Questions & Answers
September 15, 1943

Questions and Answers

on the

International Stabilization Fund

Revised September 15, 1943

U. S. Treasury Washington, D. C.

Question 1

Will the operations of the International Stabilization Fund be limited to the immediate post-war period?

Reply

In the Foreword to the tentative proposal for an International Stabilization Fund, Secretary Morgenthau said:

> "When the United Nations have brought this war to a successful conclusion, they will be faced with many urgent international economic and financial problems. Some of these are new problems arising directly from this war; others are continuing consequences of failure to solve the problems that have been with us since the last war. The solution of these problems is essential to the development of a sound economic foundation for world peace and prosperity."

It is still too soon to know the precise form and magnitude of postwar monetary problems. But it is certain that we shall be confronted with three inseparable monetary tasks: to prevent the disruption of foreign exchanges, to avoid the collapse of monetary systems, and to facilitate the restoration and balanced growth of international trade. Clearly, such formidable problems can be successfully handled only through international action.

While the Fund can be of enormous help in the solution of the monetary problems growing out of the war, it would be a serious mistake to regard the Fund as an agency designed exclusively or even largely for the postwar period. To think of international monetary problems as simply an aftermath of the war is to overlook the fundamental realities. For two decades before the war the world suffered from serious monetary disorders without having any means to act together to prevent or to remedy the ills out of which they grew and the evils which were their fruit.

Long before the war, the necessary monetary and financial basis for international prosperity had been weakened by competitive currency depreciation, by exchange restrictions, by multiple currency devices, and by other discriminatory foreign exchange practices that hampered and even throttled world trade and the international flow of productive capital. Unless the United Nations cooperate to provide a sound foundation for the balanced growth of international trade, we must expect a recurrence of the same monetary disorders.

The Preamble to the draft proposal states:

> "These are not transitory problems of the immediate postwar period affecting only a few countries. The history of the past two decades shows that they are continuing problems of vital interest to all countries. There must be a general realization that world prosperity, like world peace, is indivisible. Nations must act together to restore multilateral international trade, and to provide orderly procedure for the maintenance of balanced economic growth. Only through international cooperation will it be possible for countries successfully to apply measures directed toward attaining and maintaining a high level of employment and income which must be the primary objective of economic policy."

International monetary problems cannot be solved by occasional cooperation improvised among a few great countries to meet a threatened disaster. Such monetary difficulties can be met only by continuous cooperation, to prevent them if possible, to remedy them when necessary. It is for this reason that the International Stabilization Fund of the United and Associated Nations is proposed as a permanent institution for international monetary cooperation.

Question 8

What is the formula for determining the quotas of member countries?

Reply

An exact formulation of a method to be used in measuring the participation of the various member countries was not made a part of the draft proposal for an International Stabilization Fund. This was considered to be a matter on which a decision should be reached only after there has been ample opportunity for consultation with all the prospective participants. Considerable attention has been given this matter in discussions with the technical experts of other countries.

After examining a great number of suggested bases for quotas, it is the view of the technical experts of the United States that no single factor can allocate participation among the various nations in a satisfactory manner. Several methods for combining a number of factors were then tested. The method which is discussed below seems to combine the important relevant factors in a reasonable way and to give relative quotas that seem fair when applied to the approximate data available for a number of countries,

A satisfactory quota formula must give consideration to the multiple functions of the quota. The size of a member country's quota determines the amount of the contribution which that country makes to the resources of the Fund and is the basis for determining the permissible quota of that country for the purpose of purchasing foreign exchange from the Fund. The size of the quota is also one of the factors which determines the relative voice of that country in the management of the Fund. The aggregate size of the quotas will determine the total contributed resources of the Fund.

In view of the functions of the quotas, it would seem that the formula for the determination of relative quotas for member countries should take into account the ability of a country to contribute resources to the Fund, the need of a country for use of the resources of the Fund, and the economic significance of a country.

The ability of a country to contribute resources to the Fund is best indicated by its national income. In a sense, participation in the Fund is an investment. The extent to which a country can devote resources to this or other purposes depends very largely on its national income. However, because the Fund is an international institution that can function more effectively if some of its resources are in the form of gold, it has been thought desirable to require payment of part of the quota contribution in this form. Under the circumstances, the ability of a country to contribute resources to the Fund in the form of gold is also indicated by its holdings of gold and free foreign exchange.

The probable need of a country for use of the resources of the Fund is best indicated by the magnitude of the fluctuations in its balance of payments. There is a good deal of difficulty in dealing directly with fluctuations in the balance of payments. For this reason it was found preferable to utilize import and export data. A country's need for foreign exchange generally arises from the fact that its imports may be maintained when its exports fall off. We have, therefore, made use of average annual imports and maximum fluctuations in exports as indications of a country's need for use of the resources of the Fund.

The economic significance of a country in the world's economy is an intangible factor impossible to measure even approximately. It depends on its national output, its foreign trade, its foreign investment, its economic and political strength. In the final determination of quotas allowance is made for this factor through use of a special allotment for the equitable adjustment of quotas, which is further discussed below.

In order to take account of the above factors it is suggested that the quota of a country be determined by the following formula:

(a) 2 percent of the national income of 1940;
(b) 5 percent of the holdings of gold and free foreign exchange as of July 1, 1943;
(c) 10 percent of average annual imports, 1934-1938;
(d) 10 percent of maximum variation in annual exports 1934-1938.

It is further proposed that the total so determined be increased for each country by the percentage ratio of its average annual exports (1934-1938) to its national income. In this way, special consideration is given to those countries whose national income is particularly affected by international trade.

After testing this formula for a number of countries, we have come to the conclusion that on the whole the results are as satisfactory as can be obtained through the use of any formula. We recognize that under this formula some countries may, for various reasons, be given entirely inadequate quotas. With any formula, provision must be made for adjustment of inequitable quotas. We have proposed that before determining individual quotas, 10 percent of aggregate quotas be reserved as a special allotment for the equitable adjustment of quotas. For example, if the aggregate quotas for all member countries should be equivalent to $8 billion, the formula would be used to apportion 90 percent ($7.2 billion) of the authorized aggregate quotas among the member countries. The remaining 10 percent ($800 million) could be used to increase the quotas of any countries whose quotas, as determined by application of the formula, seem inadequate. The adjustment of the quota need not always be based upon a country's need for access to the Fund. Since no formula can take account of the intangible factors, the special allotment will also be needed to assure to each country a share in the responsibility for management of the Fund commensurate with its potential position in international economic affairs.

Attention is called to the provision that quotas shall be adjusted on the basis of the most recent data three years after the establishment of the Fund, and at intervals of five years thereafter, in accordance with the agreed upon formula (II-5). At the time of revision of quotas, the special allotment may be used to increase the quota of a country if the quota as determined by the formula is still deemed inequitable. The special allotment may also be used in the periods between recurrent adjustments, if developments indicate that a country is entitled to a larger quota.

Question 9

If quotas are to be based in part on holdings of gold and foreign exchange, would not this give most facilities to those members needing them least and vice versa?

Reply

As indicated in the answer to the previous question gold and foreign exchange holdings would be only one of several factors in the determination of the quotas of member countries.

The quotas assigned to member countries in the International Stabilization Fund proposal have a three-fold purpose: to provide a measure of the appropriate contribution of resources to the Fund by member countries; to provide a measure of the appropriate utilization of resources of the Fund by member countries; and to provide a basis for responsibility in the management of the Fund. It is not regarded as feasible to set up one formula for the contribution of resources to the Fund, a separate formula for the utilization of resources of the Fund, and still another formula for voting power in the Fund. For each country the right to utilize the resources of the Fund must be related to its contribution of resources, although in practice countries will necessarily use varying proportions of their permissible quotas. Finally, the voting power in the Fund must be related to each country's contribution of resources to the Fund, although it need not be in precise proportion to contributions.

Holdings of gold and free foreign exchange are regarded as one of the appropriate factors in the determination of quotas because they indicate the capacity of a country to provide an important type of asset that will be required in the operations of the Fund. It has not been given preponderant importance in the formula for quota determination that has been suggested for consideration. The proportion of aggregate quotas arising from the use of this factor is something over 16 percent of the whole. All of the other elements used -- national income, variability of exports, average imports, and relation of exports to national income -- measure characteristics of the national economy which reflect past or potential need for the use of foreign exchange resources to meet adverse balances on current account and to maintain stability of the exchanges. Finally, where the formula does not give a country a quota properly reflecting its prospective need for use of the resources of the Fund, the quota can be adjusted from the special allotment.

It should be added that a number of provisions are included in the draft proposal intended to give consideration to the position of countries with relatively small holdings of gold and free foreign exchange. The contribution in the form of gold is smaller in proportion to the quota for such countries than for countries with relatively large gold holdings (II-3-a). Countries with gold and free foreign exchange holdings which are less than half their quotas need not use any part of their gold holdings in purchasing foreign exchange from the Fund (V-2-a). And countries with official gold holdings which are less than 25 percent of their quotas need not offer to sell to the Fund any increment of gold they acquire so long as their official holdings are below this level (V-6).

Question 10

Does the International Stabilization Fund proposal provide for a quasi-automatic increase in quotas to facilitate the financing of an increasing volume of international trade?

Reply

The characteristic feature of the draft proposal for an International Stabilization Fund is its flexibility. In general, the Fund proposal does not depend on quasi-automatic provisions for its effectiveness. Instead, the Board of Directors is commonly given authority to adjust the policies of the Fund to the conditions prevailing in particular cases, acting within broad provisions intended to safeguard the resources of the Fund and the interests of member countries.

The revised draft provides that the quotas of member countries shall be adjusted on the basis of the most recent data three years after the establishment of the Fund and at intervals of five years thereafter, in accordance with the agreed upon formula (II-5). The quota formula itself may be changed with the approval of a four-fifths vote of the Board of Directors (II-6). However, it is not necessary to wait for the termination of the initial three-year period, or subsequent five-year periods, to adjust quotas. It is within the power of the Fund to increase the quota of a member country at any time out of the special allotment reserved for the equitable adjustment of quotas (II-4).

