STATEMENT BY
THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
MARCH 10, 1980

Mr. Chairman:

Thank you for the opportunity to appear before the Committee in support of S.2271, legislation to strengthen the International Monetary Fund and to provide for maintenance of the U.S. role as the leader of this important institution.

We meet at a time of heightened international tension, affecting vital U.S. strategic and economic interests. Recent events have driven home dramatically the close interrelationship between foreign policy and economics. The turmoil in Southwest Asia has contributed to oil supply shortages and uncertainties and placed added strains on the international financial system. These developments have come at a time when the world economy is already facing extremely difficult problems. The massive oil price increases of the past year have led not only to slower growth and surging inflation but also to another period of dramatic changes in the balance of payments positions of the oil importing countries. And today's world economic environment is likely to make it both more difficult for nations to obtain the financing needed to deal with their balance of payments problems, and more difficult for them to make the necessary adjustments to changed external circumstances.

The success of our efforts to deal with political tension and maintain peace in the 1980's will depend importantly on our ability to address current economic problems. The IMF is a cornerstone of U.S. international economic policy, providing
the institutional framework for world monetary cooperation, finance and trade that is vital to the economic prosperity of the U.S. and the global economy. A strong and effective IMF is essential to our efforts to assure world monetary and financial stability and to provide the broad cooperative framework we will need to overcome fundamental economic difficulties.

The IMF serves two related functions -- general guidance of the monetary system and provision of temporary financing in support of members' efforts to overcome their balance of payments problems.

First, the IMF's Articles of Agreement constitute the operating rules of the international monetary system and establish member countries' obligations to promote a cooperative and stable world monetary order. The decade of the seventies brought major changes in the international monetary system and in the IMF's role in guiding the system's operations.

In the area of balance of payments adjustment, the Bretton Woods par value exchange rate obligations have been replaced by obligations on members to pursue policies to achieve the underlying economic stability that is needed for genuine and sustained exchange rate stability. The IMF has been given the task of surveillance over members' compliance with those obligations, and over the operations of the balance of payments adjustment process more generally.

In the area of international liquidity the IMF membership has established the objective of making the Special Drawing Right (SDR) the principal reserve asset in the international monetary system to help avoid the instabilities inherent in a system based on a multiplicity of national currencies.

These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar, with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States, and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial
markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the reserve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The second basic function of the IMF, closely tied to its role in guiding the overall operation of the system, is the provision of temporary financing in support of members' efforts to deal with their balance of payments difficulties. Its aim is to encourage timely correction of balance of payments problems in a manner that is not destructive of national or international prosperity -- and thus to promote a smoothly-functioning world payments system in the context of a strong and stable international economy. This is a central objective of the IMF and one in which all members must participate as an obligation of IMF membership.

It is important to understand the nature of IMF financing. The IMF is essentially a revolving fund of currencies provided by every member and available to every member for temporary balance of payments financing under prescribed criteria. Each country is obligated to provide its currency to the IMF to finance drawings by other countries facing balance of payments needs; and each country in turn has a right to draw upon the IMF in case of balance of payments need. When a country provides financing to the IMF -- that is, when its currency is drawn from the Fund -- it receives an automatic and unchallengeable right to draw that amount from the IMF in usable foreign exchange. This is the so-called "reserve position" in the IMF, an automatically available reserve claim on the IMF which is normally carried in countries' international monetary reserves.

Financing thus flows back and forth through the IMF depending on balance of payments patterns and financing requirements at any given time. There is no set class or group of lenders or borrowers, no concept of "donor" or "recipient." All major industrial countries have drawn upon the IMF at times, and many
members, developed and developing alike, have been both lenders and borrowers during the history of their participation in the IMF.

Proposed Increases in Quotas

Throughout its history, the IMF has needed periodic increases in its quotas in response to the rapid growth of world economic activity and international trade and financial transactions. To maintain a strong IMF, capable of encouraging needed adjustment while providing the temporary financing required to maintain monetary stability, we must assure that its resources are adequate to meet potential demands. The proposed 50 percent general increase in IMF quotas is a key element in assuring that strength.

Quotas play a central role in the IMF. Members' quota subscriptions constitute the IMF's permanent financial resources. Quotas determine both the amount of IMF resources a member can draw when in balance of payments need, and its obligation to provide resources when its balance of payments is strong. Quotas determine the distribution of SDR allocations. And, of key importance in all IMF operations, quotas also determine voting power. Unlike the case in many institutions, where member countries try to hold down their shares of participation, in the IMF countries compete to gain the largest possible share of the total because of the votes and financing that a larger quota share provides. The United States has by far the largest IMF quota and thus the largest share of votes and potential access to IMF resources.

