required repayments will not be difficult. A member may also be required to make repurchases if it has not drawn on its reserves at the same rate as it has borrowed from the Fund but such repurchases are known in advance and can be avoided.

<sup>2/</sup> This charge may be reduced to  $1/2$  or raised to 1 per cent.

Other charges, levied on net borrowings<sup>1/</sup> from the Fund, increase with the amount borrowed and the period over which it is used. These charges are designed to discourage excessive borrowing and encourage speedy repayment. They are very low as is shown in Table I. The table assumes a member borrows up to the normal maximum of 25 per cent of its quota in successive years. At the left is the rate paid on each 25 per cent borrowed in the year indicated, assuming no repayments -- it is these marginal rates which a country would consider in deciding whether to postpone repayment or borrow more.<sup>2/</sup> At the right is the average per annum rate paid on the total amount borrowed, assuming repayment in full in the year indicated. Neither the marginal nor the average rates paid on borrowings up to 5 years at least are as high as those paid for private funds in the past and they are probably lower than those at which private funds will be available in the future.

#### Borrowing Privileges Compared to Independent Reserves

To what extent borrowing from the Fund may help to avoid restrictive measures depends partly on the size of the total normal borrowing privileges of countries as compared to their independent reserves. If borrowing privileges are small by comparison they will probably have little effect on the policies adopted. Table II shows the relation between total

- <sup>1/</sup> These charges are levied on the Fund's holdings of a country's currency in excess of its quota. In other words they are not levied until after a country has obtained foreign exchange from the Fund up to the amount of its gold subscription. A country is a net borrower from the Fund when the Fund's holdings of its currency exceed its quota. Both interest and service charges are payable in gold.
- <sup>2/</sup> The marginal rate charged increases by 1/2 per cent for each upward step in amount and in time. When the rate reaches 4 per cent members must consult with the Fund with a view to finding ways to repay the Fund. After 5 per cent is reached the Fund may impose such charges as it deems appropriate. The whole scale of charges may be altered by a 4/5 vote.



Table I

## INTEREST RATES PAID ON BORROWINGS FROM THE FUND

Assumed Net Borrowing	Interest Rate Paid Per Annum on Amount of Net Borrowing Indicated During:					Average Interest Rate Paid Per Annum on Total Amount Borrowed Assuming All Borrowing Repaid at End of Year Indicated				
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 1	Year 2	Year 3	Year 4	Year 5
25 per cent of quota at beginning of year 1	<u>1/</u> .4	1	1.5	2	2.5	.4	.7	1.0	1.2	1.5
An additional 25 per cent of quota at beginning of year 2		1	1.5	2	2.5		.8	1.1	1.3	1.6
An additional 25 per cent of quota at beginning of year 3			1.5	2	2.5			1.3	1.4	1.7
An additional 25 per cent of quota at beginning of year 4				2	2.5				1.5	1.8

1/ No charge first 3 months, 1/2 per cent next 9 months.

normal borrowing privileges (equal to their quotas) and estimated gross official gold and dollar reserves<sup>1/</sup> as of the end of 1945 for all members other than the United States and Canada. The countries are grouped according to the percentage of their normal borrowing privileges to their reserves. The percentage of the exports of each group to the total in 1938 is used as a rough measure of the importance of the group in world trade. The borrowing privileges of countries accounting for 93 per cent of the 1938 exports of the countries analyzed are equal to 20 per cent or more of their independent reserves, and the borrowing privileges of countries accounting for 51 per cent of 1938 exports equal 51 per cent or more of their independent reserves. The total normal borrowing privileges are large enough to be of some significance for all countries in the more than 20 per cent range and of very considerable significance to all countries in the more than 50 per cent range. With special permission of course the normal limits on borrowing privileges may be exceeded.

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<sup>1/</sup> It would be preferable to include holdings of currencies other than dollars, especially those which are likely to be convertible, but data on such holdings is not readily available. For most countries they are not of great importance but the accumulated sterling balances of some of the Empire countries may represent an important addition to their reserves if they become convertible or if these countries have sterling deficits.