It is clear that under these provisions there will be an expansion of quotas periodically as national incomes rise, as the stock of monetary gold increases, and as the volume of international trade grows. With the expansion of quotas the resources of the Fund and the ability of member countries to purchase foreign exchange will be increased correspondingly. More important, however, is the fact that neither the resources of the Fund nor the ability of member countries to purchase foreign exchange from the Fund are rigidly determined by the quotas. There are flexible provisions for increasing the resources of the Fund as needed. No limitations are placed on the Fund's ability to obtain resources through borrowing scarce currencies from member countries or by issuing the Fund's own obligations. Likewise member countries may secure foreign exchange for their needs when they have exceeded the ordinary limits of the permissible quotas under provisions that safeguard the interests of the Fund. Thus with the specific approval of the Board of Directors, the Fund may purchase any local currency in excess of the limitations set forth in V-2-b if in the judgment of the Board it appears that satisfactory measures are being taken to restore equilibrium or to reduce the Fund's excess holdings of a member country's currency.

It would be a mistake to put too much stress on quasi-automatic changes in quotas. For example, if quotas were adjusted automatically to short-run changes in the volume of trade there would be an expansion of quotas in boom years and a contraction in years of slump. While the expansion of quotas in boom periods may not be disturbing of itself because the use of quotas can be controlled, there can be no doubt that a contraction of quotas in depression years would tend to have a depressing influence.

The fact is that the need for access to the resources of the Fund is not a simple function of the volume of trade. When international trade expands gradually, the growth may well be balanced, and there may be little need for help from the Fund. The need is likely to be greatest at the very time when the total volume of trade has fallen, for it is at such times that the greatest distortion in the normal balance of payments takes place. It is for this reason that the Fund proposal places great stress on fluctuations in the balance of payments on current account as a factor in the determination of quotas.

Automatic devices are unreliable guides to policy in troubled times. What is needed is not a new series of automatic signals to replace the discarded ones of the past. On monetary problems, there can be no automatic substitute for a rational policy implemented with flexible powers. While the draft proposal provides for periodic adjustment of quotas, this feature is regarded as less significant than the provisions that give the Fund flexibility in acquiring resources and in permitting member countries access to resources.

When the Fund requires additional resources it has the power to acquire the particular currencies it needs in its operations through discounts or advances secured by the assets it holds, or by issuing its own obligations. No limit is placed upon the power of the Fund to raise additional resources in this manner. In actual practice, it is likely that after the Fund has demonstrated its usefulness as an agency for international monetary cooperation, it will have ready access on the most favorable terms to the resources of the more important money markets and of the central banks of all member countries.

It should also be noted that the permissible quota of a member country is the basis for determining the amount of foreign exchange it may normally purchase from the Fund. Under the present provision, after two years of operation, the Fund may sell foreign exchange to a member country until its holdings of local currency and securities are equal to 200 percent of the quota of a member country. Under any circumstances, the stated limits on the Fund's holdings of local currency and securities of a member country are not absolute. Upon specific approval of the Board of Directors, the Fund may acquire local currency in excess of these limits under appropriate conditions.

If the successful operation of the Fund indicates that its usefulness can be increased by an expansion of aggregate quotas, each member country can accept the increase in its quota when the periodic adjustment of quotas is made. If generally regarded as desirable, the member countries can at any time change the formula by which quotas are determined. Such an important step, affecting as it would the relative position of each member country in the Fund, should be undertaken only after careful consideration by the Board of Directors and only with the general approval of member countries. For this reason, a four-fifths vote is required to change the quota formula. To safeguard any country from being compelled to contribute additional resources to the Fund, it is provided that an increase in the quota of a country can be made only with its consent.

Question 11

In what form will member countries meet supplementary contributions if their quotas are increased?

Reply

No specific provision is made for the form in which member countries may meet supplementary contributions if their quotas are increased. Unless specific provision is regarded as necessary by some member countries, it would be desirable to give the Board of Directors complete authority to require member countries to meet supplementary contributions in the form which seems most appropriate to the Board at the time the supplementary contributions are made.

It would not be possible to specify in advance in what form it would be most desirable to have supplementary contributions to the resources of the International Stabilization Fund. If the Fund has experienced a period of successful operation, with its resources appropriately distributed among different member currencies and with adequate holdings of gold, there could be no objection to having supplementary contributions paid largely in member currencies. On the other hand, if the Fund has experienced some difficulty in meeting the demands for some currencies, it would be preferable to strengthen the Fund by having some part of the supplementary contributions paid in gold.

There may be some member countries that would wish to assure themselves against a requirement that they meet supplementary contributions with an excessive payment in gold. While a country could withhold its consent to an increase in its quota if too large a part of the supplementary contribution is called for in gold, this may not be regarded as an adequate safeguard. Such countries might prefer a provision that supplementary contributions should be made in the same proportions as the original contributions and on the basis of the relation of gold and free foreign exchange holdings to the revised quota as prescribed in II-3-a.

An alternative provision could provide the necessary safeguard to member countries while retaining for the Fund considerable flexibility in determining the form in which supplementary contributions should be made. The Fund could be given authority to call for contributions in whatever form it deems in the general interest, but limiting the contribution to be paid in gold to not more than the proportion specified in II-3-a. Of course, any schedule for payments in gold in connection with supplementary contributions should be applied uniformly to all member countries.

Question 12

Would the International Stabilization Fund contribute in any way to the maintenance of a market for gold?

Reply

Because gold has a world-wide market, it is superfluous to speak of the Fund as contributing to the maintenance of a market for gold. With or without the Fund, gold will continue to be held as monetary reserves and to be used throughout the world in the settlement of international balances. The provisions of the Fund in no way change the established position of gold. They are designed to utilize the recognized status of gold as the accepted medium of international payments in order to facilitate the settlement of international balances and the maintenance of stable exchanges.

The International Stabilization Fund utilizes the accepted position of gold in a number of ways. In the first place, the Fund itself is expected to hold gold, entirely for the purpose of assuring to member countries an adequate supply of any member currency that may be demanded. As has been indicated in the reply to Question 6, the Fund must hold an adequate amount of general resources such as gold and currencies equivalent to gold.

The Fund is authorized to hold gold and to buy and sell gold (V-1), and provision is made for the Fund to acquire gold to enable it to meet the needs of member countries. Part of the quota contribution is required in gold (II-3), and member countries are required to pay for part of their foreign exchange purchases from the Fund in gold unless their own gold and exchange holdings are inadequate (V-2-a). Member countries holding a stated minimum of gold must repurchase the Fund's holdings of their local currencies with part of the gold they acquire in excess of their holdings at the time of becoming members of the Fund (V-6). In the case of blocked balances, the countries selling the balances and the countries in which the balances are held must repurchase regularly with gold stated portions of the Fund's holdings of such balances (V-8-b, c). Provision is also made for collecting various charges in gold (V-14; V-8-d).

The Fund also utilizes the accepted position of gold to facilitate the maintenance of exchange stability. It is generally recognized that when a currency is defined, directly or indirectly, in terms of gold and the monetary authorities are prepared to buy and sell gold (or currencies equivalent to gold) at approximately fixed prices in terms of local currency, the exchange rates can be maintained stable within an appropriate range. Various provisions of the Fund proposal make use of these customary devices.

The monetary unit of the Fund, the unitas, is defined in terms of gold (III-1) and member countries' currencies are established in terms of the unitas (III-2). Member countries may not induce a de facto depreciation of their currencies by purchasing gold, directly or indirectly, at a price in local currency in excess of the gold-unitas-currency parity; nor may member countries induce a de facto appreciation of their currencies by selling gold, directly or indirectly, at a price in local currency below this parity.

The Fund itself is expected to buy and sell local currencies for gold when this becomes necessary for avoiding a fluctuation in exchange rates beyond the range established by the Fund (IV-1). Member countries, in turn, are expected to take appropriate action to maintain exchange rates within the prescribed range (VII-1). By established custom, such appropriate action includes the use of gold and foreign exchange reserves to prevent depreciation and the acquisition of gold to prevent appreciation of the exchanges.

While the Fund utilizes the recognized status of gold to facilitate its operations, the Fund does not impose any specific obligations on member countries to hold or use gold for any purposes other than to help maintain stability of the exchanges. There is no obligation on the part of any member country to offer to redeem its local currency in gold. Nor is it expected that the Fund will regard appropriate action to maintain exchange rates as requiring a member country to exhaust all of its reserves of gold and foreign exchange.

Question 13

Is the International Stabilization Fund under any obligation to buy gold offered to it at a fixed price except under the conditions set out in V-7?

Reply

There is no specific obligation on the Fund to buy gold at a fixed price from member countries in all circumstances. No obligation is regarded as necessary, for, as stated in the answer to Question 11, the Fund will always be willing to accept gold freely at a fixed price. Moreover, it is clear that under the provisions of the Fund proposal a country with gold will always be able to meet its foreign exchange needs by the sale of gold to the Fund.

The Fund is required to establish rates at which it will buy and sell gold for local currency (IV-1). This provision is not intended as an obligation of the Fund to buy gold. Rather, it provides for the establishment of rates at which gold transactions of the Fund are to be undertaken in accordance with other provisions authorizing or requiring such transactions.

A member country applying to the Fund for foreign exchange to meet an adverse balance of payments predominantly on current account must pay for one-half of such exchange with gold (if the country's holdings of gold and free foreign exchange exceed 50 percent of its quota). The Fund is under no compulsion to sell foreign exchange to a member country unless it is satisfied that the member country conforms to the provisions of V-2 and V-3. However, if the Fund does agree to the sale of foreign exchange, then it is specifically provided that the Fund "shall require that one-half of such exchange shall be paid for with gold" (V-2-a). This is clearly a mandatory provision requiring the Fund to accept gold in part payment for foreign exchange when a member country requires the foreign exchange to meet an adverse balance of payments predominantly on current account and the Fund agrees to the sale of the foreign exchange. While the provision states that half the payment must be made in gold or in free foreign exchange, obviously the Fund would not hesitate to accept payment in full in gold.