To ensure that IMF quotas remain realistic and adequate, they are reviewed periodically in relation to the growth of international transactions, the size of payments imbalances and financing needs, and world economic prospects. Such a review was initiated in 1977 and led to a resolution adopted by the IMF Board of Governors on December 11, 1978, with the U.S. Governor concurring, calling for an increase in overall IMF quotas by 50 percent, raising total quotas from about SDR 39 billion to roughly SDR 58 billion. The increase proposed for the U.S. quota amounts to SDR 4,202.5 million, equivalent to about $5.4 billion at current exchange rates. This increase would raise the U.S. quota by 50 percent from SDR 8,405 million (or about $10.9 billion) to SDR 12,607.5 million (or about $16.3 billion).

The negotiation of quota shares is always difficult with pressures on the U.S. to accept a smaller quota share. Given the key roles of the dollar and the U.S. economy in the international monetary system, and the IMF's central role in guiding the operations and evolution of the system, it is essential that the U.S. maintain an appropriate share of quotas and votes, and thus its influence over basic decisions about the system. In the end, the pressures for a reduced U.S. share were successfully resisted during the most recent review, and only a very few selective changes in quota shares, all within the LDC group, were agreed.
The decision to propose a 50 percent overall increase in quotas reflected a widely felt view that quotas had, by any measure, failed to keep pace with potential balance of payments financing needs. Despite quota increases on four occasions during the IMF's history, aggregate quotas had fallen to about four percent of annual world imports in comparison with 8 to 12 percent during the 1960s and 10 to 14 percent during the 1950s. The adequacy of quotas had eroded particularly during the seventies, as the ratio of quotas to members' aggregate deficits fell by two-thirds between 1971-73 and 1978. In mid-1978 the Fund's usable quota resources -- that is, its holdings of the currencies of members then in strong payments positions -- totaled only about SDR 16 billion, or just over one percent of world imports. In November 1978, before the Supplementary Financing Facility was put in place, the amount of usable quota resources was effectively halved to around SDR 8 billion when the U.S. drew the equivalent of $3 billion and the dollar was taken off the IMF's "budget" of currencies used in financing current drawings.

These shifts in the IMF's "liquidity" illustrate the difficulties of projecting either the level of usable IMF resources or the level of future drawings on the Fund. In its 1977 quota review, the IMF estimated that the level of international transactions between 1978 and 1983 would increase by 60 percent in SDR terms. In fact, that 60 percent figure is now much too low, as inflation, oil price increases, and other factors have caused a much more rapid expansion in the value of world trade and financial transactions. And even if we could accurately predict future levels of world trade, we would not know the pattern of trade, the size and distribution of payments imbalances, or the availability of financing from banks and other sources.

In determining how large a quota increase would be needed, it was recognized that the IMF's Supplementary Financing Facility, introduced last year to provide badly needed resources to the IMF on a temporary basis, would be phased out after a 2-3 year period. That Facility was proposed and is regarded as a bridging operation to be followed by an increase in the IMF's permanent resources.

It was in the light of these considerations that the IMF membership concluded that a 50 percent increase in total quotas would be the minimum required to assure that the IMF remained in a strong position to meet prospective needs. Even a 50 percent increase will do little more than slow the decline in the relative size of IMF resources into the mid-1980's. In fact, most developing countries and some OECD members, fearing growing world economic uncertainties, pressed hard for a much larger increase.

Events since completion of the quota review have strengthened the justification for the quota increase. Oil market developments have again radically altered economic prospects and have drawn the world into a pattern of payments imbalances reminiscent of that following the 1973-74 oil price increase. Countries must, and will, begin adjusting to these developments, and that will cause further
changes in world balance of payments patterns and financing needs that cannot be foreseen. Moreover, events in Iran and Afghanistan have created a climate of concern and uncertainty that makes it all the more important to have in place the institutional means for assuring monetary stability and for providing advice and financial support to countries facing the growing economic and financial problems of the 1980s.

At present, the IMF has usable quota resources estimated at about SDR 10 billion, plus SDRs held by the IMF totaling approximately SDR 1.1 billion. These resources are supplemented by amounts remaining available under the General Arrangements to Borrow equal to SDR 5.7 billion, and SDR 7.4 billion under the Supplementary Financing Facility which is scheduled to end in early 1981 or 1982.

Severe payments imbalances and consequent financing needs will very likely intensify during the next several years. At present, in broad terms, we anticipate an OPEC current account surplus of about $120 billion in 1980 and current account deficits, after official transfers, of about $70 and $50 billion for the OECD and LDC group respectively. A world environment of slower growth, high inflation, heightened caution in the private financial sector, and the continuing threat of energy supply disruptions will simultaneously make the financing of external deficits and the adjustment of national economies to reduce those deficits more difficult.

The private financial sector will again be called upon to meet the bulk of expanding international financing needs, and we believe that the private banking system, including the U.S. banks, can and will continue to participate in the recycling process without incurring undue risk. At the same time, our regulatory authorities will be monitoring developments closely to help insure that the banks' loans are sound and that excessive concentrations do not arise. Moreover, flows of official development assistance will continue to rise. But we have to anticipate that a number of countries, developed and developing, will encounter growing financial difficulties, and pressures to adjust and bring their external positions closer into line with sustainable flows of financing. This will result in increased demands for official balance of payments financing, and early in 1980, the IMF is already processing requests for balance of payments financing that far exceed the total drawn in 1979 as a whole.