The official gold and dollar reserves at the end of 1945 include amounts which must be paid to the Fund in gold as part of each country's subscription. Estimated gold subscriptions were not deducted because each member can obtain foreign currencies from the Fund up to the amount of its gold subscription in addition to borrowing up to the full amount of its quota. No account is taken in the table of estimated new foreign gold production which will undoubtedly continue to add substantially to foreign international means of payments. Countries other than the United States, Canada, and Russia were producing between 8 and 9 hundred million dollars worth a year from 1938-1941. A large part of this gold production, however, will presumably find its way very quickly to the surplus countries rather than lead to an increase in the level of foreign holdings.

Table II

CLASSIFICATION OF MEMBERS ACCORDING TO PERCENTAGE OF THEIR TOTAL BORROWING PRIVILEGES TO THEIR RESERVES <sup>1/</sup>

(1)	(2)	(3)	(4)	(5)
Groups	Percentage of Total Borrowing Privileges of Individual Countries to Their Reserves	Countries	Value of 1938 Exports of Each Group as Percentage of Exports of All Countries Analyzed	Column (4) Percentages Cumulated
I	Over 100	Czechoslovakia, Denmark, Ethiopia, Honduras, India, Iraq, Luxembourg, Poland	13	13
II	76 to 100	Costa Rica, Dominican Republic, Egypt, Yugoslavia	3	16
III	56 to 75	China, Paraguay, Peru	4	20
IV	51 to 55	Greece, United Kingdom	31	51
V	36 to 50	Bolivia, Chile, Philippine Commonwealth	3	54
VI	26 to 35	Belgium, Brazil, Colombia, Mexico, Netherlands	24	78
VII	20 to 25	Cuba, France, Nicaragua, Norway, Panama	15	93
VIII	Less than 20	Ecuador, Guatemala, Iceland, Iran, El Salvador, Union of South Africa, Uruguay	7	100

<sup>1/</sup> Total borrowing privileges are total normal borrowing privileges, i.e. equal to a member's quota. Reserves are <sup>estimated</sup> gross official gold and dollar reserves as of the end of 1945. The table analyzes all members of the Fund other than the United States and Canada, which presumably will not borrow. The data for Belgium, France, Netherlands, and the United Kingdom include data for their respective colonies. No data is available on exports of Luxembourg and Ethiopia. The figures for Belgian exports include Luxembourg.

Borrowing from the Fund versus Using Reserves

The ability to borrow from the Fund may make a real difference in the policies even of countries whose normal total borrowing privileges are less than 50 per cent of their independent reserves. Many of these are countries which have relatively large independent reserves, but their borrowing privileges are also large and borrowing from the Fund may be regarded differently by them and have substantially different effects than those which follow from the use of reserves. For various reasons, partly psychological and political, most countries seem loath to use their reserves. Even the war-devastated countries, with the exception of France, <sup>and the Netherlands</sup> have shown little inclination to draw heavily on reserves to meet their urgent needs. Borrowing from the Fund may be regarded differently since it involves taking advantage of a privilege which might not be available at another time or for other purposes, whereas a country may use its own reserves at any time and for any purpose. The internal monetary effects of borrowing from the Fund may also be different from those of a loss of reserves. Monetary authorities should regard borrowing from the Fund as equivalent to a loss of reserves in the sense that it indicates a deficit which must be watched and may have to be corrected but differences arise in other respects. The effect on confidence may be quite different, <sup>and</sup> however, ~~the~~ effect on domestic monetary policies may be much less as long as gold continues to be needed to meet legal reserve requirements and the net position of a member vis-a-vis the Fund is not taken into account in the calculation of legal reserves.

It is important to bear in mind that countries with reserves in excess of their Fund quotas <sup>1/</sup>do not have a choice, over a period of a year

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<sup>1/</sup> See Table V. Countries accounting for 83 per cent of 1938 exports had reserves in excess of their quotas at the end of 1945.

or more, between using only their reserves or only the Fund to meet a deficit. The repurchase provisions, described below, require member countries year by year to draw on their reserves at the same rate that they borrow from the Fund. It is possible, however, that a loss of reserves will be regarded so differently from use of the Fund that a halving of the loss of reserves will enable a member to pursue different policies. Furthermore, a lump payment of gold or foreign currencies to the Fund at the end of the year in discharge of repurchase obligations may have quite different effects from a steady loss of reserves.