So long as the Fund's holdings of the local currency and securities of a member country are less than the quota (not permissible quota) of that country the Fund can place no restrictions on the sale of foreign exchange for equal amounts of gold and local currency (or local currency alone if the gold and free foreign exchange holdings are less than 50 percent of the quota), provided the foreign exchange is needed to meet an adverse balance predominantly on current account (V-2-a). As a matter of practice the Fund will not restrict purchases of foreign exchange paid for with gold and currency even when the member country acquiring the exchange is permitting capital outflows provided the Fund's holdings of that currency do not exceed the quota of that country. In short, a member country can acquire foreign exchange from the Fund for gold and currency so long as the Fund's holdings of its currency do not exceed its quota.

Furthermore, whenever the Fund's holdings of the currency of a member country exceed the quota of that country the member country has the right to repurchase the excess local currency from the Fund with gold or acceptable foreign exchange (V-7). Under this provision a member country can always reduce the Fund's holdings of its local currency to the point where the Fund is required to sell foreign exchange to enable the country to settle an adverse balance of payments predominantly on current account.

In practice a member country would always be able to acquire any member currency for gold. This point is further elaborated in the answers to the questions 12 and 14.

A number of provisions of the Fund proposal indicate clearly that the Fund is expected to buy all gold offered by member countries at the price in local currency fixed in accordance with IV-1. These provisions, principally V-2-a and V-6, are intended to strengthen the Fund by increasing its liquidity, largely through the replacement of local currency by gold. In general, it has been the view of the technical experts of the United States that there is no need to include a provision that the Fund accept gold from a member country -- the Fund will always be willing to do so. The need, rather, is to require member countries to utilize their own gold and foreign exchange resources, whenever possible, to meet their current needs for exchange, and to repurchase from the Fund the local currency accumulated by the Fund.

It should also be noted that under provision VII-1 member countries undertake to maintain by appropriate action exchange rates established by the Fund. This provision is interpreted to require member countries to support the foreign exchange value of their currencies by appropriate use of their gold and foreign exchange reserves. Obviously, the Fund should do all it can to facilitate the maintenance of exchange rates it has established when member countries offer gold for foreign exchange in order to support their currencies.

Question 14

Are all countries that are members of the International Stabilization Fund under obligation to buy all gold offered to them at a fixed price?

Reply

The Fund proposal provides no explicit obligation on the part of member countries to buy all gold offered to them at a fixed price. Provision III-2 is intended to prevent member countries from depreciating or appreciating their currencies through an increase in the price at which gold is bought or a decrease in the price at which gold is sold. While this provision does place limitations on the prices at which gold transactions may be undertaken, it does not itself require a member country either to buy or sell gold at all.

Despite the fact that there is no explicit provision requiring member countries to buy all gold offered to them, it is our view that provision VII-1 implicitly requires member countries to buy gold offered to them by member countries when this becomes necessary to prevent an appreciation of the exchange beyond the range established by the Fund. Appropriate action to maintain established exchange rates involves the acquisition of gold offered by other member countries or by the Fund.

Obviously, a member country can take steps to limit the demand for its currency by the nationals of other countries and in this way it can minimize the import of gold. It may, with the approval of the Fund, restrict capital movements when the influx of foreign funds is regarded as undesirable. It may even adopt measures that will reduce the demand for its exports in other countries, although certain forms of such measures can be adopted only with the approval of the Fund. But in any case, so long as there is a demand for its currency to settle international transactions on current account, a member country is implicitly obligated to provide its currency for gold.

Also, it is clearly expected that the Fund can replenish its supply of the currency of any member country through the sale of gold when this is necessary to provide exchange for the purposes for which the Fund is authorized to sell exchange. Because the Fund's gold holdings are regarded as a liquid asset equivalent to any member currency, provision is made for the gradual replacement of local currency by gold. It would be contrary to the purposes of these provisions if gold were not purchased freely by member countries if gold were not purchased freely by member countries when this becomes necessary to prevent an appreciation of the exchanges.

Question 15

Would the International Stabilization Fund create unitas in using the resources of the Fund?

Reply

The unitas would serve only as a unit of account. The accounts of the Fund would be kept in unitas and reports on the financial condition of the Fund would be stated in terms of unitas, although reports might also carry a detailed breakdown of the Fund's holdings by quantity of local currency assets as well as by value in unitas (III-1). There is an obvious advantage in employing an international unit whose value is fixed in terms of gold and is independent of the values of the currencies of the individual member countries.

The Fund proposal makes no provision for transferable currency or deposits in terms of unitas. The operations of the Fund are exclusively in currencies of member countries (and their securities) and in gold. To assure the Fund against exchange risks, the value of the local currency assets of the Fund are guaranteed by member countries against depreciation in terms of the Fund's unit of account, the unitas (III-3). The Fund does not have any means of creating, holding or transferring unitas currency or deposits.

In fact, the International Stabilization Fund proposal does not anywhere provide for the creation by the Fund of transferable credits whether denominated in unitas, gold, or in currencies. The resources of the Fund in currencies and other assets plus what resources the Fund can borrow, represent the facilities the Fund can put at the disposal of member countries. The facilities of the Fund are flexible but they are not indefinitely expandable in the sense that international credits are created by the process of a country's getting into debt to the Fund. The creation of credit remains exclusively a function of the monetary authorities of member countries.

We believe that this arrangement is more desirable for the following reasons:

First, with this restriction the management of the Fund is likely to be more vigilant in taking steps which will correct a persistent disequilibrium in the balance of payments position of member countries than if there were no definite limit to the total volume of credit balances which could be created by means of loans or overdrafts.

Second, a system under which a member country assumes a known and limited obligation to provide resources for the Fund gives needed protection to all countries, and Governments will be more willing to enter into such an arrangement with a definite and specified limit to their obligations.

Third, the financial strength and stability will be greater in the case of a Fund which possesses a substantial amount of tangible resources for carrying on its operations than in the case of an international institution which has no resources other than an agreement on the part of member countries to accept the credits of that institution in exchange for real goods and services.

Fourth, if the operations of the Fund reveal a need for additional resources for its successful functioning, such resources can be secured through the borrowing power of the Fund, without the indirect compulsion inherent in the creation of credit.

Question 16

What will be the procedure for establishing initial rates of exchange?

Reply

The task of considering and determining anew the initial rates of exchange for all countries that will become members of the International Stabilization Fund would seem to be overwhelming. If the process of determining initial exchange rates by negotiation can be avoided, it would simplify the problem of organization of the Fund. What is wanted is a criterion for the initial fixing of rates of exchange which can be applied generally without prolonged and difficult negotiations with each member country.

It is believed that for most countries that will be invited to become members of the Fund, the prevailing rates of exchange will prove to be entirely satisfactory. In the case of such countries there is clearly no need for the negotiation of a new rate of exchange. For this reason the draft proposal now provides that for any country which becomes a member prior to the date on which the Fund's operations begin, the rates initially used by the Fund shall be based upon the value of the currency in terms of U.S. dollars which prevailed on July 1, 1943 (IV-2-a). To make sure that this rule will impose no hardship, either the member country or the Fund may request that the initial rate shall be determined by consultation between the member country and the Fund wherever the rate prevailing on July 1, 1943 is regarded either by the Fund or by the country as clearly inappropriate (IV-2-a).

In countries occupied by the enemy there were no dollar rates on July 1, 1943. Nor, because of the drastic economic changes that have taken place in occupied countries, would it be reasonable to apply a general rule, such as the prewar rate, for determining the initial rates of exchange for their currencies. It is provided, therefore, that for any member country which has been occupied by the enemy, the Fund shall use the exchange rate fixed by the government of the liberated country in consultation with the Fund (IV-2-b). No operations need be undertaken by the Fund until an acceptable rate has been determined. Because of the great uncertainty of their post-war position, some occupied countries may be justly reluctant to have a definitive rate of exchange agreed upon immediately after their liberation. Under such circumstances, a liberated country may determine a provisional rate in consultation with the Fund. Operations at the provisional rate would be undertaken at the discretion of the Fund in limited amounts and for a limited time.

Except where specifically provided otherwise, all decisions are made by a majority of the member votes (VI-4). Therefore, in those instances in which the rate of exchange prevailing on July 1, 1943 is not used and the Fund must agree with the member country on the initial rate of exchange, the Fund's approval would be given by a majority of member votes. To make certain that the Fund would have a representative membership before taking action on rates of exchange, it has been provided (IV-3) that the Fund shall not come into operation until a sufficiently important group of countries (that is, a group having among them more than half of the aggregate quotas) has reached agreement upon the rates of exchange for their currencies.

Question 17

What facilities are provided by the International Stabilization Fund for correcting an initial rate of exchange that proves unsatisfactory?

Reply

The provisions of the Fund recognize certain fundamental concepts with respect to exchange rates. First, it is not desirable to alter exchange rates unnecessarily or when there are other satisfactory means of restoring equilibrium in a country's international balance of payments. Second, it is not possible to support indefinitely an exchange rate that does not reflect a country's international economic position. Third, an alteration of the exchange rate affects the economic life of other countries and should, therefore, be undertaken only after consultation with other countries. Fourth, the interest of a country in its own exchange is paramount, and no change in the exchange rate for a currency should be made except with the consent of that country.

In order to avoid the unnecessary changing of exchange rates, the Fund provides that exchange rates should not be fixed unilaterally or definitively where an appropriate initial exchange rate cannot be determined. Where the rate that prevailed July 1, 1943 is clearly inappropriate, in the judgment either of the member country or the Fund, the initial rate must be determined by consultation between the member country and the Fund (IV-2-a). It is obviously difficult, if not impossible, to determine now the appropriate exchange rates for countries that have been under enemy occupation. By permitting such countries to fix their exchange rates in consultation with the Fund, after they are liberated, it will be possible to avoid the choice of initial rates which are likely to prove impracticable (IV-2-b).

