F-100

~~MEMORANDUM FOR THE SECRETARY~~

Questions at issue on the Fund

1. Quotas

Many countries believe that the proposed quotas are inadequate for their needs.

China has pressed the view that her quota must be the fourth largest as a recognition of her role in the war. This would probably involve a quota of more than $500 million. France has said that her quota must be fourth or fifth. India takes the view that as the largest exporting and importing country in the Far East her quota should be larger than that of China. Australia has said that she cannot assume the obligations of membership unless assured a quota of $300 million. England supports the view that the quota of all small countries should be raised - in particular, that quotas under $150 million should be doubled.

The American technical advisers have regarded the determination of quotas as fundamentally an objective matter. Quotas must be based on a formula that recognizes a country's ability to subscribe to the Fund, her need for use of the Fund, and the responsibility that must be given to her in the management of the Fund. The formula proposed by the American technical advisers takes account of national income, gold and dollar holdings, foreign trade, fluctuations in exports, and the importance of foreign trade in national income. Because the data of the past are not completely applicable to the future and because intangible considerations cannot be measured by a formula, it is proposed to set aside 10 per cent of the aggregate quotas ($800 million) to be apportioned among countries whose quotas, based on the formula, are clearly inequitable.

The principal interests of the United States in quotas may be summarized brifely as follows:

(a) Aggregate quotas should not be above $8.5 billion as a maximum. If an objective formula results in aggregate quotas of $8.5 billion, it is better to depend on the formula than to cut arbitrarily the quotas of some countries.

(b) The quota of the United States should be about $2.5 billion, and under no circumstances more than $2.75 billion.

(c) The quota of the United Kingdom and the Crown colonies should not be more than $1.3 billion, and the total quotas of the British Empire must be less than the quota of the United States.

6/23/44 Mailed to Secy. Morgenthau at the Farm.

(d) Russia should have the third and China the fourth largest quotas.

(e) The apportionment of quotas among other countries is a matter that can safely be left to them within the framework of the principles stated above. We should, of course, see that the Latin American Republics are given fair treatment on quotas.

2. Gold Subscription

Several countries, including Russia, wish to have a reduction of 50 per cent in the required gold subscription of countries that have suffered substantial damage by enemy action or occupation.

The required gold subscription to the Fund is 25 per cent of a country's quota or 10 per cent of its holdings of gold and dollar balances, whichever is less. Russia has expressed the view that as a country that has suffered most severely from enemy destruction, it will have the greatest need for independent resources of gold in meeting the costs of imports for reconstruction. Recognition of the special needs of Russia should be given by allowing a reduction in one-half of her required gold subscription to the Fund which would be about $150 million on the basis of the formula. France has taken a similar position. Its gold holdings are large, but they will be depleted rapidly in meeting the costs of imports essential to reconstruction. The French regard these holdings as already set aside for the immediate post-war period and feel that her present holdings should not be regarded as the proper basis for gold subscription to the Fund.

As would be expected, the occupied countries all hold these views, although not so strongly pushed by them as by Russia and France. On the other hand, England holds that destruction by enemy action may be less important than the deterioration in a country's international economic position resulting from the war. Thus, England has lost billions in foreign investments and in other foreign exchange assets, and the problem of balancing her international accounts will be more difficult than for some of the occupied countries. If any concession on the required gold subscription is given to other countries, England insists that the same concession be given to her.

The attitude of the American technical advisers has been that there is some basis for a reduction in the required gold subscription of occupied countries, and to some extent for England. In the view of the technical advisers, this concession is much less important than the occupied countries believe. The ability of a country to purchase foreign exchange from the Fund with local currency within its quota is reduced precisely to the same extent as its gold subscription is reduced. The aggregate potential exchange resources of a country, its gold holdings plus the unused portion of its quota in the Fund, remains the same, although the amount available to the country within the first two or three years (from its own resources and from the Fund) is temporarily greater with a reduction in gold subscription.

Recently, Russia has suggested that the reduction in the required gold subscription be graduated, the countries with the greatest damage being allowed a reduction of 50 percent (Russia) and the rest being allowed varying reductions ranging from 25 percent to 50 percent of the required gold subscription. The view expressed by the American technical advisers is that a graduated reduction is not feasible and would lead to endless controversy in estimating relative damage and need. If any reduction is allowed, it should be uniform and it should not exceed 25 percent of the required subscription.

3. Official holdings of gold

> The U.K. wishes to have gold subscription based on net holdings of gold, offsetting their gold holdings in part by gold obligations.