The IMF must have adequate resources -- and this means adequate quotas -- to encourage countries to adjust in an appropriate way, rather than adopt trade and capital restrictions, aggressive exchange rate policies, or unduly restrictive domestic measures in order to reduce their financing needs. Such restrictive measures could have serious implications for the entire world economy and the prosperity of all nations, as well as for the economy of the country introducing them. We must not forget the lessons of the 1930's, when serious economic troubles were worsened by ultimately self-defeating actions of nations trying individually to preserve employment and prosperity.
during times of economic distress and international tension. The impact on the United States today could be especially harmful. Our economy has grown heavily reliant on world trade and financial flows. An interdependent world brings real economic benefits, but also greater vulnerability to outside developments. Imported goods, from raw materials to high technology products, are integrated into all phases of U.S. economic activity. Export markets constitute a major source of demand for U.S. goods and services. One out of every seven U.S. manufacturing jobs and one out of every three acres of U.S. agricultural land produce for export. For the U.S. economy specifically and the world economy generally, prosperity is dependent on a well-functioning international financial system.

Uncertainties about the magnitude, distribution, and financing of payments imbalances over the next few years make it impossible to project the precise level of IMF resources that will be used during the next five years. But we must assure ourselves that the IMF's resources are sufficient to enable it to meet its important responsibilities — sufficient as measured against historic standards and current trends, and sufficient against a realistic appreciation of the dangers we face as we enter a new decade.

The IMF and National Balance of Payments Adjustment Programs

Let me turn, Mr. Chairman, to the IMF's role in fostering balance of payments adjustment on the part of its member countries. This is an area that has drawn a great deal of public attention in recent years, and one in which the IMF is again likely to become quite heavily involved as its members address the difficult problems they now face.

In trying to gain an understanding of the appropriate role for the IMF, it is important to bear in mind the purpose for which it provides financing — to help members overcome their balance of payments problems without recourse to measures destructive of national or international prosperity.

Access to IMF financing is contingent upon the member meeting certain criteria which are designed to ensure that the IMF's financial resources are used in a manner consistent with this purpose. In the initial stages of a member's use of IMF financing, the requirement is simply that the member have a balance of payments need. As a member makes greater use of regular Fund resources, it must demonstrate that it is making "reasonable efforts" to overcome its balance of payments difficulties. And if there is a need for further financing from the Fund -- and the member begins to enter into the higher stages of its access to Fund resources -- the IMF requires that a comprehensive adjustment program be developed by the member that provides "substantial justification" in terms of correcting the country's balance of payment problems. Such programs generally involve the use of certain "performance criteria" which establish concrete policy objectives and which are used at
regular intervals during the program as indicators of the progress being made toward those objectives. This progression of policy requirements is what is referred to as Fund "conditionality."

It is generally agreed that the "conditionality" attached to IMF lending is essential to achievement of the IMF's purposes. Whatever the cause of a country's balance of payments problem, unless it is temporary and self-reversing, the country will ultimately have to adjust — it cannot indefinitely spend reserves and borrow abroad. Restrictions on trade and on exchange transactions may provide temporary relief, but can lead to retaliation from abroad and to pervasive distortions in the economy which often compound the member's economic problems. If policy adjustments are delayed too long, the country's creditworthiness and ability to borrow abroad will inevitably decline; trade credit will evaporate; investment and productivity will generally fall; and growth will decline or become negative. This in itself is one form of adjustment, but it is a harsh and inefficient adjustment. What may look like the easy way out is in fact very costly.

Most governments will make policy adjustments before the situation deteriorates to that extreme, but sometimes a country will not approach the Fund until the situation is desperate. This is a key point to remember. The Fund does not cause the lack of foreign exchange that interrupts vitally needed imports. Indeed the IMF, oftentimes alone, tries to help by providing resources to maintain the economy and balance of payments temporarily, and by providing policy advice that will help the borrower restore sustained economic stability and growth. In return for this financing, the world community expects the government to forego measures disruptive to the world economy. To assure repayment and the most beneficial results for the country, the Fund requires that the member undertake appropriate measures to solve its balance of payments problem. But barring a major change in the country's economy -- such as discovery of oil or a political decision by other nations to finance the deficits of the country, on a more or less permanent basis -- every nation will have to adjust. In most cases the sooner needed adjustments can be initiated the better since the longer adjustment is delayed, the more difficult and painful it will be.

Quite often, the adjustments that must be made require difficult policy choices for the country concerned and can involve short-term restraint and hardship affecting virtually all segments of the population. The immediate difficulties of a relatively short-term restraint program must be weighed, however, against the pervasive, destructive -- and lasting -- effects of an inflation that is allowed to go unchecked on investment, employment, development, and general welfare. If the IMF can help a country to restore a sound basis for growth and development through implementation of an adjustment program, then the longer-term benefits, economic and social, can far outweigh the shorter-term costs.