It is recognized in the Fund proposal that alteration in exchange rates may be necessary to correct fundamental disequilibrium. Neither a member country nor the Fund can succeed in supporting indefinitely an exchange rate which does not reflect a country's international economic position. Where other satisfactory measures cannot be taken to restore equilibrium in a country's balance of payments position, it is necessary to adjust the rate of exchange. There is general agreement that some exchange rates fixed during and immediately after the war may have to be altered. For this reason, it is believed that some changes in such exchange rates should be permitted with a little more freedom than would be justified after international economic relationships have attained a greater degree of stability. Where a moderate change is needed, a member country may change the established rate for its currency by not more than 10 percent after notifying the Fund and consulting with the Fund on the advisability of its action (IV-5-b).

An alteration in an established rate of exchange is a matter of interest not only to the country whose currency is changed but to other countries whose economics may be affected by the alteration of the rate of exchange. A change in exchange rates should not be made, therefore, unless it is essential to the correction of fundamental disequilibrium, and unless it is approved by other countries. The Fund proposal provides that no change in exchange rates can be made without prior consultation with the Fund, and that changes that alter the established rate by more than 10 percent can be made only with the approval of the Fund.

Although there are times when an alteration of exchange rates is in the general interest, the significance of the rate of exchange is of such paramount importance in the economic life of a country, that a change in the exchange rate for a currency should not be imposed on a country. The Fund proposal recognizes the special interest of a country in its own exchange rate and provides that a change in the exchange value of a currency shall require the approval of the country concerned.

While the Fund cannot compel a country to accept an exchange rate it does not regard as desirable or to change an exchange rate it wishes to keep, the Fund need not make its resources available to support an exchange rate it regards as inappropriate. The Fund cannot undertake operations in a currency until a definitive or tentative initial rate is fixed which has its approval (IV-2-a, b). Further, the Fund may place conditions upon the additional sale of foreign exchange to a country which is using its permissible quota to prevent or unduly delay the establishment of a sound balance in its international accounts (V-2-d). Obviously, under this provision the Fund would not provide resources to a country whose currency, in the judgment of the Fund, bears an exchange rate which prevents the restoration of equilibrium.

Question 18

What will be the position of countries, members of the International Stabilization Fund, whose currencies are customarily tied to the dollar or sterling?

Reply

The practice followed by many countries of maintaining close relationships between their currencies and either the dollar or sterling has undoubtedly been of great help to them. To a considerable extent, such relationships have been helpful in maintaining a greater degree of exchange stability than would otherwise be possible. There is nothing in this practice that is necessarily contrary to the purposes of the Fund, and there is much in this practice that can facilitate the operations of the Fund.

Countries whose currencies have been tied to the dollar or to sterling can continue their customary relationship. They may define their currencies in terms of the dollar or sterling; they may hold their monetary reserves in the form of dollar or sterling balances; they may make their currencies redeemable in dollars or sterling. In general, there will be for such countries no need to terminate or to alter the prevailing relationship between their currencies and the dollar or sterling.

Such countries will be particularly interested in the stability of the exchange rates for their currencies in terms of dollars or sterling. When the initial rates of exchange are determined, it is expected that in most instances the Fund will use the rates that prevailed on July 1, 1943. Unless such rates are clearly inappropriate, and they do not appear to be for most currencies which were tied to the dollar or to sterling, there will be no reason to disturb the existing rates between such currencies and the dollar or sterling.

Once established, the exchange rate for a currency continues in effect so long as a member country is satisfied with its rate, for the Fund cannot on its own initiative compel a country to alter its exchange rate. There is no reason for assuming, therefore, that the Fund would in the future require a country to discontinue the special relationship of its currency to the dollar or sterling.

The only occasion when a country could experience any difficulty, as a member of the Fund, in retaining the customary relationship of its currency to the dollar or to sterling would be if the exchange rate for either the dollar or sterling were altered. Even so, there is reason for believing that the difficulty is more apparent than real. A change in the rate of exchange for a currency can be made only after consultation with the Fund and, with one exception, only with the approval of the Fund. Assuming that the rate of exchange for either the dollar or sterling were changed, would countries whose currencies are linked to the dollar or sterling be able to alter the exchange rate for their currencies correspondingly?

Aside from the exception previously referred to, a country desiring to alter the exchange rate for its currency to maintain its previous relationships to the dollar or sterling would have to secure the prior approval of the Fund. Such approval would be granted if it were shown that a change in the exchange rate is necessary to correct a fundamental disequilibrium. In most instances in which a currency is tied to the dollar or sterling, the special relationship has been established because of the close ties of the two countries in international commerce or finance. If this is so, a change in the dollar or sterling exchange rate is likely to lead to a change for such a country in the demand for exports to or imports from the United States or England. Obviously, if such a change in the dollar or sterling exchange rate would have the effect of bringing about a disequilibrium in a country's international payments position, the Fund would undoubtedly permit a country to make the corresponding change in the exchange rate for its own currency.

Apart from exchange rates, there are two points of particular interest to countries whose currencies are tied to the dollar or to sterling.

In the first place such countries are not exempt from the provisions of V-6. If a country whose currency is tied to the dollar increases its official holdings of dollars, assuming that its official gold and free foreign exchange holdings exceed the prescribed minimum, it must offer for sale to the Fund one-half of the dollars it acquires in excess of its official holdings at the time it became a member of the Fund. As payment for the dollars would be made in its local currency, the obligation is applicable only so long as the Fund holds the local currency of the member country.

In the second place, there is no provision in the Fund proposal for pooling or transferring the permissible quotas of member countries. Undoubtedly, to some extent it is possible for member countries to use their permissible quotas to support the currency of another country. The Fund, however, could prevent any considerable use of its resources for this purpose.

Question 19

How will the range of permissible fluctuation in exchange rates, as fixed by the International Stabilization Fund, compare with the old spread between gold points?

Reply

There would appear to be three sets of limits on exchange rates to be considered in connection with this question: (1) the gold import and gold export points; (2) the highest and lowest points within which exchange rate established by the Fund may be permitted to fluctuate; and (3) the Fund's buying and selling rates for foreign exchange in terms of local currency.

In the opinion of the technical experts of the United States it is on the whole desirable to have the range established by the Fund somewhat broader than the range of the gold points. It is a moot question whether the Fund's buying and selling rates should be the same as the lower and upper limits of the range established by the Fund. There are, however, some disadvantages in having the Fund's buying and selling rates lie within the range of fluctuations permitted by the Fund, and some advantages in having the Fund's buying and selling rates lie outside the range of permitted fluctuations.

In general, it is our view that the range that the Fund would establish would be somewhat greater than the traditional gold points that prevailed in the 1920's. A broader range within which exchange rates could fluctuate might have some effect in inducing member countries to use their independent resources of gold and foreign exchange before resorting to the Fund. It would be in the general interest if member countries would undertake to meet normal and moderate needs for additional exchange by their nationals out of their holdings of gold and foreign exchange, while the resources of the Fund would be reserved for occasions when member countries experience a real need for supplementary resources to be used while working out the basic adjustments in their international position. The inducement to a country to use its resources of gold and foreign exchange is further increased if the Fund's buying and selling rates for exchange lie outside the range of permitted fluctuations, as this would directly penalize the monetary authorities of a member country for using the resources of the Fund.

It is too much to hope that even a relatively broad range, say 2 percent, within which member currencies might be permitted to fluctuate would provide sufficient flexibility for adjusting a country's international balance of payments through a movement in exchange rates. There will, nevertheless, be seasonal or even small cyclical pressures that can be considerably offset by a movement of exchange rates within such a broad range prescribed by the Fund.

There is to this extent something to be said even on the economic side for broadening the range of exchange rates prescribed by the Fund as compared with the old spread between gold points. On the other hand, the permissible variations must not introduce a risk of exchange fluctuations so considerable as to deter short-term financing of international trade or long-term lending for investment. Neither should the permissible fluctuation encourage speculation of a character that would tend to weaken the established structure of exchange rates, or too easily introduce a disrupting influence in the money and exchange markets.

The range prescribed by the Fund should for administrative reasons be greater than the spread between the gold points. In the post-war period, it is almost certain that under any circumstances the spread between the gold points will be considerably greater than it was in the 1920's. While lower interest rates, the higher monetary value of gold, and perhaps improved transport facilities will tend to narrow the gold points, other factors, particularly the difference between the buying and selling prices for gold in various countries, will tend to broaden the gold points.

In the 1920's there was in fact no difference between the buying and selling prices for gold in the United States and a difference of less than 1/6 of 1 percent in the United Kingdom. Differences between the buying and selling prices of gold were an insignificant factor in determining the dollar-sterling gold points in the 1920's. Now, under the Gold Reserve Act of 1934, there is a charge of 1/4 percent for buying or selling gold. If this difference of 1/2 percent were to be adopted by the United Kingdom, there would be a spread of approximately 1 percent between the exchange rate equivalents for gold in New York and London. Probably another 3/5 of 1 percent should be allowed for actual costs of moving gold in both directions. The spread between the gold points would then be 1.6 percent.

It would seem, therefore, that if the range of fluctuations in exchange rates permitted by the Fund is to be somewhat greater than the spread between the gold points, the Fund's range will have to be very close to 2 percent. This would seem to be sufficient inducement to a country to utilize its own gold and exchange resources rather than to draw upon the resources of the Fund to meet normal and moderate needs for foreign exchange. As already stated, a further penalty would be placed upon a country using the Fund's resources if the Fund's buying and selling rates for exchange were outside the range of permitted fluctuations.

In this connection, it should be noted that the range of exchange rates permitted by the Fund has been compared with the normal gold points that might be expected in the post-war period. Some countries may have so large a difference between the official buying and selling prices for gold that their gold points might in fact lie outside any broad but reasonable range the Fund might be expected to establish. In such cases the Fund might recommend that the member country narrow the spread between its buying and selling prices for gold. Obviously, too, in a country with a monopoly of exchange transactions, a country could not be permitted to retain buying and selling rates for exchange outside the range established by the Fund.

There is another point of some interest that may be mentioned. In general, the spread between the gold points is a function of the distance between the two exchange markets under consideration. In the 1920's, the spread between the gold points was much narrower between New York and Montreal than between New York and Bombay. It may be desirable to standardize the range established by the Fund in order to give all member countries whatever advantage there may be in a broad range within which exchange rates may be permitted to fluctuate.