#### Borrowing Privileges as Compared to Probable Needs

The extent to which the ability to borrow from the Fund will affect the policies of individual countries depends also on whether borrowing privileges are large enough in relation to probable needs to be significant. The quotas which determine the maximum normal borrowing privileges of members could not be determined solely on the basis of need. They govern both borrowing privileges and lending obligations and were determined partly on the basis of the ability of members to lend through the Fund. To some extent, then, the distribution of quotas reflects the wealth and balance of payments position of countries in the same way as the present distribution of independent gold and dollar reserves.

A satisfactory measure of the need of member countries for foreign exchange assistance would be a measure of the probable size of the deficits on current account which they are likely to face. It would be extremely difficult to obtain reasonable estimates of probable future deficits. It may be useful, however, to compare the normal annual borrowing privileges of members with a rough estimate of the value of their exports in a post-transition period year. The value in current dollars of their exports in

1938 may be taken as this rough estimate. Table III classifies member countries according to the percentage of their annual normal borrowing privileges (equal to 25 per cent of their quotas) to the value in current dollars of their exports in 1938. The table shows that countries accounting for 88 per cent of 1938 exports have annual borrowing privileges equal to 10 per cent or less of their exports, countries accounting for 82 per cent of the 1938 exports have annual borrowing privileges equal to 7.5 per cent or less of their exports, and countries accounting for 21 per cent of the 1938 exports of the countries analyzed have annual borrowing privileges equal to less than 5 per cent of their exports. This suggests that the members which will be able to meet a 10 per cent or even a 7.5 per cent decline in the value of their exports by using their normal annual borrowing privileges are few and relatively unimportant. A 10 per cent decline in the value of a country's exports might well occur as a result of crop failures, a decrease in the price of major exports, or for other reasons. Annual normal borrowing privileges, therefore, seem to be quite small compared to possible needs.

To increase the normal annual borrowing privileges to more than 25 per cent of the quotas of members would probably be unwise because members should be able to count on assistance over a period of a few years and higher annual borrowing privileges would encourage them to exhaust their privileges too quickly. It seems reasonable to require special Fund permission to exceed 25 per cent of the quota in a single year. Furthermore, an increase in the annual privileges to  $33\frac{1}{3}$  or even 40 per cent of the quota would not change the relation between annual borrowing privileges and exports sufficiently to alter the general conclusions reached as to the adequacy of annual borrowing privileges. However, the Fund will

undoubtedly be willing to exceed the normal borrowing limits in some cases. Furthermore, members adequately supplied with reserves are required to use their reserves at the same rate they draw on the Fund. Borrowing privileges equal to half such deficits as tend to develop would enable them to make maximum possible use of the Fund.

A more interesting problem to consider in many ways is the role which the Fund might play in a period of widespread balance of payments difficulties resulting from the onset of a world-wide depression. It is obvious that the Fund could not finance deficits of the size which most countries experienced in the course of the 1929-1933 depression. But it is hoped that borrowing from the Fund will act as a buffer and prevent the

Table III

CLASSIFICATION OF MEMBERS ACCORDING TO PERCENTAGE OF THEIR  
ANNUAL BORROWING PRIVILEGES TO THE CURRENT DOLLAR VALUE OF THEIR EXPORTS IN 1938 <sup>1/</sup>

(1)	(2)	(3)	(4)	(5)
Groups	Percentage of Annual Borrowing Privileges of Individual Countries to Current Dollar Value of Their 1938 Exports	Countries	Value 1938 of Exports of Each Group as Percentage of Exports of All Countries Analyzed	Column (4) Percentages Cumulated
I	Less than 5	El Salvador, Iceland, Iran, Netherlands, Norway, Panama, Paraguay, Philippine Commonwealth, Union of South Africa, Uruguay	21	21
II	5 to 7.5	Belgium, Bolivia, Chile, Cuba, Czechoslovakia, Denmark, Dominican Republic, Egypt, France, Guatemala, Honduras, Nicaragua, Peru, United Kingdom	61	82
III	7.6 to 10	Brazil, Costa Rica, Ecuador, Greece, Iraq, Mexico, Yugoslavia	7	88 <sup>2/</sup>
IV	Over 10	China, Colombia, India, Poland	12	100

<sup>1/</sup> The dollar value of each country's exports in 1938 was multiplied by the ratio of wholesale prices in the United States in 1945 to wholesale prices in the United States in 1938. The table analyzes all member countries other than the United States and Canada which are not expected to borrow, and Ethiopia and Luxembourg for which export data was not readily available. In the case of Belgium, France, the Netherlands, and the United Kingdom, the data include their respective colonies.