England has expressed the view that official holdings of gold do not represent the appropriate basis for determining the required gold subscription to the Fund. Against its holdings of gold England has certain liabilities expressed in gold. In particular, there is an obligation to Portugal to redeem certain sterling balances in gold within five years after the war. There is also an obligation to convert Swiss balances into gold whenever they exceed about 5 million pounds. Apart from such specific gold obligations, there are registered sterling balances (held by U.S. nationals and Swiss nationals) which can be converted into dollars or Swiss francs, and sterling balances held by Iran and guaranteed against depreciation in terms of gold.

The American technical advisers are prepared to recognize that certain offsets can be legitimately claimed. This is particularly the case if the gold obligation of the debtor country is regarded as a gold asset by the creditor country and is included in its gold holdings. Any rule on offsets should be uniformly applicable in order to assure that the gold holdings excluded by one country are included by another. The American technical advisers have on several occasions asked for a specifi statement from the British experts on what offsets would be clai and the justification in each case. No specific claims have been put forward, and the question will have to be given furt consideration after the British experts arrive.

4. Newly-mined gold

Russia believes that the requirement to repurchase local currency with gold should not apply to newly-mined gold.

The Joint Statement on the International Monetary Fund provides that member countries must repurchase their local currency with one-half of the increase in their gold holdings. The Russians have stated that this provision should not apply to newly-mined gold because such gold is not the result of a favorable balance of payments and does not put pressure on the gold reserves of other countries. The American technical advisers have taken the view that the purpose of the Fund is to provide aid in maintaining exchange stability for countries that have inadequate gold and exchange resources. The fact that a country's gold holdings increase, even if it is newly-mined gold, is evidence that it is in a position to repurchase from the Fund the local currency holdings of the Fund in excess of 75 percent of its quota.

More recently, the Russians have proposed that the requirement to repurchase local currency with gold should not apply during the first five years to newly-mined gold in countries where enemy action has resulted in substantial damage. Such a definition would be applicable only to Russia and the Philippine Islands, the only important gold-producing countries occupied in whole or in part by the enemy. It might be possible to allow Russia to accumulate her newly-mined gold during a moderate period of two to three years on the theory that she has been unable to engage in normal gold-mining operations, so that her gold reserves could not be built up because of the complete conversion of Russia's industry to war.

5. Exchange Rates

Belgium, China, Czechoslovakia, Netherlands and several other occupied countries favor a more flexible provision for the alteration of exchange rates. In particular, they favor setting exchange rates provisionally at the time of the establishment of the Fund, leaving definitive rates for subsequent determination.

The problem of determining initial exchange rates is a very difficult one. It is the view of the American technical advisers that agreement on each of 44 individual exchange rates would be an impossible task. Furthermore, there is no need for considering anew the exchange rates of most countries. For the United States, the Latin American republics, and the British Empire countries, the probability is strong that prevailing exchange rates are in fact appropriate. The countries in which there is reasonable doubt on the satisfactory nature of the exchange rates are countries that have been occupied by the enemy. The American technical advisers recommend that initial rates of exchange be based on the official dollar rates as of July 1, 1944, but that in those cases where the Fund or the member country regards the prevailing rate as inappropriate, a new rate would be determined by agreement between the Fund and the member country. No exchange transactions should be undertaken by the Fund until a rate has been determined that is satisfactory to the Fund and to the member country.

So far as concerns changes in exchange rates, no special provision should be made for occupied countries, particularly as it may be possible to delay the determination of definitive rates for a few months. However, in passing upon requests for adjustment in exchange rates the Fund should take into consideration the uncertainties of the post-war period and should give a country requesting a change in exchange rates the benefit of reasonable doubt.

6. Russia's Exchange Rate

Russia wishes to reserve power to change her exchange rate without the approval of the Fund since she holds that her exchange rate has no effect on international transactions.

The Russian experts have taken the view that because Russia is a state trading country her exchange rate is not of significance to other countries. Russian exports are priced in terms of foreign exchange and are sold for foreign exchange in world markets. Russian imports are purchased in foreign markets in terms of foreign exchange and payment is made in foreign exchange. The Russian exchange rate, according to the Russian experts, is a matter of internal bookkeeping and does not affect the international economic relationships of Russia.

The American technical experts are of the opinion that there is a good deal of truth in the contention of the Russian experts that the imports and exports of Russia are determined on the basis of an overall plan for the economy and that they are not affected by the ruble exchange rate. It may well be that the ruble exchange rate is significant only as a matter of internal bookkeeping.