Because of the importance of these unsettled questions and the difference of opinion on the technical merits of alternative policies, it was considered best not to include in our tentative proposal any specific provisions on such technical matters until agreement has been reached on these questions. There is no doubt that decisions on such technical questions can be worked out to the satisfaction of member countries.

Question 20

Would differential rates of exchange for different classes of imports and exports (visible and invisible) be permitted by the International Stabilization Fund?

Reply

Differential rates of exchange would come under the provisions of the Fund plan which deal with multiple currency practices. These provisions (I-5, VII-5) are based on a view that the use of such methods should not be encouraged because they may so easily become the means for discrimination in trade relationships and because they usually involve control of the exchanges so complete as to offer a strong temptation to restrict transactions on current account.

As stated in provision I-5, one purpose of the Fund is to reduce the use of such multiple currency devices (and other exchange practices) that hamper world trade and the international flow of productive capital. This is implemented by having member countries undertake (VII-5) not to engage in multiple currency practices which in the judgment of the Fund do retard international trade and the flow of productive capital.

Where a country has centralized the exchange dealings of its nationals for purposes of supervision, differential rates on imports may provide a convenient substitute for customs duties. At the time the exchange authorities make foreign exchange available to importers it is very simple for them to collect what are in effect import duties. Insofar as various classes of imports are distinguished and different exchange rates are assigned to them, the same result is produced as by an ad valorem tariff with different rates of duty on the various classes of merchandise. Differential rates that are not the same for all currencies are obviously discriminatory. Of course, if the exchange rates for some classes of imports are extremely low (say, lower than the exchange rates for some classes of exports) there may in fact be a subsidy for some imports. Obviously, differential exchange rates for imports may easily lead to restriction of international trade.

Differential rates of exchange for exports act as a subsidy for some exports and an export duty on others. This may create important although disguised discrimination among the importing countries, especially where the differentials are not the same for all currencies. On the whole, the case for differential rates of exchange for exports is even weaker than for differential rates for imports.

While differential rates have these administrative advantages in a country which has centralized its foreign exchange dealings and which secures substantial revenues from them, there are serious disadvantages and dangers inherent in their use. Comparability of international values becomes much more tenuous where there are multiple exchange rates. Also, differential rates can hardly be prevented from channelizing trade in a fashion that results in intentional or unintentional discrimination among countries. Differential exchange rates can become an instrument for the worst form of unfair competition in international trade. There is also the risk that multiple currencies may again be used, as Germany used them, to produce division and domination of weaker countries for political purposes. On the whole, differential exchange rates open the way to dangerous abuses, while offering few offsetting advantages that cannot be equally well achieved in other ways.

For these reasons, it is provided that member countries may not engage in multiple currency practices which in the judgment of the Fund restrict international transactions. In countries where differential rates of exchange for different classes of imports and exports are used, their continuance would require the approval of the Fund. It is conceivable that the Fund would in some instances decide that multiple currencies are being used by a member country in such a way that they do not conflict with the purposes of the Fund. In other cases the Fund may permit adequate time for the abandonment of the practice, in order to give member countries ample opportunity to arrange for collection of revenue by other methods based on the foreign transactions of their nationals.

There is, nevertheless, one category of invisible exports where a differential exchange rate would seem to be within the purposes of the Fund. For social and political reasons it may be desirable to attract tourists and students from other countries. A differential rate of exchange for these purposes could very well be regarded by the Fund as an appropriate means for encouraging friendly relations between countries, and in some instances may be found to be an effective device for helping to correct disequilibrium in a country's balance of payments. It would seem undesirable, therefore, not to allow some flexibility in this matter. The Fund, of course, would have to give its approval before such differential exchange rates were established.

Question 21

If a country has exhausted its rights of recourse to the International Stabilization Fund, does its undertaking to maintain a stable rate of exchange lapse?

Reply

The obligations of a country to other member countries and to the Fund are not terminated when it has exhausted its permissible quota or for any other reason has no further access to the resources of the Fund.

Specifically, a member country is obligated to maintain exchange rates within the range prescribed by the Fund by taking whatever appropriate measures are necessary for this purpose. Such measures cannot, of course, include the practices opposed to the purposes of the Fund and proscribed in section VII of the Fund proposal. Obviously, one appropriate measure is the use of the gold and foreign exchange resources of a country to support its currency.

A country cannot succeed indefinitely in maintaining stable its exchange rate by the use of its own resources of gold and foreign exchange if the established rate does not reflect approximately its international economic position. Where the disequilibrium in a country's balance of payments is of a fundamental character, measures will ultimately have to be taken to restore equilibrium either through an approved change in the exchange rate or through other appropriate means.

As a matter of fact before a country has reached the stage where its access to the resources of the Fund will be terminated, the Fund will have reported on the measures that can be taken to restore equilibrium in the country's balance of payments. In the exceptional cases where the recommended measures have been taken without having restored the necessary balance in the country's position, the Fund would necessarily recommend measures of a more direct character. These might include alteration of the exchange rate, control of capital movements, or in extreme cases direct measures to limit the volume of imports.

It would be unfortunate if any member country should adopt the attitude that its obligations to the Fund could be disregarded when it has exhausted its right to draw further on the Fund. The provision of resources to facilitate the maintenance of exchange stability is only one aspect of the Fund's functions. The Fund must be regarded as an agency with general responsibilities for international monetary cooperation. The duty to take all possible measures to avoid unilateral exchange depreciation is not a qualified duty.

Alteration of exchange rates can only be undertaken with the approval of the Fund, except that a member country may change the established rate for its currency by not more than 10 percent, provided the Fund is notified and consulted on the advisability of the action (IV-5). Both a member country and the Fund have a duty to cooperate in taking measures to prevent an authorized depreciation in exchange rates.

Question 22

When a country's currency becomes scarce, does that country's obligation to keep constant by "appropriate action" its rate of exchange on the currencies of all other countries remain unaffected?

Reply

As indicated in the answer to the previous question, it is the view of the technical experts of the United States that the obligation of a member country to maintain its exchange rate within the range specified by the Fund cannot be terminated without the consent of the Fund. The fact that a currency has become scarce within the meaning of provision V-5 is indicative of a demand for the currency which, if not met or restricted, will tend to appreciate that currency. It is clearly the intention of provision V-5, if no additional supply is forthcoming, to restrict the demand for the currency in some equitable manner, in order to prevent an appreciation of the exchange rate.

As one of its obligations as a member of the Fund, each member country undertakes to maintain by appropriate action exchange rates within the range established by the Fund (VII-1). For a country with a favorable balance of payments, the obligation to maintain exchange rates by appropriate action includes the acquisition of gold that is offered for its currency to support the exchanges of the gold selling countries and to prevent the appreciation of the currency of the country with a favorable balance of payments.

The acquisition of unlimited amounts of the currencies of any other countries cannot reasonably be regarded as appropriate action within the meaning of VII-1. It is not intended that any provision of the draft proposal shall make it mandatory for any member country to acquire and to hold the currency of another member country. Instead, it is the Fund as a cooperative enterprise which undertakes to acquire the currencies of member countries in accordance with the provisions of the proposal.

When a country's currency becomes scarce, the Fund itself takes steps either to increase the supply or to restrict the demand. By apportioning the available supply, the demand is directly restricted. In general, such action by the Fund would prevent an appreciation of a scarce currency. In the countries where a scarce currency must be rationed, the controls should be effective in restricting imports. It follows that the exporters of the country whose currency is scarce will not, in fact, have foreign exchange to offer for sale, and there will be no need for placing limitations on the sale of foreign currencies by exporters. However, a member country could apply such direct limitations with the approval of the Fund and in cooperation with other member countries.

Question 24

Will the International Stabilization Fund sell foreign exchange to a member country to support its rate of exchange if that rate is not in accord with the country's international economic position?

Reply

While it is a major purpose of the Fund to help stabilize exchange rates, the Fund cannot and should not as stated in the Preamble, undertake to provide foreign exchange to prolong a basically unbalanced position. Numerous provisions of the Fund proposal are intended to provide safeguards against the use of the Fund's resources to support an exchange rate not in accord with a member country's international economic position.

When initial rates of exchange are determined, the rate established for a currency must, in the judgment of the Fund be appropriate. Until the Fund has given its approval to an initial rate of exchange, no operations may be undertaken by the Fund in such a currency (IV-2-a). In the case of an occupied country, the definitive rate of exchange established after the liberation of the country must be acceptable to the Fund. However, prior to the determination of the definitive rate, operations in the currency of a liberated country may be undertaken at a tentative rate of exchange fixed by the member country in consultation with the Fund. Such operations require the specific approval of the Board and, except under special circumstances, may not continue for more than 3 months after the liberation of the country or after the Fund's holdings of such local currency equal the quota of the country (IV-2-b). From these provisions it may be clearly seen that the Fund is not expected to sell foreign exchange to help maintain a rate of exchange which does not have its approval.

Even after the initial rate of exchange has been fixed with its approval, the Fund is not required to sell exchange to a member country (when the Fund's holdings of the local currency of the country exceeds its quota) to support an unbalanced position. When a member country is using its permissible quota in a manner that clearly has the effect of preventing or unduly delaying the establishment of a sound balance in its international accounts, the Fund, after notice, may place such conditions upon additional sales of foreign exchange to that country as it deems to be in the general interest of the Fund (V-2-d). The conditions, of course, would be the adoption of measures designed to correct the unbalanced position of the member country.

A permissible quota of the Fund's holdings of the local currency and securities of a member country is established for each country partly because it is regarded as desirable to have an objective indication of a limit to the Fund's acquisition of local currency, to help a country to support its exchange rate (V-2-b). There is implicit in this provision the view that when the Fund's holdings have reached the permissible quota, it is generally an indication that there is a fundamental disequilibrium in a country's international position that calls for remedial action. While the Fund may sell additional foreign exchange to such a country, the sale requires the specific approval of the Board of Directors and can be made only if satisfactory measures are being or will be taken to correct the disequilibrium or if it is believed that the disequilibrium is temporary and the excess holdings of the Fund can be disposed of within a reasonable time.