<sup>2/</sup> This figure does not correspond with the figure in Column (4) because of rounding.



international spread of balance of payments difficulties and deflationary influences in the event of the development of serious disturbances in certain countries. Timely use of the Fund to enable members to maintain their imports while avoiding deflationary measures and, in fact, adopting measures to offset the effect of reductions in exports due to deflationary pressures abroad, should help to prevent a recurrence of the cataclysm of the thirties.

A comparison of the annual borrowing privileges of members with a rough estimate of the possible decline in their exports in the first year of a depression may be of interest. The value in current dollars of the decrease in their exports from 1929 to 1930 may be taken as such a rough measure. From the point of view of any individual country this is obviously a very poor measure of its possible needs in the first year of a future depression. In the 1929-1933 depression some countries ran into difficulties later than others and some encountered more serious difficulties than others. There is no ground for anticipating that the same pattern would be repeated in a future depression. But the general impression as to the adequacy of borrowings from the Fund as a means of meeting such a situation may be meaningful. It is important to realize, of course, that the cessation of foreign lending was a very important factor in the development of current deficits in the 1929-1933 depression and the measure used here takes no account of this factor. On the other hand, use of the decline in the value of exports as a rough measure neglects the fact that falling prices may enable a country to import the same amount of goods at a lower money cost.

Table IV classifies members according to the percentage of their annual borrowing privileges to the current dollar value of the decrease in their exports from 1929-1930. It shows that members accounting for 40 per

To increase annual borrowing privileges to 33 or 40 per cent of the quota would not alter the general conclusions reached.

cent of the 1938 exports of the countries analyzed have annual borrowing privileges equal to less than 25 per cent of the current dollar value of the decline in their exports from 1929-1930, countries accounting for 82 per cent of 1938 exports/ have annual borrowing privileges of 35 per cent or less, and countries accounting for 88 per cent of 1938 exports/ have annual borrowing privileges of 50 per cent or less. This suggests that few countries could make up for even half of the decline in their exports during the first year of a future world-wide depression by drawing on the Fund up to the amount of their normal annual borrowing privileges. In a period of widespread difficulties, furthermore, it is doubtful if many countries would be allowed to exceed the normal limits. However, timely use of the Fund to sustain the level of imports of members so that they can avoid deflationary measures and actually adopt offsetting policies might prevent the development of deficits within the year of the size of those experienced in 1929-1930.

#### Conclusions on Significance of Borrowing Privileges

On the whole, total borrowing privileges tend to be large compared to independent reserves but / annual borrowing privileges are small compared to possible deficits. Many countries will be much better able to meet deficits than they would be without the Fund but borrowing privileges may not be large enough to affect substantially the policies of member countries. On the other hand, if the effects of and attitude toward borrowing from the Fund are quite different from the effects of and attitude toward using gold and dollar reserves, the ability to borrow from the Fund may help to avoid unnecessary exchange rate changes, restrictions on trade, and deflationary pressures. For most countries, however, borrowing from the Fund and use of reserves must be at the same rate.