This does not mean that the IMF should take a rigid or
doctrinaire approach in dealing with its members. Indeed, it is widely overlooked that the institution has, in fact, adapted its policies and practices and taken a large number of steps to improve its effectiveness and ability to respond to members' changing needs.

First, reflecting the generally increased scale and persistence of balance of payments problems, the IMF now provides more financing for longer periods for nations with adjustment problems. Quota limits on drawings have been expanded; and for drawings with higher conditionality, in the upper credit tranches, two and three year programs have become much more the accepted rule, in contrast to the one-year program that was traditional in earlier days.

In addition, a variety of IMF facilities are now available to members, ranging from unconditional reserve tranche drawings through facilities such as the Compensatory Financing Facility and the first credit tranche (both with relatively "light" conditionality requirements) to the upper credit tranche and Extended Fund Facility drawings. Of total drawings amounting to nearly $30 billion since 1973, roughly two-thirds has been drawn from unconditional or relatively unconditional facilities. Some countries have, of course, gotten into more serious difficulty and have had to turn to the more conditional facilities -- which have themselves been expanded and adapted -- and these are the cases one hears about most often. But it is important to bear in mind the whole spectrum of IMF financing facilities when assessing its role in balance of payments financing and adjustment.

Second, the IMF has undertaken a major review of conditionality in the upper credit tranches and has established a new set of guidelines for its application. To an extent, these new guidelines formalize certain protections for borrowing countries that had already existed in practice, but they also add important new features. For example, they now emphasize the desirability of encouraging countries to adopt corrective measures at an early stage -- before very severe adjustment problems arise -- and recognize the need for more gradual and more flexible adjustment over longer periods. They also recognize that adjustment measures frequently encompass sensitive areas of national policy, and provide that in helping to devise adjustment programs the Fund will pay due regard to the concerns of governments about the compatibility of such programs with their domestic social and political objectives and economic priorities. They provide that "performance criteria" will normally be confined to macro-economic variables (other than those performance criteria needed to implement specific provisions of the Articles, such as the avoidance of exchange restrictions). The new guidelines should help dispel the idea that conditionality is a weapon for imposing unnecessary hardship and make clear that for countries with severe imbalances, the adequate and timely adjustment which is the objective of IMF conditionality is in the best interests of both the individual country involved and the world community.
A third change in the IMF's approach to adjustment, and a particularly important one, is one that I mentioned earlier -- its new role in surveillance. Surveillance over every IMF member's efforts to foster orderly underlying economic and financial conditions provides valuable IMF leverage for promoting sound adjustment policies by all countries, surplus or deficit, whether or not they draw on the IMF's resources. It is designed to introduce a badly needed symmetry in the international monetary system, more effectively encouraging adjustment efforts by surplus countries, and not leaving the entire burden of adjustment on deficit countries. Development of IMF surveillance can be helpful in various ways. To the extent it encourages earlier adjustment action, it helps to avoid the more severe corrective measures which become necessary as a country's situation worsens; and to the extent it encourages adjustment action by all countries with large imbalances, it reduces the relative emphasis on those deficit countries drawing upon the IMF.

Thus the IMF is making a continuing effort to adapt to the changing needs and circumstances of its members. This process should, and will, continue. But as we move to adapt IMF policies and practices, we need to keep the IMF's basic purposes clearly in view, and ensure that its programs do, in fact, effectively promote adjustment by its members. This is in the individual borrower's own interests and of the international community as well.

**Budgetary Treatment of IMF Quota Increase**

Before I conclude, Mr. Chairman, let me briefly mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and considerable interest has developed in an alternative approach which would involve the following elements:

- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

- Payment of the quota increase by the United States would result in budgetary outlays only as cash transfers are actually made to the IMF on the U.S. quota obligation (25 percent of our quota increase will be transferred immediately in the form of SDRs; subsequent transfers can occur when dollars are needed by the IMF in its operations).

- Simultaneously with any cash transfer under the quota subscription, an offsetting budgetary receipt, representing an increase in the U.S. reserve position in the IMF, would be recorded.
-- As a consequence of these offsetting transactions, therefore, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing our consultations on this matter. The point I would stress today is that under either the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

Conclusion

Mr. Chairman, the proposed quota increase is important for three reasons.

First, from the point of view of the international monetary system as a whole, it will help assure that the IMF can continue to meet its responsibilities for international monetary stability in a period of strain, danger, and financial uncertainty.

Second, from the point of view of individual countries, it will provide additional resources to encourage cooperative balance of payments adjustment policies -- and I note that IMF resources have been of major direct benefit to the United States when we faced severe balance of payments pressures.

