The IMF and Its Barbarous Relic

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The International Monetary Fund has a wonderful heritage, a priceless legacy. It was created for the loftiest of economic purposes—to provide a stable monetary foundation to facilitate free trade and international capital flows—and to provide hope to a world beset by vicious and destructive war. Its architects, Harry Dexter White and John Maynard Keynes, surmounted personality clashes and political strains to carry out the mission that garnered their mutual respect: to establish optimal conditions for achieving world prosperity and world peace.

The emphasis, from the beginning, was to set up an international monetary system. For White, the chief goal was to stabilize exchange rates to obtain the maximum productive benefits of foreign trade and investment; for Keynes, it was important to keep capital resources circulating rather than allow them to sit idle. Both men were intrigued with the idea of a universal currency, a global monetary unit that would transcend the vagaries of individual national monies. And both men favored the formation of supranational organizations to ensure orderly economic arrangements across borders and to bring about what Keynes (1942) described as global "financial disarmament."

Fall from Grace

Sixty-five years after the International Monetary Fund came into being at the United Nations Monetary and Financial

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Conference—which took place in the resort area of Bretton Woods, New Hampshire, during the first three weeks of July 1944—and 38 years after the United States, under President Richard Nixon, ended the "Bretton Woods system" of exchange rate management that permitted foreign central banks to redeem dollar holdings at the fixed conversion rate of $35 per ounce of gold, it seems reasonable to question whether the IMF still has a legitimate role to play in the global monetary and financial arena.

A quick look at the IMF website reveals what the organization itself believes are its main functions—and presumably, its reason for continued existence. In a section "About the IMF," one finds a concise paragraph describing the organization:

> The International Monetary Fund (IMF) is an organization of 186 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world [IMF 2009a].

Less concise are the words themselves, with nebulous adjectives preceding high-minded objectives. What does it mean, exactly, to "foster" global monetary cooperation in a world that has lacked any kind of international monetary system since August 1971? And what should we make of the IMF's stated claim that it is working to "secure" financial stability? As the world struggles in the aftermath of a financial crisis that is compared to the Great Depression, does the IMF take any responsibility for the less-than-secure conditions of global finance that permitted it? To "facilitate" international trade would seem to encroach on the mission of the World Trade Organization—likewise initiated in the immediate postwar years as a UN effort to fight protectionism through the General Agreement on Tariffs and Trade, a worthy cause but not the IMF's responsibility. Likewise, to "promote" high employment and sustainable economic growth sounds more like the mandate of the Federal Reserve, except for one glaring omission: The Fed is also charged with obtaining stable prices.

Nothing is mentioned about the pursuit of stable prices among the purposes of the IMF. How is it possible that an organization dedicated to financial stability and international trade—an organization that literally defines itself by the word "monetary"—cannot bring itself to mention price stability among its objectives? Given that the purpose of money, besides providing a medium of exchange, is to serve as a meaningful unit of account and reliable store of value, the IMF's reticence to embrace global monetary stability as a primary objective is troubling. How can we speak of a global economy and a global marketplace, and not think in terms of a global monetary unit of account?

It's not as if the organization's founders had difficulty recognizing the pursuit of international price stability as the main purpose for establishing what was initially described as a "United Nations Stabilization Fund." White felt strongly that the stability of price levels was an important economic goal at home, as well as a vital social and political objective worldwide. "Wide swings in price levels," he wrote in an early draft proposal for the Fund, "are one of the destructive elements in domestic as well as international trade" (White 1942). Price stability across borders was the impetus behind concepts put forward by both Keynes and White for an international currency. Despite his earlier reference to gold as the "barbarous relic" of a crumbling monetary system, Keynes wanted *bancor* (derived from the French words for bank and gold) to serve as bookkeeping money for settling international balances. White, too, clearly acknowledged the link between internal and external monetary policies and hoped the establishment of an international stabilization fund based on a gold-convertible *unitas* would exert a healthy influence in reducing price fluctuations within individual countries.

That White was particularly committed to the importance of stable exchange rates is evident in his analysis of the worldwide benefits that could be attained. His arguments, reproduced below, still ring with clarity and logic:

> The advantages of obtaining stable exchange rates are patent. The maintenance of stable exchange rates means the elimination of exchange risk in international economic and financial transactions. The cost of conducting foreign trade is thereby reduced, and capital flows much more easily to the country where it yields the greatest return because both short-term and long-term investments are greatly hampered by the probability of loss from exchange depreciation. As the expectation of continued stability in foreign exchange rates is

> strengthened there is also more chance of avoiding the disrupting effects of flights of capital and of inflation [White 1942].

Muddled Mission

In stark contrast to such straightforward language, the IMF today treads softly around the issue of exchange rates among currencies, perhaps fearing that to acknowledge the advantages of stable exchange rates—so well defined by the man who designed the IMF—would be to highlight the organization's failure to prevent the dissolution of the Bretton Woods system. Moreover, to embrace the connection between stable exchange rates and the goal of realizing maximum global economic returns from foreign trade and investment is to question the IMF's current relevance with regard to achieving global monetary stability.