It may be suggested that the total borrowing privileges of members should be increased so that total and annual borrowing privileges will be large enough to meet such deficits as are likely to occur. But as long as demands are likely to concentrate on dollars

Table IV

CLASSIFICATION OF MEMBERS ACCORDING TO PERCENTAGE OF THEIR ANNUAL BORROWING PRIVILEGES TO THE VALUE IN CURRENT DOLLARS OF THE DECREASE IN THEIR EXPORTS FROM 1929 TO 1930 <sup>1/</sup>

(1)	(2)	(3)	(4)	(5)
Groups	Percentage of Annual Borrowing Privileges of Individual Countries to Current Dollar Value of Decrease in Exports from 1929-1930	Countries	Value of 1938 Exports of Each Group as Percentage of Exports of All Countries Analyzed	Column (4) Percentages Cumulated
I	Less than 25	Bolivia, Brazil, Chile, Cuba, Dominican Republic, Egypt, El Salvador, Iceland, Nicaragua, Panama, Peru, Philippine Commonwealth, United Kingdom	40	40
II	26 to 35	Belgium, Czechoslovakia, France, Iran, Iraq, Mexico, Netherlands, Union of South Africa	42	82
III	36 to 50	India, Paraguay	6	88
IV	51 to 75	China, Costa Rica, Denmark, Greece, Norway, Poland, Yugoslavia	11	98 <sup>2/</sup>
V	Over 75	Colombia, Ecuador, Guatemala, Uruguay	2	100

<sup>1/</sup> The dollar value of the decrease in exports from 1929 to 1930 was multiplied by the ratio of wholesale prices in the United States in 1945 to wholesale prices in the United States in 1929. The table analyzes all members other than the United States and Canada which are not likely to borrow, Ethiopia and Luxembourg for which export data is not readily available, and Honduras the exports of which were higher in 1930 than in 1929.. In the case of Belgium, France, the Netherlands, and the United Kingdom, the data include their respective colonies. Annual borrowing privileges are normal annual borrowing privileges, i.e. equal to 25 per cent of each member's quota.

<sup>2/</sup> This figure does not correspond with the figure in Column (4) because of rounding.

substantial increases in the quotas of potential borrowers would be unwise unless the quota of the United States was correspondingly increased and there is little prospect of raising the United States quota. There is also some limit to the size of the quotas which it would be desirable to have in the sense that excessive borrowing from the Fund might postpone corrective measures and make the eventual adjustments much more difficult.

The Fund's lending operations may have important effects on the policies of members even in cases in which <sup>total</sup> borrowing privileges are small compared to independent reserves and <sup>annual borrowing privileges are small compared to</sup> probable needs. If members find it convenient to use the Fund frequently, close relations may be built up between national monetary authorities and the officials of the Fund. Through establishing this banker relationship the resources of the Fund may substantially increase the Fund's influence month by month over the policies of members. The weight attached to the Fund's advice and recommendations may reflect the fact that it is in a position to give or withhold financial assistance. The banker relationship rests on the discretionary, rather than automatic, character of the Fund's lending operations.

#### Borrowing Privileges and the Fund's Ability to Supply Dollars

It has been assumed in considering the size of the borrowing privileges of members that the Fund would always be able to meet the demands upon it in whatever currency was needed. It is possible, however, that one or more currencies will become scarce in the Fund. If a member could not borrow the currency needed to make payments -- e.g. dollars -- the borrowing privileges would be of little use. As a matter of fact the American dollar and, to a lesser extent, the Canadian dollar are the currencies of present members on which demands are most likely to concentrate.<sup>1/</sup>

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<sup>1/</sup> The currencies of certain other members may be in demand especially if countries such as Sweden and Switzerland become members.

The initial dollar position of the Fund and the repurchase and gold sales provisions indicate that members will probably be able to borrow up to the amount of their total maximum normal borrowing privileges in American or Canadian dollars. This does not mean that there may not be a general scarcity of dollars. But it does mean that the Fund will probably be in a position for some years to come in which it can meet all demands within the normal borrowing privileges in dollars.

The Fund will hold at the outset gold, United States dollars and Canadian dollars equal to 76 per cent of the total normal drawing privileges of members other than the United States and Canada.<sup>1/</sup> As additional members which are potential borrowers are admitted, the percentage of gold and currencies in demand to drawing privileges will be reduced. On the other hand, other countries may be admitted to membership the currencies of which will be in demand. Unless Russia enters, the borrowing privileges of new members will probably not be large enough to affect substantially the ratio of gold and dollar holdings to total drawing privileges.