It is nevertheless the opinion of the American technical advisers that it is not feasible to exempt Russia from the requirement that any change in the ruble exchange rate must be subject to approval by the Fund in precisely the same way as for every other country. If, in fact, the Russian exchange rate does not affect the international economic position of Russia and other countries, it may be presumed that the Fund will take the view that no harm is done in permitting a change in the ruble rate. It is, of course, necessary to provide that a change in the ruble exchange rate for internal bookkeeping purposes, as distinguished from international transactions, is possible within the terms of the Fund. This, the American technical advisers are prepared to recommend provided the Fund retains the power to approve or reject a proposed change in the exchange rate for the ruble.

7. Quotas and Voting Power

> Several countries object to the close relationship between quotas and voting power. Russia believes that, in determining voting power, other considerations than those entering into the determination of quotas should be considered.

The Russians have taken the position that in determining voting power in the Fund consideration should be given to the international responsibility of the country. In particular, they feel that the United States, England, Russia, and China should each have at least ten percent of the aggregate voting power regardless of their quotas.

The position of the American technical advisers has been that it is not feasible to separate voting power from quotas. Countries that contribute the resources to the Fund must have responsibility in the management of the Fund approximately in proportion to their participation. While it may be possible to give Russia nearly ten percent of the votes (it should have ten percent of the aggregate quotas) it is not possible to make provision for giving any other country either so large a proportion of the quotas or of the votes. It is probable that the Russian technical men will not press the point so far as China is concerned. They may insist that Russia have additional votes sufficient to raise its proportion of the total voting power to ten percent.

8. Executive Committee

> U.K. wishes voting power in the executive committee to be in the order of importance of the countries but not necessarily very closely related to their quotas.

It has been agreed that voting power in the Executive Committee as well as in the Board of Directors should be closely related to quotas. There is some difference of opinion between the American technical advisers and the British experts on the most appropriate means of apportioning voting power in the Executive Committee. The British experts have proposed that there be 100 votes in the Executive Committee of which 25 would be assigned to the United States, 20 to the United Kingdom, 15 to Russia, 10 to China, 10 to France, with 5 votes allotted to each of four elected members of the Executive Committee.

Such an arrangement would result in giving the United Kingdom, Russia, China, and France much greater voting power in the Executive Committee than their relative quotas. The American technical advisers recommend that the 5 permanent members of the Executive Committee (US, UK, Russia, China, and France) each cast the number of votes to which they are entitled on the basis of their quotas, and that the 6 elected members of the Executive Committee cast the votes by which they are elected. Such an arrangement would give the United States approximately 26 percent of the votes, United Kingdom 14 percent, Russia 10 percent, China and France each 6 percent, and the 6 elected directors about 6 percent each of the aggregate votes. We have had no expression of opinion from the English experts on this proposal and we are, therefore, uncertain how they will feel.

9. <u>Limit on the votes of one country</u>

Mexico, Australia and Belgium believe that no member country should be permitted to have more than 20 or 25 percent of the aggregate votes.

The Australians are particularly disturbed to see a preponderance of American voting power in the Fund. They have taken the view that no country should have a dominant voice in the determination of policy, and that the provision on voting power should restrict the votes of a country to approximately 20 percent of the total. In particular they feel that no country should have enough votes to veto any proposal of the Fund. The Belgian view is somewhat similar to the Australian though perhaps not so extreme. The Mexican view is not so much related to a limitation on the voting power of any one country, as a desire to see the smaller countries participate more fully in the decisions of the Fund. The Mexicans feel that many matters to be considered by the Fund involve questions of sovereignty and that small countries have interests and responsibilities no less than large countries.

The American technical advisers feel that it is not desirable in principal to limit the votes of a country in connection with an international organization in which large resources are subscribed in different proportions. They believe that the U.S. must have sufficient votes to make sure that quotas cannot be changed in a manner detrimental to our interests and that no amendment to the Fund proposal can be enacted without our approval. A minimum of 20 percent of the votes would be necessary for this purpose and a larger percentage would be desirable. Under any circumstances, the United States cannot be put in a position of having less votes than the British Empire as a whole, and a limitation on the voting power of any one country might have this effect.

There is no doubt considerable merit in the position taken by the Mexican experts. Recognition should be given to the fact that countries have sovereign interests in some of the actions of the Fund. To meet this point the American technical advisers have concurred in the suggestion of the Mexican experts that suspension of membership from the Fund shall be voted only by the full board of directors and only on the basis of one vote for each country.

10. Voting on sale of exchange

> The U.S. and Canada favor a provision under which the votes of creditor countries would be increased and the votes of the debtor countries would be decreased in voting on questions relating to the sale of exchange.