Instead of advocating for the basic principle of monetary stabilization in keeping with its original defining purpose, today's IMF prefers to laud its "evolving" role in shaping the global economy and to demonstrate its versatility in responding to challenges by "adapting its lending instruments." This adaptation can apparently mean setting up oil facilities to cushion oil importers from the shock of more expensive oil due to inflation and a falling dollar. It can also mean setting up a concessional loan program for the world's poorest countries. Why such financing does not come under the aegis of the World Bank, a separate United Nations institution adopted at Bretton Woods to provide development financing, is not clear. While the IMF acknowledges that the Bretton Woods international monetary system broke down in August 1971 with the suspension of the dollar's convertibility into gold, its treatment of this calamity and its declared willingness to accept all kinds of disparate currency arrangements strikes one as inordinately acquiescent, if not perverse:

> Since the collapse of the Bretton Woods system, IMF members have been free to choose any form of exchange arrangement they wish (except pegging their currency to gold): allowing the currency to float freely, pegging it to another currency or basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union [IMF 2009b].

Gold Conundrum

So the one form of exchange arrangement IMF member countries are *not* free to choose is "pegging their currency to gold." Why should this be so? Clearly, the organization that was originally conceived to ensure a stable international monetary system based on fixed exchange rates with a dollar convertible into 0.888671 grams of gold has spurned its birthright. Since April 1978, with the acceptance of the Second Amendment to its Articles of Agreement, the IMF has abandoned the very notion of "system" with regard to international monetary relations in favor of a do-your-own-thing policy of accommodating whatever sort of exchange arrangement any member country might choose—except pegging to gold.

Despite the fact that the Articles of Agreement adopted at Bretton Woods specifically lay out the purpose for creating an international monetary fund—"To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation"—the IMF has been known to dispense advice to member countries that includes a deliberate weakening of its exchange rate against other currencies to improve its "competitiveness" and thus spur domestic industrial development.

Does it make sense that an organization that has long subjugated orderly monetary arrangements to a broad array of vaguely defined global economic objectives now be charged with introducing a new reserve currency in the form of a revamped Special Drawing Right? Although China's call for a "super-sovereign reserve currency" has sparked discussion over whether the SDR could become a new global currency, it's hard to see how an amalgam of floating fiat currencies could begin to play the anchoring role conducted by a gold-convertible dollar during the Bretton Woods era. It was the gold link that bolstered the dollar's legitimacy as a reserve currency; it was the gold link that implicitly supported the international system of fixed exchange rates.

Gold has been shown to retain its purchasing power over long intervals—indeed, over the centuries (Jastram 1977: 189). Gold occupies a significant position among the official international reserves of major industrialized countries. According to the World Gold Council (2009), the United States holds 77.4 percent of its reserves in gold, and euro area countries (including the European Central Bank) hold 59.7 percent of reserves in gold. The IMF was originally funded by quotas payable in gold (or gold-convertible dollars) and today ranks third in the world among major holders with its residual gold holdings of 3,217.3 tons—this despite the fact that the organization has utterly turned away from using gold for monetary purposes.

All of which raises the issue: Why does the IMF still hold gold? Who exactly has a claim to the gold—the IMF or the member countries that contributed it? While the IMF considers the gold an asset on its balance sheet, the organization does not have legal authority to use gold as collateral. Moreover, the Articles provide for restitution of the gold at the official price of 35 SDR per ounce (since the SDR was initially valued as equivalent to the gold-convertible dollar) to members who agree to buy it in proportion to their quotas on the date of the Second Amendment (IMF 2009c).

Proposal

Just as White made clear in an early draft that preceded the creation of the IMF, stabilizing the international monetary system and supplying cheap loans to countries in distress are two different tasks. "Monetary stabilization is a highly specialized function calling for a special structure, special personnel, and special organization," he noted, suggesting that two separate institutions would be required (Horsefield 1969: 12).

Since the IMF has gravitated toward the lending function after having been rendered irrelevant with regard to the former, it seems appropriate to assign the monetary stabilization function—if the notion of a new global reserve currency is to be seriously pursued—to a new entity separate from the IMF. The gold holdings accumulated prior to 1978 for the explicit purpose of complying with the requirements of participation in the Bretton Woods system of fixed exchange rates should be remitted to member countries as entitled, or else transferred to the new entity on a voluntary basis. Countries wishing to explore arrangements for issuing gold-linked financial instruments as part of a transition to a future international monetary regime based on a politically neutral and universally recognized asset—that is, gold—might begin to lay out the intellectual framework for doing so.

It is imperative that the status of IMF gold be clarified before further actions are taken by the Executive Board to devote additional portions of it (beyond the 13 million ounces approved earlier this year) to fulfilling the funding needs of the organization's new income model. Given that the IMF seems forever snake-bit on using gold to achieve global monetary stabilization, it would be best to remove the temptation of relying on an asset that was contributed in good faith for precisely that purpose. And those countries which still recognize the vital connection between stable money and the achievement of maximum sustainable economic growth should be the first to insist on a new international monetary regime worthy of being designated a system.

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