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## CHAPTER II

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### The Jamaica Agreement

International Exchange arrangements that have been operating since March 1973 were stop-gap arrangements meant to fill the void created by the collapse of the par value system. The dominant characteristic of these exchange arrangements has generally been described as managed floating under which monetary authorities of the floating currencies intervened in the exchange market. Still as the IMF Annual Report 1975 points out, very short-term movements in exchange rates have been quite sharp and erratic on a number of occasions, during the past three years. Even movements of somewhat longer duration were probably in some cases greater than could be justified on the basis of changes in the underlying economic conditions.

Though the exchange arrangements of the past three years were not strictly legal in the sense that they did not conform to the tenets of the one and only international monetary system that was still supposed to formally prevail, mutual inter-country consultation and cooperation, among the Group of Ten in particular, was continued. Even the Fund came out with its guidelines on floating. Efforts to provide a new framework for international exchange arrangements also continued and an agreement was reached in January 1976 at Jamaica.

Floating  
Legalised

According to this agreement, while member countries are given the freedom to adopt the exchange arrangement of their choice they must at the same time "collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates". The members are also required to avoid manipulation of exchange rates either to prevent effective balance of payments adjustment or to gain an unfair advantage over other members. To ensure their compliance, the Fund has been asked to exercise "firm surveillance over the exchange rate policies of the members" and to adopt guidelines with respect to these policies.

Thus while the Jamaica agreement can be said to ratify the system of managed floating which had already come into existence, it does allow for the possibility that the international monetary system might one day get back to a par value system with stable but adjustable exchange rates. But that could happen only if a large majority, 85 per cent of voting power, decides that conditions exist for such a system to work satisfactorily. Even then however, any member country retains the freedom to maintain for its own currency different exchange arrangements of its own choosing.<sup>19</sup>

Of the other main points, which the agreement at Jamaica covered in addition to the exchange rate arrangements, one was the monetary role of gold and the other was the role of the SDRs. Both of these points, as we shall see presently, are closely inter-related. Then there was the agreement on the increase in the members' quotas in the Fund.

Gold Clauses

A number of decisions were taken on the future monetary role of gold. It was agreed that the official price of gold will be abolished. When the dollar went off gold in

early 1971, the official price of gold meant virtually nothing but since March 1973, even the fiction of an official dollar price of gold was done away with. Still the monetary authorities were continuing to value their gold holdings at the 1973 dollar price. What was now endorsed at Jamaica was to abandon this practice of valuing monetary gold at a price other than the market price.

The much more important decision on gold was that it would no longer be the common denominator of the par value system (i.e., if any were established); nor were the SDRs to be denominated in gold. In fact, the value of SDRs was already being expressed, for two years now, in terms of package of 16 major currencies. These are the currencies of countries with a share of world exports in excess of 1 per cent on average over the five-year period from 1968 to 1972.

It was agreed at the same time to dispense with the obligation to use gold in transactions with the Fund. This included the requirement so far to pay 25 per cent of the quota in gold. So the quota increase agreed upon at Jamaica did not carry the gold obligation.

It was decided also that the Fund will gradually dispose of its gold holding. A beginning in that direction would be made by disposing of one-third of the Fund's gold in the first four years, half of it by sale in the market and half by restitution to members. The profit made on the portion sold would be set apart in a Trust Fund for giving balance of payments assistance to countries with 1973 per capita income of SDR 300 or less.<sup>20</sup> As for the balance of two-thirds of the Fund's gold holding, there would be enabling provisions for its disposal also but actual disposal would be done on the basis of 85% majority decision. One of the possibilities envisaged is that the Fund might decide, by 85% majority of course, to use the profit on sale of this remaining two-thirds of its gold for the general operations of the Fund and at the same time increase correspondingly the quotas of all the countries.

The underlying purpose of the various decisions reached on gold was undoubtedly to effectively reduce the monetary role of gold. In this context, a formal note also was taken at Jamaica that the Group of Ten had already agreed not to peg the price of gold and also not to increase the total stock of gold with the Fund and the monetary authorities. But it could not be overlooked that (a) this agreement among industrial countries was subject to review after two years and (b) since in the changed situation, i.e., after the abolition of the official price of gold, the members were free to deal in gold, there was nothing to prevent the principal holders of monetary gold from agreeing after two years to peg the price of gold. Even if the U.S.A. does not join this group, the others with 60 per cent of monetary gold will be strong enough to make an effective start towards pegging gold. Whatever one may think of the eventual fate of gold as a monetary reserve, the prospect of a serious attempt for a return to gold in the near future cannot therefore be ruled out altogether.