The Fund's ability to supply dollars does not depend only on its initial gold and dollar position. The repurchase provisions will help to maintain balance in the Fund's holdings of various currencies in a more or less automatic fashion. These complicated provisions may be briefly summarized as follows:

(1) A country with monetary reserves<sup>2/</sup> in excess of its quota must use its own reserves at the same rate, year by year, as it borrows

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<sup>1/</sup> Total normal drawing privileges equal total normal borrowing privileges plus the original gold subscriptions of members. See footnote 1, page 2.

<sup>2/</sup> Monetary reserves are described as net official holdings of gold and convertible currencies.

from the Fund. At the end of each year it must in general repurchase its own currency from the Fund with gold or dollars<sup>1/</sup> to the extent necessary to bring about this result.<sup>2/</sup>

This provision does not necessarily lead to a movement of gold and dollars into the Fund since members may use their reserves during the year at the same rate they borrow from the Fund. However, the question of whether or not actual repurchases take place is relatively unimportant. The purpose of this provision is to reduce the rate at which members use the Fund year after year. If a country's total deficit is less than twice its normal borrowing privileges it will be prevented from using the Fund up to the full amount of its annual borrowing privileges. Furthermore, countries which are reluctant to draw on their reserves will be restrained from borrowing from the Fund.

(2) Any country with monetary reserves in excess of its quota, which is a net debtor to or has borrowed from the Fund and adds to its gold or dollar reserves during any year must, in addition, use half the increase to reduce its indebtedness to the Fund.<sup>3/</sup> Any country, then, which develops a favorable balance of payments is required to take advantage of the opportunity to repay past borrowings.

This provision will tend to lead to direct movements of gold or dollars into the Fund. If countries which borrow to meet deficits later

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- <sup>1/</sup> The term dollars is used in the above summary of the repurchase provisions as a short cut to describe any convertible currency of which the Fund holds less than 75 per cent of the country's quota.
- <sup>2/</sup> Actual repurchases may not be required in full. The repurchases are due in gold or convertible currencies in proportion to the amounts held and no repurchases are required in currencies which are not in short supply on the Fund.
- <sup>3/</sup> Countries which originally subscribed less than 25 per cent of their quotas in gold must also use half the increase to repurchase the excess amount of currency originally subscribed.

develop surpluses, the Fund's holdings of gold and dollars will be steadily replenished. It is possible, of course, that countries using the Fund in substantial amounts in certain years will not succeed for long periods of time in developing a surplus.<sup>1/</sup>

It has been suggested that the repurchase provisions will not be very effective even if borrowing countries later succeed in developing surpluses because the members which will borrow most from the Fund will be those whose reserves are smaller than their quotas and, therefore, exempt from the repurchase obligations. Table V classifies members other than the United States and Canada according to the percentage of their reserves to their quotas with a view to analyzing to what extent the Fund quotas belong to members which will be subject to the repurchase provisions. The table shows that the countries with reserves equal to or less than their quotas, and therefore not now subject to the repurchase obligations<sup>2/</sup> have only 16 per cent of the quotas or total normal borrowing privileges of the

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<sup>1/</sup> There is a third type of repurchase obligation. If a country is a net debtor to the Fund and has reserves in excess of its quota, it must use any increase in its holdings of a particular currency, e.g. dollars, (or of gold purchased in that country) during any year to repay past borrowings, provided the increase in dollars is due to payments in gold or dollars received as a result of net exports to a country other than the United States. The increase in holdings is measured after the repurchases described above have been made. This provision applies regardless of whether or not the country has experienced a net increase in its total reserves.

This provision will also tend to lead to direct movements of gold or dollars into the Fund. It is designed to prevent currencies in short supply in the Fund from being used to settle net payments due between countries other than the country of the currency in short supply and then entering into the reserves of such countries. It may not be very effective in doing so since it only applies if the country adding to its reserves is in debt to the Fund and if its reserves exceed its quota.

<sup>2/</sup> The table uses gross official gold and dollar holdings as of the end of 1945. Since monetary reserves equal net official holdings of gold and convertible currencies, the percentages in the table are not an accurate measure of whether or not a country is now subject to the repurchase obligations. On the whole, however, additions due to holdings of convertible currencies will much more than offset deductions due to obligations due in gold or dollars.