Third, from the point of view of the United States, it maintains our financial rights and our voting share in the institution during a time when far-reaching changes in the monetary system -- for example, a substitution account -- may be under consideration.

The record of the IMF is a good one in adapting to changing world circumstances and responding to the needs of its members. The proposed quota increase will provide the Fund with resources needed for its valuable work, and I urge the Committee to approve this legislation.
Mr. Chairman:

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These changes have paralleled and to a large extent reflected changes in the position and role of the dollar in the system. The original Bretton Woods arrangements assumed a fixed and central role for the dollar, with the U.S. position essentially passive and the product of other countries' actions in pursuing their own balance of payments policies and objectives. That arrangement ultimately became both unsustainable and intolerable in terms of U.S. economic interests. The new arrangements have provided much more scope for balance of payments adjustment by the United States, and recognize the need for greater symmetry in encouraging adjustment by all nations -- those in surplus as well as those in deficit.

At the same time, the world's reserve system has been undergoing significant change. Increases in the relative economic size and financial capacity of other major countries have tended to bring some growing use of their currencies in international transactions and reserves. On the one hand, such a development could help to mitigate some of the burdens on the dollar and U.S. financial
markets that arose from its extremely large international role. On the other hand, the process of change can itself be unsettling and disruptive, and there is a widespread view that increasing reliance on the SDR -- an internationally created and managed reserve instrument -- would be preferable to development of a full-scale multiple currency reserve system. The IMF over the past few years has taken a number of important steps to promote the role of the SDR and is presently considering a potentially significant further step in its examination of the substitution account.

The dollar nonetheless remains critically important to the operation of the international monetary system, and the U.S. economy remains a powerful element of that system. This will continue to be the case, and we recognize and accept the responsibilities incumbent on the United States to maintain a sound economic position and a stable dollar. At the same time, a strong IMF -- able to encourage effective economic and balance of payments adjustment by all countries and able to guide the orderly evolution of the reserve system -- is of direct and immediate importance to our economy and to our efforts to maintain the integrity and strength of the dollar.

The second basic function of the IMF, closely tied to its role in guiding the overall operation of the system, is the provision of temporary financing in support of members' efforts to deal with their balance of payments difficulties. Its aim is to encourage timely correction of balance of payments problems in a manner that is not destructive of national or international prosperity -- and thus to promote a smoothly-functioning world payments system in the context of a strong and stable international economy. This is a central objective of the IMF and one in which all members must participate as an obligation of IMF membership.

It is important to understand the nature of IMF financing. The IMF is essentially a revolving fund of currencies provided by every member and available to every member for temporary balance of payments financing under prescribed criteria. Each country is obligated to provide its currency to the IMF to finance drawings by other countries facing balance of payments needs; and each country in turn has a right to draw upon the IMF in case of balance of payments need. When a country provides financing to the IMF -- that is, when its currency is drawn from the Fund -- it receives an automatic and unchallengeable right to draw that amount from the IMF in usable foreign exchange. This is the so-called "reserve position" in the IMF, an automatically available reserve claim on the IMF which is normally carried in countries' international monetary reserves.

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Quotas play a central role in the IMF. Members' quota subscriptions constitute the IMF's permanent financial resources. Quotas determine both the amount of IMF resources a member can draw when in balance of payments need, and its obligation to provide resources when its balance of payments is strong. Quotas determine the distribution of SDR allocations. And, of key importance in all IMF operations, quotas also determine voting power. Unlike the case in many institutions, where member countries try to hold down their shares of participation, in the IMF countries compete to gain the largest possible share of the total because of the votes and financing that a larger quota share provides. The United States has by far the largest IMF quota and thus the largest share of votes and potential access to IMF resources.

To ensure that IMF quotas remain realistic and adequate, they are reviewed periodically in relation to the growth of international transactions, the size of payments imbalances and financing needs, and world economic prospects. Such a review was initiated in 1977 and led to a resolution adopted by the IMF Board of Governors on December 11, 1978, with the U.S. Governor concurring, calling for an increase in overall IMF quotas by 50 percent, raising total quotas from about SDR 39 billion to roughly SDR 58 billion. The increase proposed for the U.S. quota amounts to SDR 4,202.5 million, equivalent to about $5.4 billion at current exchange rates. This increase would raise the U.S. quota by 50 percent from SDR 8,405 million (or about $10.9 billion) to SDR 12,607.5 million (or about $16.3 billion).