#### Misgivings of the Poor

The developing countries too were not very happy with the agreements reached on gold. They were concerned that the decision to abolish the official price of gold would, by enabling the monetary authorities to revalue their holdings, lead to an unjustified increase in international liquidity in the hands of countries least in need of larger resources. According to the prevailing market price of gold, the total volume of international liquidity could easily expand as a

result of the gold revaluation by about 40 per cent. The distribution of the new liquidity thus created would be extremely regressive since the bulk of it would accrue to industrial countries which together accounted for some 84 per cent of the monetary gold towards the end of 1975. Even from the narrow point of view of balance of payments needs, while the worst sufferers of the past few years have been developing countries (the current account deficit of the non-oil exporting developing countries in 1974 was \$28 billion as against the deficit of the industrial countries of \$11 billion; in 1975 while the industrial countries showed a collective surplus of \$15 billion, the non-oil exporting developing countries showed a rise in their deficit to \$35 billion) the gains in liquidity from gold revaluation are to go largely to the developed countries, and even among them to the ones with large gold stocks.

However, it is the lack of a firm provision in the Jamaica Agreement which could bind the monetary authorities both not to peg the price of gold and also to reduce their stock of monetary gold gradually that will turn out to be decisive for the future monetary role of gold. Even if the major holders of monetary gold do not decide after two years to peg the price of gold, the fact that they will still be holding large quantities will be enough to keep them pressing for a continuing role for gold in the world monetary system. It is in this context that the matter of the massive injection of liquidity through gold revaluation into the international monetary system assumes very much larger significance.

#### The Role of SDRs

It was agreed at Jamaica that hereafter the SDR, and not gold, will be the principal reserve asset of the international monetary system. It is significant however that no steps were envisaged to enlarge the volume of SDRs, either immediately or in the foreseeable future. One major argument, spoken or not, against any such enlargement in the supply of SDRs is not difficult to surmise and that must have been the existence already of such large international liquidity, particularly after the revaluation of monetary gold. So right at the outset gold came in the way of SDRs. Already, the SDRs in existence were too small a percentage of total global reserves (only 4.5% in 1975); with gold revaluation the percentage will be even smaller (less than 3%). In the circumstances, it is only a bold person who would expect that the SDRs could still play a pivotal role in a system of international liquidity control, even though they were not - in terms of quantity - the main reserve asset.<sup>21</sup>

It is true that several provisions were made at Jamaica to make SDRs more extensively usable from immediate effect. It has already become the Fund's unit of account. Members will hereafter have full freedom to engage in transactions in SDRs with each other without limitation and also without having to meet the test of need that was being applied in the past. There will also be greater scope for other official entities to hold and use SDRs in a broad range of transactions. At the same time, the possible uses of SDRs in the operations and transactions of the Fund will be expanded.

It is true also that even outside of the monetary system, the SDR unit is coming into use in a variety of ways. For example, airlines are adopting the SDR for calculating air fares and banks are floating loans denominated in SDR.

All the same, it is difficult not to feel that the faith professed at Jamaica in SDR becoming the principal reserve asset of the international monetary system was not matched

by adequate concrete steps in that direction. The path leading towards that objective is going to be therefore quite a difficult one and gold will possibly be the principal obstacle to be reckoned with. But as we note below there could be another impediment which might arise from the attitude of the reserve centres of the new system.

Quota  
Increase

Though it was not strictly a part of the reform package, it was decided also at Jamaica that the quotas should be raised by 32.5 per cent from SDR 29 billion to 39 billion. However, since this increase in quotas could take time to come into effect, it was agreed to increase temporarily the credit tranches by 45 per cent so that access to credit for all members was increased immediately. As was stated above, it will no longer be necessary for the members to pay 25 per cent of the quota increase in gold. This 'gold portion' may be paid in SDRs, in the currencies of the other members specified by the Fund, subject to their concurrence or even in the members' own currency without an obligation to repurchase.

Reserve  
Currency  
Role

It was in this context of the increase in quotas however that it was underlined that since an important purpose of increasing quotas was to strengthen the Fund's liquidity, an obligation should be placed on all members to make arrangements so that their currencies in the Fund are usable in Fund transactions. Since in actual practice, only a few currencies could be expected to become usable in this sense, the Fund developed the concept of a "freely usable currency" which (1) was in fact widely used to make payments in international transactions and (2) was widely traded in the principal exchange markets. Naturally, only a few currencies will meet these two tests. But all members will have the obligation to exchange their currencies purchased from the Fund, or needed to make repurchases, for the freely usable currencies.