It cannot be emphasized too frequently that the Fund is not designed simply to sell foreign exchange needed by member countries to meet their adverse balances on international account. The resources of the Fund may properly be used to help a country through a period of temporary disequilibrium. The resources of the Fund are available to member countries under adequate safeguards to help them maintain stability of their currencies, while giving them time to correct maladjustments in their balance of payments without resorting to extreme measures destructive of international prosperity. A Fund operating successfully should be influential in inducing member countries to adopt policies making for an orderly return to equilibrium.

Question 25

Does the International Stabilization Fund provide facilities for multilateral clearing to a country which has its overall international payments on current account in balance but has an adverse balance of payments on current account with some countries?

Reply

Under the present provisions of the Fund plan there can be no doubt that in almost all circumstances a member country will be able to use freely the proceeds of its transactions in one country for the settlement of balances due on current account in another country.

Let us suppose that England has a favorable balance with France and an adverse balance of equal amount with the Netherlands. France and the Netherlands are in equilibrium with each other, and so is each of the three countries with all countries other than the three. This situation may manifest itself in an accumulation of francs by England and a need by England for guilders. Under provisions V-6 or V-7 it might be possible for England to offer all or part of its accumulated holdings of francs to the Fund which the Fund could then accept and pay for with guilders. However, the Fund is under no obligation to undertake such a transaction.

Nevertheless, England would, in fact, find it possible to acquire the necessary guilders by virtue of provision V-2-a. In the first instance, England would offer francs for sale in the exchange market either directly for guilders or for sterling. If there is a franc-guilder market, there would be no difficulty in acquiring the necessary guilders. Although France and Holland are themselves in equilibrium, the offer by England of francs for guilders might have the effect of forcing the franc-guilder exchange rate outside the range established by the Fund. It would then become the duty of France to support the franc rate and for this purpose it could apply to the Fund for the necessary guilders. If francs are not held by the Fund in excess of the limits set up under the Fund proposal and France is not making unwarranted use of the Fund's resources, the Fund could make the guilders available, and no difficulty would arise.

Assuming, however, that there is no franc-guilder market, it would then be necessary for England to offer the francs for sale in the exchange market for sterling. In that case, if France is not prepared to support the sterling-franc exchange independently, France would have to apply to the Fund for sterling for the purpose. If the Fund supplied sterling, the Fund's holdings of sterling would be reduced by the amount made available in the franc-sterling market. Simultaneously, England might offer sterling for guilders in the sterling-guilder market. Under the conditions assumed, this would have the effect of forcing the sterling-guilder rate outside the range specified by the Fund and England would apply to the Fund to support sterling with guilders.

If the Fund's holdings of sterling are not outside the limits specified in the proposal (which is unlikely in view of the fact that the Fund's holdings of sterling would have been reduced by support of the franc), and if England is not making unwarranted use of the Fund's resources (which is unlikely in view of the fact that there is no net change in the Fund's holdings of sterling), the Fund could under the provisions of the proposal make available the necessary guilders. Under provision V-2-a the Fund has authority to sell guilders to England for sterling to help it meet its adverse balance of payments on current account with the Netherlands.

It is also possible to show, in fact, that England has an over-all adverse balance of payments predominantly on current account. The reason for this is that the Fund's transactions in sterling are part of England's balance of payments. When the Fund uses sterling it holds on deposit in England to acquire foreign exchange held by England, the transaction is in effect a capital export by England. With this transaction included in England's balance of payments, the result is that its over-all balance of payments (formerly in balance) is now adverse to the extent of the Fund's acquisition of francs for sterling. England's adverse balance is equal to its specific adverse balance with the Netherlands. As this adverse balance is predominantly on current account, the Fund would be permitted under provision V-2-a to sell guilders to support sterling.

The implicit assumption in the above analysis has been that there are in fact, free markets in sterling, francs and guilders. If such markets exist, it is our view that the above transactions can be consummated quickly and without any difficulty, with the Fund supplying foreign exchange from time to time on application by the country requiring support for its currency.

If free exchange markets do not exist, it is recognized that it may be necessary for the country which wishes to dispose of foreign exchange to apply directly to the Fund. A provision (IV-1) has, therefore, been added that the Fund shall purchase, for local currency or needed foreign exchange, any member currency acquired by another member country in settlement of a balance of payments on current account where such currency cannot be disposed of in the foreign exchange markets within the range established by the Fund.

Under this provision the Fund would buy freely from a member country any currency which the Fund does not hold in excess of the limits prescribed (V-2-b), and which does not come under the provision (V-2-d) for limiting unwarranted use of the Fund. The Fund will give in exchange either local currency or member currency which has not been declared scarce in accordance with V-5. The provision applies only to such currency acquired by a member country in settlement of a balance of payments on current account.

Question 26

Would it be possible for the International Stabilization Fund to provide the exchange needed to support the currency of a member country if the deficit giving rise to this need for foreign exchange is in the balance of payments with a third country?

Reply

The resources of the Fund are intended to be used to aid all member countries in meeting adverse balances of payments predominantly on current account. There is no intention of establishing pockets of resources to be reserved for meeting adverse balances only with selected countries. The Fund is regarded as having general resources that may be used wherever necessary for meeting the adverse current balances of member countries.

Nor is it the purpose of the Fund to restrict the exchange markets that a country may use in financing its international transactions or in disposing of the proceeds of its international transactions. So long as member countries permit their currencies to be sold freely on other exchanges and permit their exchange markets to be used for the sale of exchange arising from transactions not involving their nationals, the Fund has no interest in preventing such exchange transactions.

For example, if Canada has a favorable balance on current account, arising say from an excess of exports to the United Kingdom, it is not intended to have the Fund restrict the right of Canada to offer such sterling bills for sale in the customary way on the New York exchange market. The increased supply of sterling bills (assuming the reciprocal supply and demand for sterling-U.S. dollar exchange to be otherwise in equilibrium) may make it impossible for the market to maintain the sterling-U.S. dollar exchange rate within the specified range. It would then become the obligation of the United Kingdom to support sterling exchange and, if necessary, utilize its right to purchase U.S. dollars from the Fund for this purpose.

The action of the Fund in providing U.S. dollars in this instance to support sterling exchange would not be fundamentally different from its use of gold to acquire Canadian dollars to support sterling exchange if the bills were offered in the Canadian market and resources were needed to maintain the sterling-Canadian dollar exchange rate in Montreal. The alternative would otherwise be to force an equilibrium in each specific balance of payments whenever the Fund was short of the local currency of a member country with a credit balance of payments. It is clearly the purpose of the Fund to avoid such bilateralism in aiding member countries to meet their adverse balances on current account. However, such bilateralism can be avoided only if the Fund's resources are regarded as general resources available for use wherever it may be necessary to use them.

While in most instances an adverse balance of payments on current account could most conveniently be settled by the Fund's providing the local currency of the member country with a favorable balance, it must be recognized that this direct method cannot be made compulsory where countries maintain free exchange markets. Thus, if Canada has a favorable balance with the United Kingdom, and the United States-United Kingdom balance and the United States-Canadian balance are in equilibrium (assuming other countries do not affect the situation) powerful forces will ordinarily be at work to cause the shifting of sterling bills held in Canada to the New York market. This is simply the operation of ordinary arbitrage forces.

The reasons are fairly clear. If in a preceding period, the U.S. dollar-sterling-Canadian dollar rates were adjusted to each other through the cross rates, then the appearance of a new force (say, the favorable Canadian balance) would tend to cause a downward movement in the value of sterling bills in Montreal. The New York market for sterling bills, not having been directly affected by a change in the United States-United Kingdom balance of payments, would for the time being presumably be slightly higher than the Montreal market for sterling. Arbitragers would consequently buy sterling in Montreal and sell sterling in New York (with or without offsetting transactions in other exchange).

With free exchange markets, there is only one pattern of exchange rates that can prevail, and this pattern reflects supply and demand in aggregate and not in particular markets. If free exchange markets are permitted, arbitrage is inevitable. More important, such arbitrage transactions do not constitute a danger to the Fund nor do they result in a significantly different composition of the resources of the Fund than would prevail if local currency were provided by the Fund to settle each bilateral balance of payments.

Thus, for example, if each member country were to come to the Fund for foreign exchange with which to meet its adverse balance of payments with any other member country (the Fund in each instance providing the local currency desired), the change in the composition of the Fund's resources would be the result of the over-all balances of payments of member countries. That is to say, the Fund's holdings of the local currency of a member country would be increased by the amount of its net debit balance of payments or decreased by the amount of its net credit balance of payments. If a member country with a credit balance disposed of the exchange represented by this credit balance in the exchange markets of another country, the composition of the Fund's resources could be temporarily affected by such transactions. But the Fund has means of offsetting such transactions to bring about somewhat the same end result as if direct recourse were had to the Fund for meeting each adverse balance of payments with another member country.

It may be well to consider the effect of the sale of sterling bills in the New York market by Canadian holders of such bills. Let us assume that the Fund holds an adequate supply of Canadian dollars. If the sale of sterling bills increases the U.S. dollar resources of Canada to an amount in excess of what Canada held at the time of becoming a member of the Fund, then Canada would be obligated to offer half of the additional dollar exchange to the Fund for Canadian dollars. The Fund would thus replenish its U.S. dollar resources to one-half the extent that they were depleted by the provision of U.S. dollars to the United Kingdom to support sterling exchange in the New York market.

If the Fund holds adequate Canadian dollar funds it can replenish its holdings of U.S. dollars to the full extent that they were depleted (provided there is a free market in Canadian exchange), even if Canada is not obligated to offer to the Fund the U.S. dollars derived from the sale of sterling exchange in New York. Presumably the Fund could offer to sell Canadian dollars for U.S. dollars in the exchange market and thus reacquire as much in U.S. dollars as it wishes. As a matter of fact, there would be nothing to prevent the Fund from offering to the United Kingdom the amount of Canadian dollars represented by sterling bills sold in New York for Canadian account, the Canadian dollars being offered for sale for U.S. dollars to the extent needed to support sterling exchange in New York.