The negotiation of quota shares is always difficult with pressures on the U.S. to accept a smaller quota share. Given the key roles of the dollar and the U.S. economy in the international monetary system, and the IMF's central role in guiding the operations and evolution of the system, it is essential that the U.S. maintain an appropriate share of quotas and votes, and thus its influence over basic decisions about the system. In the end, the pressures for a reduced U.S. share were successfully resisted during the most recent review, and only a very few selective changes in quota shares, all within the LDC group, were agreed.
The decision to propose a 50 percent overall increase in quotas reflected a widely felt view that quotas had, by any measure, failed to keep pace with potential balance of payments financing needs. Despite quota increases on four occasions during the IMF's history, aggregate quotas had fallen to about four percent of annual world imports in comparison with 8 to 12 percent during the 1960s and 10 to 14 percent during the 1950s. The adequacy of quotas had eroded particularly during the seventies, as the ratio of quotas to members' aggregate deficits fell by two-thirds between 1971-73 and 1978. In mid-1978 the Fund's usable quota resources -- that is, its holdings of the currencies of members then in strong payments positions -- totaled only about SDR 16 billion, or just over one percent of world imports. In November 1978, before the Supplementary Financing Facility was put in place, the amount of usable quota resources was effectively halved to around SDR 8 billion when the U.S. drew the equivalent of $3 billion and the dollar was taken off the IMF's "budget" of currencies used in financing current drawings.

These shifts in the IMF's "liquidity" illustrate the difficulties of projecting either the level of usable IMF resources or the level of future drawings on the Fund. In its 1977 quota review, the IMF estimated that the level of international transactions between 1978 and 1983 would increase by 60 percent in SDR terms. In fact, that 60 percent figure is now much too low, as inflation, oil price increases, and other factors have caused a much more rapid expansion in the value of world trade and financial transactions. And even if we could accurately predict future levels of world trade, we would not know the pattern of trade, the size and distribution of payments imbalances, or the availability of financing from banks and other sources.

In determining how large a quota increase would be needed, it was recognized that the IMF's Supplementary Financing Facility, introduced last year to provide badly needed resources to the IMF on a temporary basis, would be phased out after a 2-3 year period. That Facility was proposed and is regarded as a bridging operation to be followed by an increase in the IMF's permanent resources.

It was in the light of these considerations that the IMF membership concluded that a 50 percent increase in total quotas would be the minimum required to assure that the IMF remained in a strong position to meet prospective needs. Even a 50 percent increase will do little more than slow the decline in the relative size of IMF resources into the mid-1980's. In fact, most developing countries and some OECD members, fearing growing world economic uncertainties, pressed hard for a much larger increase.

Events since completion of the quota review have strengthened the justification for the quota increase. Oil market developments have again radically altered economic prospects and have drawn the world into a pattern of payments imbalances reminiscent of that following the 1973-74 oil price increase. Countries must, and will, begin adjusting to these developments, and that will cause further
changes in world balance of payments patterns and financing needs that cannot be foreseen. Moreover, events in Iran and Afghanistan have created a climate of concern and uncertainty that makes it all the more important to have in place the institutional means for assuring monetary stability and for providing advice and financial support to countries facing the growing economic and financial problems of the 1980s.

At present, the IMF has usable quota resources estimated at about SDR 10 billion, plus SDRs held by the IMF totaling approximately SDR 1.1 billion. These resources are supplemented by amounts remaining available under the General Arrangements to Borrow equal to SDR 5.7 billion, and SDR 7.4 billion under the Supplementary Financing Facility which is scheduled to end in early 1981 or 1982.

Severe payments imbalances and consequent financing needs will very likely intensify during the next several years. At present, in broad terms, we anticipate an OPEC current account surplus of about $120 billion in 1980 and current account deficits, after official transfers, of about $70 and $50 billion for the OECD and LDC group respectively. A world environment of slower growth, high inflation, heightened caution in the private financial sector, and the continuing threat of energy supply disruptions will simultaneously make the financing of external deficits and the adjustment of national economies to reduce those deficits more difficult.

The private financial sector will again be called upon to meet the bulk of expanding international financing needs, and we believe that the private banking system, including the U.S. banks, can and will continue to participate in the recycling process without incurring undue risk. At the same time, our regulatory authorities will be monitoring developments closely to help insure that the banks' loans are sound and that excessive concentrations do not arise. Moreover, flows of official development assistance will continue to rise. But we have to anticipate that a number of countries, developed and developing, will encounter growing financial difficulties, and pressures to adjust and bring their external positions closer into line with sustainable flows of financing. This will result in increased demands for official balance of payments financing, and early in 1980, the IMF is already processing requests for balance of payments financing that far exceed the total drawn in 1979 as a whole.

The IMF must have adequate resources — and this means adequate quotas — to encourage countries to adjust in an appropriate way, rather than adopt trade and capital restrictions, aggressive exchange rate policies, or unduly restrictive domestic measures in order to reduce their financing needs. Such restrictive measures could have serious implications for the entire world economy and the prosperity of all nations, as well as for the economy of the country introducing them. We must not forget the lessons of the 1930’s, when serious economic troubles were worsened by ultimately self-defeating actions of nations trying individually to preserve employment and prosperity
during times of economic distress and international tension. The impact on the United States today could be especially harmful. Our economy has grown heavily reliant on world trade and financial flows. An interdependent world brings real economic benefits, but also greater vulnerability to outside developments. Imported goods, from raw materials to high technology products, are integrated into all phases of U.S. economic activity. Export markets constitute a major source of demand for U.S. goods and services. One out of every seven U.S. manufacturing jobs and one out of every three acres of U.S. agricultural land produce for export. For the U.S. economy specifically and the world economy generally, prosperity is dependent on a well-functioning international financial system.