In the context of the reform of the international monetary system, the concept of a freely usable currency is not materially different from the old concept of the reserve currency. Not that the reserve currencies would not be there or that their role could altogether be extinguished, but the formal introduction of the concept of a freely usable currency does enrobe a few currencies - the U.S. dollar in particular - for playing the role of reserve assets of the Fund and the monetary authorities and this time this privilege will be enjoyed by the reserve currency countries without the obligation which they had to enter into under the Bretton Woods system, namely to keep their exchange rate stable. So the reserve currency countries have everything to gain under the new system and nothing to lose. In the circumstances, they too are bound to oppose any substantive expansion of SDRs or even other forms of multilateral liquidity. The anti-SDR lobby is going to be strong indeed hereafter.

With gold stocks of the monetary authorities likely to remain virtually frozen in spite of revaluation, with no expansion in the volume of SDRs, and with only the reserve positions of the members likely to increase by SDR 2.5 billion in a period of at least three years, the field is open entirely to the reserve currencies. In this connection it is relevant to recall that already during the past three years of managed floating more than nine-tenths of the total increase by \$78 billion in international reserves was accounted for by currency reserves, by and large dollar reserves.

An Overview  
of the New  
Package

So we can now put together the major pieces of the new international monetary system as conceived at Jamaica. To start with the exchange rate, the members will have the freedom to choose the exchange arrangement of their liking but they are obliged to collaborate with the Fund and among themselves to maintain orderly exchange arrangements and to promote a stable system of exchange rates. The Fund is given in this connection the authority to exercise 'firm surveillance' over the exchange rate policies of members. As for international liquidity to buttress the new system, while it is sought to reduce the monetary role of gold - the formal abolition of the official price of gold and the reduction of the Fund's gold holding by one-third are two major steps taken in that direction - it appears unlikely that the position of gold will be affected considerably. In fact, with revaluation of monetary gold, the proportion of international reserve accounted for by gold will immediately go up from 18 per cent in 1975 to nearly 40 per cent. The SDR, with all the pious talk of members' obligations to make it the principal reserve asset, will be in limbo. Whatever liquidity needs are not satisfied by the revaluation of gold held by monetary authorities will be met (to some extent no doubt, by the Fund but) very largely through the creation of currency reserves.

Whether these currency reserves are created directly by the monetary authorities of the reserve centres, or indirectly through the Euro-dollar market which, as already stated, is by now very strongly entrenched is a different matter. But there can be no doubt that this market is going to play quite an important role in balance of payments financing in the coming years. The parallel with the 1944 Bretton Woods arrangement can still not be missed in so far as the reserve centres are concerned. Then too the dollar's reserve currency role was not spelt out clearly. And because the role of the reserve centres was not clearly spelt out no provisions were made for controlling the creation of reserves by them. The problem of inequitable distribution of the real resource transfer involved in the creation of currency reserves was, of course, far from the minds of the authors of the Bretton Woods agreement. But what about the international policy makers of 1976? They too have avoided facing squarely the question of reserve creation by the reserve centres. In the current context, they seem to have closed their eyes also to the virtually unregulated activities of the Euro-dollar market. These matters are highly pertinent regardless of one's position today on the inequity of real resource transfer involved in these operations.

Sop for the  
Poor

The one decision at Jamaica that made some attempt at correcting the highly regressive distribution of the gains arising from the working of the international monetary system concerned the establishment of the Trust Fund out of the profit on the sale of one-sixth of the Fund's gold for giving balance of payments assistance to the low-income developing countries. Assistance out of this Fund is however unlikely to amount to more than \$500 million a year over the next four years. Compare this with the estimated balance of payments deficit of the non-oil exporting developing countries of \$35 billion for 1975 and their projected deficit of \$32 billion for 1976.<sup>22</sup>

Another measure decided upon at Jamaica with developing countries specifically in mind was the liberalization of what is called the Compensatory Financing Facility designed to assist primary produce exporters faced with a sudden decline in export earnings. Liberalizing changes have been made (1) to take account of the effects of inflation and

(2) to increase access to compensatory financing by raising the quota related limits. This assistance, though linked to quota, was over and above a member's access to credit branches. This decision too will perhaps alleviate somewhat the position of the developing countries but, to keep one's perspective, it is necessary to note that in the 12 years of the facility's existence the total balance of payments assistance extended under its auspices added up to a little over \$1 billion. So, even a several fold increase in this facility could not play more than a marginal role in providing balance of payments support to the non-oil developing countries.\*

In the circumstances, it will not be an unfair assessment to say that the new monetary arrangements agreed upon at Jamaica go hardly any distance to meet the balance of payments problems of the poor three-fourths of the world. Their struggle for much more equitable monetary arrangements has, therefore, to go on.

\* in 1976 drawings from this facility amounted to \$ 1.7 billion.