So long as the Fund has Canadian dollars, there is no doubt it can act to assure approximately the same end result as if Canadian dollars were provided in the first instance to meet the adverse balance of the United Kingdom with Canada. If Canadian dollars are a scarce currency, the Fund cannot of course recapture the U.S. dollars. But under such circumstances the Fund would not have been in a position to provide Canadian dollars in the first instance, and would have found it necessary to acquire such Canadian dollars either with gold or with some acceptable foreign exchange, such as U.S. dollars.

It would appear that the Fund has adequate safeguards to prevent the unnecessary accumulation of strong currencies by countries whose local currency is not scarce. Under the circumstances, there is no reason why the Fund need limit the operations of free exchange markets, nor why the Fund should insist on bilateral settlement of balances even when the Fund provides the resources to help maintain exchange rates of member currencies.

Obviously, in the above illustration, exchange regulations of the United Kingdom, Canada, or the United States could prevent the sale of sterling exchange in New York by Canadians. If such regulations were established with the consent of the Fund, other member countries would be expected to cooperate in making them effective. In the absence of such regulations, it is not the purpose of the Fund to forbid such transactions.

Question 27

Would member countries exporting capital be permitted to purchase foreign exchange from the International Stabilization Fund?

Reply

If a member country has an adverse balance of payments toward which capital exports are contributing only in small part, the Fund would undoubtedly permit its resources to be utilized by the member country. Provision V-2-a allows the Fund to sell foreign exchange to member countries intended to meet an adverse balance of payments predominantly, but not exclusively, on current account. In general it would appear to be more expedient for the Fund to provide a member country with some resources to support the exchange market than to require the imposition of a system of exchange control merely to prevent the export of a moderate amount of capital.

The Fund can safely take this position so long as its holdings of the local currency in question are not excessive. But the Fund cannot allow its resources of other currencies to be serious depleted to facilitate the speculative movement of funds, nor can it sanction the dissipation in this way of resources of the Fund which should be reserved for the maintenance of international interchange of goods and services. The unlimited right of a country to utilize resources of the Fund to meet an adverse balance of payments arising in part from the export of capital is terminated when the Fund's holdings of the local currency of a country exceed the quota (V-2-d). Thereafter the Fund may require as a condition for the further sale of foreign exchange that the member country establish effective machinery for stopping or reducing net outflows of capital that fall within the undesirable category.

Where it is in the general interest, the Fund may continue to sell foreign exchange to a member country to facilitate a transfer of capital until the Fund's holdings of its currency and securities reach 150 percent of the quota of that country. Thereafter, in exceptional circumstances, the Fund may still sell foreign exchange to a member country for this purpose with the approval of three-fourths of the member votes (V-3).

It is clear from these provisions that it is not intended that the Fund should ever rigidly exclude the utilization of its resources to facilitate the export of capital. It is recognized that there will be instances when permitting an export of capital will not involve a net drain on the resources of the Fund and will be beneficial from the point of view of the general international economic situation. Under such circumstances, the Fund will want to allow its resources to be used in moderation by a country exporting capital.

It may be of interest to consider the conditions under which the Fund might regard the export of capital as in the general interest and as not in conflict with the primary objectives of the Fund. In fact, an export of capital, even when some of the foreign exchange is provided by the Fund, may reduce the net call on the Fund's resources and may give the Fund a more balanced distribution of its assets. For example, one member country may export capital to another member country which has an adverse balance on current account and may wish to purchase from the Fund part of the exchange needed for this purpose. Such a capital export may reduce correspondingly the need of the second country to call upon the Fund for exchange with which to meet its adverse balance on current account. The net amount of exchange sold by the Fund under such conditions would be less because it facilitated the capital export. Further, if this capital export is from a country whose currency the Fund holds in a moderate amount to a country whose currency the Fund holds in an excessive amount, the distribution of the Fund's assets would become more balanced, and as a result of the transaction the Fund would be in a better position to serve all member countries.

Apart from the general conditions, the Fund might be more favorably disposed toward permitting certain types of capital transfer than toward permitting others. The repayment of a short-term credit is, in a sense, a capital movement. However, if the credit was acquired to finance trade, it may have served when made to obviate a corresponding use of the Fund, and the Fund would ordinarily provide exchange for the repayment of such a credit. The meeting of normal sinking fund installments on a debt is usually regarded as a capital movement. Nevertheless, if such sinking fund payments are not large relative to the Fund's holdings of the currency of a member country, the Fund would ordinarily provide foreign exchange to facilitate a capital export by a country with a maturing obligation which cannot be fully met at once but which its balance of payments could absorb within two or three years.

In considering the probable attitude of the Fund toward the sale of foreign exchange to facilitate a transfer of capital, it should be borne in mind that the provisions of the draft proposal are designed to give effect to the general principal that the Fund's resources should be used primarily for settling international balances on current account. However, sufficient flexibility is provided so that the resources of the Fund can be used for meeting a capital export where it is deemed to be generally desirable. There is no reason to believe that a country making payments of a capital nature will be debarred untirely from recourse to the Fund unless and until the Fund has given sufficient notice to the member country that such payments are not in the general interest.

It is important for the Fund to build up in the course of its operations accurate statistics on international payments of all types, as it easily can do under its authority to require full reports from member countries. In the period before these records are available, however, completely accurate records of a country's capital inflow or outflow are not essential to the proper execution of the policy outlined above. The Fund will be concerned only with large movements, not with flows that are small relative to a country's volume of international transactions. Large non-recurring capital flows — like a large redemption operation, or defaulted loan settlement — would be known to the Fund, while recurring net outflows of significant size would be difficult to obscure. It is not necessary to know precisely the amount of net outflow; it is enough to be able to ascertain whether the net outflow is significantly large or not. It would be desirable, of course, for member countries to arrange to receive regular reports on capital movements into and out of their countries, and to make such data available to the Fund.

An extended discussion of the control of capital movements will be found in the answers to questions 38 and 39.

Question 28

In determining the International Stabilization Fund's holdings of a country's currency at a given date does "currency" include or exclude securities expressed in that currency?

Reply

In general, the Fund's holdings of a currency for purposes of the permissible quota are regarded as the net position of the Fund with respect to that currency. The Fund's holdings of a currency may be defined, therefore, as all of the assets of the Fund in a given currency minus all of the liabilities of the Fund in that currency. Quite definitely, in calculations on the permissible quota of a country, the security holdings of the Fund in any local currency should be included as part of the local currency.

There is one exception to the rule stated above. Blocked balances acquired by the Fund are intended to be excluded from the computation of the Fund's holdings of local currency, except to the extent that such balances become free. Securities acquired with blocked balances would generally be treated in the same manner as the balances themselves. Provision V-8-j states that blocked balances shall not be included in computing the amount of foreign exchange the Fund may sell to member countries under their permissible quotas.

It should be noted that a distinction could be made between local currency holdings as defined for the purpose of determining the amount of foreign exchange that may be sold to a member country (V-2, 3) and as defined for the purpose of determining the charges to be levied on a member country with respect to the Fund's balances of its currency (V-14). So far as concerns computations for determining the sale of foreign exchange, all local currency assets, except blocked balances, are treated in the same manner. For applying the penalty on local currency holdings in excess of the quota, it would be possible to exclude interest-bearing securities. If contributed securities are made non-interest bearing, they should, of course, be included in the balances on which charges may be levied by the Fund.

The way in which the Fund acquires assets in terms of a given local currency does not affect the inclusion of the assets in the Fund's holdings so far as the permissible quota is concerned. Therefore, the Fund's holdings of local currency include initial subscriptions in local currency and securities (II-3-b), supplementary subscriptions in these forms (II-5, 6), currency acquired by the purchase of part of a country's increased holdings of foreign exchange (V-6), and the proceeds of security sales (V-11). Devaluation does not affect the calculated holdings of the currency and securities of a member country as the unitas value of such holdings are not affected by devaluation (III-3).

The Fund's position in a local currency may be modified whenever the local currency is sold to the Fund or bought from the Fund by a member country. Increments of exchange sold by a member country to the Fund are likewise included. No distinction is made between currencies acquired in each of these ways, because any purchase of a member currency by the Fund tends, directly or indirectly, sooner or later, to support the foreign exchange value of that currency.

When the Fund sells the securities of a member country for its local currency, the Fund's local currency position is in the first instance unaffected, for cash is increased as much as securities are decreased. Nor is the Fund's position affected when it makes loans or investments in local currency, for cash is then decreased and securities increased correspondingly. Similarly, when the Fund borrows any local currency from that member country, the position of the Fund in that currency is in the first instance unaffected, for the local currency liabilities are increased to the same extent as the local currency assets.

There is one instance in which the Fund's transactions in securities or loans do affect the net position of the Fund with respect to holdings of local currency. If the Fund sells the securities of one country to acquire the local currency of another, the local currency position of the Fund with regard to the two currencies is changed. Such a transaction decreases the Fund's holdings of the currency of the country whose securities are sold, and increases the Fund's position in the currency of the country where the securities are sold. However, no injustice results from this arrangement. So far as concerns the country whose securities are sold, the unused portion of its permissible quota is increased. So far as concerns the country where the securities are sold, the Fund's holdings of its currency must be extremely low (say, 20 percent of the quota) or the sale would not have been made. It should be added that permission must be secured from both countries for the above transaction (V-11).

No difficulty seems to us to inhere in the type of transaction authorized in V-5, namely, the borrowing by the Fund of a scarce currency from the foreign exchange holdings of a member country. The Fund would in the first instance acquire an asset (cash) and incur a liability in a scarce currency. So far as concerns the country whose currency is scarce, its position is unaffected--the Fund's net holdings remain the same until the borrowed currency is used. So far as concerns the lending country, it acquires a claim on the Fund for the specific type of foreign exchange it lent.

Question 29

What provision is made to permit a country with abnormally low holdings of foreign currencies and gold to accumulate such resources while a member of the International Stabilization Fund?

Reply

Provision V-6 requires each member country to offer to sell to the Fund one-half of the foreign exchange resources and gold it acquires in excess of its official holdings at the time it became a member of the Fund. However, no country need sell gold or foreign exchange under this provision unless its official holdings are in excess of 25 percent of its quota.