Uncertainties about the magnitude, distribution, and financing of payments imbalances over the next few years make it impossible to project the precise level of IMF resources that will be used during the next five years. But we must assure ourselves that the IMF's resources are sufficient to enable it to meet its important responsibilities -- sufficient as measured against historic standards and current trends, and sufficient against a realistic appreciation of the dangers we face as we enter a new decade.

The IMF and National Balance of Payments Adjustment Programs

Let me turn, Mr. Chairman, to the IMF's role in fostering balance of payments adjustment on the part of its member countries. This is an area that has drawn a great deal of public attention in recent years, and one in which the IMF is again likely to become quite heavily involved as its members address the difficult problems they now face.

In trying to gain an understanding of the appropriate role for the IMF, it is important to bear in mind the purpose for which it provides financing -- to help members overcome their balance of payments problems without recourse to measures destructive of national or international prosperity.

Access to IMF financing is contingent upon the member meeting certain criteria which are designed to ensure that the IMF's financial resources are used in a manner consistent with this purpose. In the initial stages of a member's use of IMF financing, the requirement is simply that the member have a balance of payments need. As a member makes greater use of regular Fund resources, it must demonstrate that it is making "reasonable efforts" to overcome its balance of payments difficulties. And if there is a need for further financing from the Fund -- and the member begins to enter into the higher stages of its access to Fund resources -- the IMF requires that a comprehensive adjustment program be developed by the member that provides "substantial justification" in terms of correcting the country's balance of payment problems. Such programs generally involve the use of certain "performance criteria" which establish concrete policy objectives and which are used at
regular intervals during the program as indicators of the progress being made toward those objectives. This progression of policy requirements is what is referred to as Fund "conditionality."

It is generally agreed that the "conditionality" attached to IMF lending is essential to achievement of the IMF's purposes. Whatever the cause of a country's balance of payments problem, unless it is temporary and self-reversing, the country will ultimately have to adjust -- it cannot indefinitely spend reserves and borrow abroad. Restrictions on trade and on exchange transactions may provide temporary relief, but can lead to retaliation from abroad and to pervasive distortions in the economy which often compound the member's economic problems. If policy adjustments are delayed too long, the country's creditworthiness and ability to borrow abroad will inevitably decline; trade credit will evaporate; investment and productivity will generally fall; and growth will decline or become negative. This in itself is one form of adjustment, but it is a harsh and inefficient adjustment. What may look like the easy way out is in fact very costly.

Most governments will make policy adjustments before the situation deteriorates to that extreme, but sometimes a country will not approach the Fund until the situation is desperate. This is a key point to remember. The Fund does not cause the lack of foreign exchange that interrupts vitally needed imports. Indeed the IMF, oftentimes alone, tries to help by providing resources to maintain the economy and balance of payments temporarily, and by providing policy advice that will help the borrower restore sustained economic stability and growth. In return for this financing, the world community expects the government to foreshare measures disruptive to the world economy. To assure repayment and the most beneficial results for the country, the Fund requires that the member undertake appropriate measures to solve its balance of payments problem. But barring a major change in the country's economy -- such as discovery of oil or a political decision by other nations to finance the deficits of the country, on a more or less permanent basis -- every nation will have to adjust. In most cases the sooner needed adjustments can be initiated the better since the longer adjustment is delayed, the more difficult and painful it will be.

Quite often, the adjustments that must be made require difficult policy choices for the country concerned and can involve short-term restraint and hardship affecting virtually all segments of the population. The immediate difficulties of a relatively short-term restraint program must be weighed, however, against the pervasive, destructive -- and lasting -- effects of an inflation that is allowed to go unchecked on investment, employment, development, and general welfare. If the IMF can help a country to restore a sound basis for growth and development through implementation of an adjustment program, then the longer-term benefits, economic and social, can far outweigh the shorter-term costs.

This does not mean that the IMF should take a rigid or
doctrinaire approach in dealing with its members. Indeed, it is widely overlooked that the institution has, in fact, adapted its policies and practices and taken a large number of steps to improve its effectiveness and ability to respond to members' changing needs.

First, reflecting the generally increased scale and persistence of balance of payments problems, the IMF now provides more financing for longer periods for nations with adjustment problems. Quota limits on drawings have been expanded; and for drawings with higher conditionality, in the upper credit tranches, two and three year programs have become much more the accepted rule, in contrast to the one-year program that was traditional in earlier days.