Table V

CLASSIFICATION OF MEMBERS ACCORDING TO PERCENTAGE OF THEIR RESERVES TO THEIR FUND QUOTAS <sup>1/</sup>

(1)	(2)	(3)	(4)	(5)
Groups	Percentage of Reserves of Individual Countries to Their Fund Quotas	Countries	Borrowing Privileges of Countries in Group as Percentage of Total Borrowing Privileges of Countries Analyzed	Column (4) Percentages Cumulated
I	400 and Over	Cuba, Ecuador, El Salvador, France, Guatemala, Iceland, Iran, Nicaragua, Norway, Panama, Union of South Africa, Uruguay	16	16
II	301 to 400	Belgium, Brazil, Colombia, Mexico	12	28
III	201 to 300	Bolivia, Chile, Netherlands	8	36
IV	151 to 200	Greece, Paraguay, Peru, Philippine Commonwealth, United Kingdom	32	68
V	101 to 150	China, Egypt, Yugoslavia	15	83
VI	100 or Less	Costa Rica, Czechoslovakia, Denmark, Dominican Republic, Ethiopia, Honduras, India, Iraq, Luxembourg, Poland	17	100

<sup>1/</sup> Reserves are gross official gold and dollar reserves as of the end of 1945. The table analyzes all members of the Fund other than the United States and Canada, which are not expected to borrow.



countries analyzed. Countries with 83 per cent of total quotas or normal borrowing privileges have reserves larger than their quotas, countries with 68 per cent of total normal borrowing privileges have reserves equal to 151 per cent or more of their quotas, and countries with 36 per cent of normal borrowing privileges have reserves equal to 201 per cent or more of their quotas.

In considering how long countries will be subject to repurchase obligations it is important to bear in mind that once countries have borrowed and used reserves to repay the Fund they may borrow again and, their reserves being reduced meanwhile, not be subject to the repurchase obligations the second time. However, new gold production will probably continue to add almost a billion a year to foreign reserves. Unless the new gold production goes entirely to countries which have not borrowed and are not likely to borrow, it will constantly increase the probability that members will be subject to the repurchase provisions.

There is a further question as to whether the independent reserves used by a member will flow through the Fund or not. The repurchase provisions do not require them to do so but there is another provision saying that members must sell gold through the Fund if they wish to obtain foreign currencies with gold and can do so through the Fund with equal advantage. If members find it equally advantageous to sell gold through the Fund, the Fund's position will be strengthened to the extent that the currencies purchased with gold through the Fund are not scarce currencies.

The initial gold and dollar holdings of the Fund, equal to 76 per cent of the total normal drawing privileges of members other than the United States and Canada, equal the maximum normal demands of all members other than the United States and Canada for 3-3/4 years. Actually, there is little

prospect that all members other than the United States and Canada will borrow the maximum each year. Some members will not have deficits during some of the years and others which borrow in the first year or two will develop favorable balances later and be subject to the repurchase provisions. It seems likely, therefore, that the Fund will be able to meet all normal demands for dollars for some years to come.

British authorities have indicated that the United Kingdom probably will not borrow from the Fund.

Borrowing Privileges and Revolving Fund

The Fund can only continue to be of use to members if members normally have a substantial proportion of unused borrowing privileges. Members are intended to borrow for short periods and repurchase their currencies with gold or currencies in demand as soon as they are in a position to do so. If the Fund is properly managed, then, it will be a revolving Fund and its holdings of strong currencies and currencies in demand will constantly be replenished. If the Fund succeeds in seeing that its resources are used properly, that corrective measures are taken, and that countries repay the Fund as soon as possible, members will normally be able to borrow from the Fund and the Fund will be in a position to meet demands on it. It does not seem likely that the repurchase provisions alone will succeed in securing such a revolving fund. If countries which borrow do not later develop surpluses in their balances of payments the only way to ensure replacement of strong currencies in the Fund is through pressure by the Fund for repayment rather than the automatic working of the repurchase provisions. The higher interest charges levied, and the possibility of being excluded from future use of the Fund, should act as strong incentives to repayment. Principal reliance must be placed, however, on recognition by member countries of their obligation to repay the Fund as soon as possible, and to take sufficient corrective measures to balance their international transactions and thus enable them to do so.

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