While there is no likelihood of a combination of debtor countries assuming control of the Fund and permitting liberal or generous use of its resources without adequate safeguards, it is the view of the Canadian experts and the American technical advisers that some provision should be made for decreasing the voting power of countries who are using their quotas in the Fund and increasing the voting powers of countries whose currencies are being sold by the Fund. The American technical advisers propose that for every $2 million of net sale of a country's currency by the Fund its voting power be increased by one vote, and that for every $2 million of net purchase of a country's currency by the Fund its voting power be decreased by one vote. The effect of such a provision would be to increase the votes of the United States and Canada, assuming them to be creditor countries, from a total of approximately 30 percent on the basis of their subscriptions to a maximum total of 45 percent if all of their initial currency subscriptions were sold by the Fund.

This question has been discussed with a few countries, including England, who has raised no serious objection to the provision. It is expected, nevertheless, that some of the smaller countries, and particularly Australia, will take a strong position against this provision.

11. Pressure on Creditor Countries

> Many countries believe that more pressure should be put upon creditor countries, whose currencies have been declared in scarce supply, to secure an appropriate balance of payments.

A number of countries led by Australia, but not without some support from Canada and England, take the view that disequilibrium in the international balance of payments is as much the responsibility of the creditor countries as of the debtor countries.

The difficulty in such a contention, even if admitted, is in finding appropriate means of exerting pressure on the creditor countries. The American technical advisers believe that the Fund should be in a position to make recommendations to any member country, whether creditor or a debtor, on international economic policies necessary for the restoration of equilibrium in the balance of payments.

In the nature of things, the action taken by the Fund cannot be parallel for debtors and creditors. Debtor countries must apply to the Fund for the purchase of foreign exchange with which to meet their adverse balance of payments. Under the circumstances, the Fund is in a position to say to such countries that it will sell foreign exchange only if steps are taken to correct the maladjustment in their accounts, and only on terms and conditions that safeguard the interests of the Fund. Creditor countries are not in the position of applying to the Fund for the purchase of exchange. There is no sanction that the Fund can apply against such countries. The Fund must, therefore, rely solely on the force of its recommendations and on the strength of public opinion in supporting reasonable policies in creditor countries that will make possible the maintenance of international equilibrium.

12. Penalties

> Some countries believe that if penalties are applied to debtor countries using the Fund, penalties should also be applied to creditor countries.

The American technical advisers will propose a system of graduated penalties on countries making use of the resources of the Fund. The objective of these penalties is to provide a deterrent on countries making excessive use of the Fund's resources for unreasonable periods of time. Penalties will be graduated according to the amount of the local currency holdings of the Fund and the period of time during which the Fund holds such currency. The penalty would rise from approximately 1 percent per annum to 4 or 5 percent per annum, when the Fund holds balances of local currency for periods of 3 or 4 years.

In the opinion of the American technical advisers, such penalties are essential to induce countries to make use of the Fund's resources in moderation and for as short a period as possible. Penalties, of course, would terminate as soon as a country repurchased its local currency from the Fund with gold.

The Canadians take the view that if such penalties are placed on debtor countries, then creditor countries who are equally responsible for disequilibrium should also be subject to penalties. There is no doubt that this position will be supported by Australia and by other countries. The American technical advisers are of the opinion that it is not feasible to provide any penalties against creditor countries. Penalties are not applied on the basis of disequilibrium, but on the use of the Fund's resources. The creditor countries are not users of such resources and they are passive in determining the amount of their resources made available by the Fund. The debtor countries are users of these resources and they should be induced to restore the Fund's position in their currencies by applying penalties on the excessive holdings of their currencies. For greater effect, such penalties should rise as the amount is increased and as the period during which the currency is held by the Fund is extended.

13. Silver

Mexico wishes to make provision for the partial substitution of silver for gold in the subscriptions to the Fund.

Mexican technical experts have made the point that silver is predominantly the metal produced in the Western Hemisphere, that it is highly regarded as a money metal by a large part of the population of the world, and that silver should be given some place in the Fund by providing for the joint use of gold and silver in subscriptions to the Fund and in the purchase of exchange from the Fund. The Mexican experts are less concerned about the proportions in which gold and silver are used and the relative values at which they are used, than with the principle that some use of silver should be made in the Fund.

The American technical advisers have put this question to the experts of the United Nations with whom they have discussed the Fund proposal. Except in the case of Bolivia, there appears to be no support whatever for the Mexican proposal. It is known that the Mexican experts will propose at the conference that the Fund give consideration to the appropriate position of silver in the monetary structure of the world and that it recommend measures for this purpose.