In addition, a variety of IMF facilities are now available to members, ranging from unconditional reserve tranche drawings through facilities such as the Compensatory Financing Facility and the first credit tranche (both with relatively "light" conditionality requirements) to the upper credit tranche and Extended Fund Facility drawings. Of total drawings amounting to nearly $30 billion since 1973, roughly two-thirds has been drawn from unconditional or relatively unconditional facilities. Some countries have, of course, gotten into more serious difficulty and have had to turn to the more conditional facilities -- which have themselves been expanded and adapted -- and these are the cases one hears about most often. But it is important to bear in mind the whole spectrum of IMF financing facilities when assessing its role in balance of payments financing and adjustment.

Second, the IMF has undertaken a major review of conditionality in the upper credit tranches and has established a new set of guidelines for its application. To an extent, these new guidelines formalize certain protections for borrowing countries that had already existed in practice, but they also add important new features. For example, they now emphasize the desirability of encouraging countries to adopt corrective measures at an early stage -- before very severe adjustment problems arise -- and recognize the need for more gradual and more flexible adjustment over longer periods. They also recognize that adjustment measures frequently encompass sensitive areas of national policy, and provide that in helping to devise adjustment programs the Fund will pay due regard to the concerns of governments about the compatibility of such programs with their domestic social and political objectives and economic priorities. They provide that "performance criteria" will normally be confined to macro-economic variables (other than those performance criteria needed to implement specific provisions of the Articles, such as the avoidance of exchange restrictions). The new guidelines should help dispel the idea that conditionality is a weapon for imposing unnecessary hardship and make clear that for countries with severe imbalances, the adequate and timely adjustment which is the objective of IMF conditionality is in the best interests of both the individual country involved and the world community.
A third change in the IMF's approach to adjustment, and a particularly important one, is one that I mentioned earlier -- its new role in surveillance. Surveillance over every IMF member's efforts to foster orderly underlying economic and financial conditions provides valuable IMF leverage for promoting sound adjustment policies by all countries, surplus or deficit, whether or not they draw on the IMF's resources. It is designed to introduce a badly needed symmetry in the international monetary system, more effectively encouraging adjustment efforts by surplus countries, and not leaving the entire burden of adjustment on deficit countries. Development of IMF surveillance can be helpful in various ways. To the extent it encourages earlier adjustment action, it helps to avoid the more severe corrective measures which become necessary as a country's situation worsens; and to the extent it encourages adjustment action by all countries with large imbalances, it reduces the relative emphasis on those deficit countries drawing upon the IMF.

Thus the IMF is making a continuing effort to adapt to the changing needs and circumstances of its members. This process should, and will, continue. But as we move to adapt IMF policies and practices, we need to keep the IMF's basic purposes clearly in view, and ensure that its programs do, in fact, effectively promote adjustment by its members. This is in the individual borrower's own interests and of the international community as well.

**Budgetary Treatment of IMF Quota Increase**

Before I conclude, Mr. Chairman, let me briefly mention the question of the budget and appropriations treatment of this quota increase. The President's budget proposes that a program ceiling on the increase be provided in an appropriations act. We have been consulting closely on this question with interested committees, and considerable interest has developed in an alternative approach which would involve the following elements:

--- Appropriations would be required in the full amount of the increase, and that sum would be included in budget authority totals for fiscal year 1981.

--- Payment of the quota increase by the United States would result in budgetary outlays only as cash transfers are actually made to the IMF on the U.S. quota obligation (25 percent of our quota increase will be transferred immediately in the form of SDRs; subsequent transfers can occur when dollars are needed by the IMF in its operations).

--- Simultaneously with any cash transfer under the quota subscription, an offsetting budgetary receipt, representing an increase in the U.S. reserve position in the IMF, would be recorded.
-- As a consequence of these offsetting transactions, therefore, transfers to and from the IMF under the quota obligations would not result in net outlays or receipts.

-- Net outlays or receipts resulting from exchange rate fluctuations in the dollar value of the SDR-denominated U.S. reserve position in the Fund would be reflected in the Federal budget. These net changes cannot be projected and thus would be recorded only in actual budget results for the prior year.

We are continuing our consultations on this matter. The point I would stress today is that under either the program ceiling contained in the President's budget or this alternative approach, U.S. payments on its quota subscription would not affect net budget outlays or, therefore, the Federal budget deficit.

Conclusion

Mr. Chairman, the proposed quota increase is important for three reasons.

First, from the point of view of the international monetary system as a whole, it will help assure that the IMF can continue to meet its responsibilities for international monetary stability in a period of strain, danger, and financial uncertainty.

Second, from the point of view of individual countries, it will provide additional resources to encourage cooperative balance of payments adjustment policies -- and I note that IMF resources have been of major direct benefit to the United States when we faced severe balance of payments pressures.

Third, from the point of view of the United States, it maintains our financial rights and our voting share in the institution during a time when far-reaching changes in the monetary system -- for example, a substitution account -- may be under consideration.

The record of the IMF is a good one in adapting to changing world circumstances and responding to the needs of its members. The proposed quota increase will provide the Fund with resources needed for its valuable work, and I urge the Committee to approve this legislation.