The significance of this provision can best be brought out by an explanation of its purpose.

1. Some member countries may be tempted to use the resources of the Fund to build up independent holdings of gold and foreign exchange. The Fund is not devised to facilitate the accomplishment of such a purpose. On the contrary, the Fund's resources are intended only for needs arising from an adverse balance of payments predominantly on current account.

Although the Fund would not sell foreign exchange for local currency to permit a member country to acquire additional balances of gold or foreign exchange, some provision is necessary to prevent the Fund from being used indirectly for such a purpose. Without such provision, a member country could resort to the Fund when it has a temporary adverse balance of payments, and keep any increment of gold or foreign exchange which it may acquire when it has a favorable balance of payments.

With provisions V-2-a and V-6, a member country cannot build up excessive gold and foreign exchange balances while at the same time drawing upon the resources of the Fund. A member country must pay for one-half its purchases of foreign exchange from the Fund with gold, provided its gold and foreign exchange holdings exceed 50 percent of its quota; and it must offer to sell to the Fund for its local currency or needed foreign exchange one-half of the gold and foreign exchange it may acquire in excess of its official holdings at the time it became a member of the Fund (provided its official holdings exceed 25 percent of its quota).

2. The tentative proposal does not generally specify a definite time or period for the repurchase of local currency which has been acquired by the Fund from the sale of foreign exchange to a member country. Presumably when the Fund sells

foreign exchange in excess of the permissible quota under provisions V-2-b-i and V-2-b-ii, there would be an understanding that the Fund's holdings of local currency would be brought within appropriate limits in some specified period. Similarly, when the Fund sets conditions upon additional sales of foreign exchange to a country that is exhausting its permissible quota too rapidly, in accordance with provision V-2-d, one condition could be that a reduction in the Fund's holdings of local currency be effected in some specified period.

The great bulk of the exchange transactions of the Fund with member countries will not require specific approval, as the Fund's holdings of the currencies of member countries will in general not exceed the permissible quotas. The Fund would not in such instances prescribe conditions for the repurchase of local currencies. It is necessary, however, that some general obligation should rest on member countries utilizing the resources of the Fund to repurchase their own currencies. Otherwise, the Fund's resources would tend to become unbalanced in the form of unnecessarily large holdings of some local currencies. Provision V-6 is in fact a method of requiring the repurchase of local currency by member countries as their balances of payments become favorable and as they acquire additional gold and free foreign exchange.

3. The Fund starts with resources of local currencies (including securities) and gold. In general, resources of this character should be adequate for the operations of the Fund. With its local currency resources the Fund may meet any moderate calls for any currency; and with its gold holdings the Fund can supplement its local currencies and meet very large calls for any few currencies. Nevertheless, it would be desirable to strengthen the Fund by gradually converting its local currency holdings into gold. Provision V-6 makes this possible.

For the world as a whole, the balance of payments, as ordinarily defined, is always active to the extent of the annual increment in gold reserves resulting from the production and distribution of newly-mined gold (perhaps modified for changes in private hoards of gold). The normal balance of payments for a country should tend to provide for an expansion in its holdings of gold and free foreign exchange. There is no good reason why part of the increment in gold and free foreign exchange should not be used by member countries to repurchase from the Fund its holdings of their local currencies. It is in the interest of all member countries that the strength and liquidity of the Fund be increased by the gradual replacement of local currencies with gold, particularly as such replacement would not involve any reduction in the reserves of member countries.

It should be emphasized that no hardship is incurred by a member country in offering to sell to the Fund part of its increment of gold and free foreign exchange. The member country offering the resources for sale is under no obligation to accept any currency other than its own. To the extent that a member country reduces the Fund's holdings of its local currency, it increases its right to acquire foreign exchange from the Fund with its local currency. In view of the general advantages that would be conferred by a strong and liquid Fund, the right to acquire foreign exchange from a Fund adequately supplied with gold is not inferior to the actual holding of gold and foreign exchange (except, of course, in the acquisition of scarce currencies).

These provisions by no means indicate a policy of discouraging the maintenance of independent monetary reserves. It is, on the contrary, the view of the technical experts of the United States that it is desirable for member countries to build up adequate holdings of gold and foreign exchange. For this reason a reduced quota contribution in the form of gold may be made by countries with small or moderate holdings, according to a graduated scale of required payments (provision II-3-a). To take account of the greater need of countries which have been occupied by the enemy, a further reduction in the contribution of gold is permitted for such countries under the same provision.

In addition, a country with gold and free foreign exchange holdings less than 50 percent of its quota need not use these resources in paying for exchange purchased from the Fund. In countries in which working balances, other than official balances, are at a very low level at the time of adherence to the Fund, these private working balances may be built up (but not excessively) without any obligation to offer to sell such increments of foreign exchange to the Fund.

The requirement to offer to sell to the Fund gold and foreign exchange acquired by a member country is also subject to qualifications designed to permit a country to accumulate some holdings of gold and foreign exchange. The provision applies only to gold and foreign exchange acquired by a member country in excess of its official holdings at the time it became a member of the Fund, and no country need offer to sell gold or foreign exchange under this provision unless its official holdings are in excess of 25 percent of its quota. Furthermore, only one-half of the gold and foreign exchange must be offered to the Fund. Finally, since such gold and foreign exchange need be sold only for local currency (or for foreign exchange needed by the member country), in practice member countries would not sell additional gold to the Fund after the Fund's holdings of their local currencies had been depleted.

To provide some assurance that private balances will not be used to defeat the purposes of this provision, each member country agrees to discourage the excessive accumulation of foreign exchange resources and gold by its nationals. The Fund is expected to inform a member country when any further growth in privately held exchange resources and gold appears unwarranted.

Question 30

When does newly-mined gold become subject to the provision that member countries must under certain conditions offer for sale to the International Stabilization Fund half of the increment in their official holdings of gold?

Reply

It is provided in V-6 that only the increase in official holdings of gold or foreign exchange (above the prescribed limits) is s ubject to purchase by the Fund to the extent of one-half the increment. Newly-mined gold held by the producers or by bullion dealers awaiting sale is not to be regarded as part of the official holdings of a country.

It is conceivable that newly-mined gold will regularly be offered for sale to the monetary authorities of a country soon after its production. It then becomes subject to the obligations of V-6 unless the operating regulations which the Fund will work out provide otherwise. It may be found advisable, however, to provide for special consideration in the case of newly-mined gold.

The technical experts of the United States had in mind that the administration of this and many other provisions of the draft proposal would be implemented by operating regulations to be set up by the Fund. Such regulations must include specific rules for determining the amount of the increments of gold and foreign exchange which are to be offered for sale to the Fund. These regulations should have as one aim to prevent the Fund from becoming involved in continuous small purchasing operations, especially if they are likely to be counteracted by subsequent sales of exchange. Obviously, such regulations would cover the conditions for the offering of newly-mined gold for sale to the Fund.

It may be pointed out again that a country holding newly-mined gold awaiting distribution does not suffer any hardship (the scarce currency problem aside) if half of the increment of such gold is offered for sale to the Fund for its local currency. To the extent that the gold was held to acquire foreign exchange, the capacity of the country to acquire such exchange is not impaired by sale of half of the increment of gold to the Fund for local currency. The member country can acquire foreign exchange to the full value of the gold held for the purpose by purchasing needed foreign exchange from the Fund, payment to be made half in gold and half in local currency.

Of course, if newly-mined gold were accumulated to an unusual extent in the hands of producers or bullion dealers, the Fund could make representations as provided in V-6.

Question 31

In computing the increment of gold and foreign exchange that member countries must offer for sale to the International Stabilization Fund is any allowance made for increased foreign liabilities?

Reply

In computing the amount of gold and foreign exchange that must be offered for sale to the Fund under this provision, no explicit allowance is made for increased liabilities to foreigners. It should be noted, however, that it is only the prescribed increase in official holdings that must be offered for sale to the Fund. So far as concerns the holdings of commercial banks and other nationals, it is provided that excessive accumulation by them of liquid exchange resources and gold should be discouraged. The intention is not to restrict the acquisition of such resources when they are needed by commercial banks and other nationals as working balances for international transactions. There is, however, a desire to avoid the accumulation of excessive holdings in this form by countries utilizing the resources of the Fund. Undoubtedly, in determining whether such holdings are excessive, consideration would be given to the foreign liabilities of commercial banks and other nationals.

No explicit allowance is made for offsetting the official holdings of Treasuries and central banks with their foreign liabilities. If it is regarded as desirable to make some allowance for such liabilities against official holdings of gold and foreign exchange, consideration can be given to the manner in which this may be most appropriately done. Provision for such effects, if regarded as desirable, could be made in the operating regulations that are adopted to implement V-6.

Question 32

What would be the nature of the collateral the International Stabilization Fund could require when its holdings of a currency exceed the permissible quota of the country?

Reply

The provision that the Fund may require a member country to deposit suitable collateral when the Fund's holdings of its local currency and securities exceed the permissible quota of a country is intended to safeguard the interests of the Fund (V-2-c). The permissible quota of a country is an objective indication of the maximum amount of a member country's local currency and securities which the Fund should ordinarily hold. With the specific approval of the Board of Directors and under adequate safeguards, the Fund may sell additional foreign exchange to a member country which has reached its permissible quota (V-2-b). One safeguard is that the member country should deposit such suitable collateral as the Board may prescribe.

The nature and the amount of the collateral would be prescribed by the Board. It is to be expected that the collateral required of a member country will be appropriate to the particular circumstances in each case. Gold, foreign or domestic currency and securities are stated as types of collateral that could be required. However, the Board could accept other suitable collateral, such as warehouse receipts for internationally traded staple commodities. The collateral required must be within the capacity of the member country and must safeguard the interests of the Fund.

From the standpoint of safeguarding the interests of the Fund, gold or free foreign exchange would be the most desirable special reserve. There may be instances in which, although a member country does not wish to sell its gold, it is prepared to deposit gold as a special reserve when buying additional foreign exchange from the Fund. This may happen when the country's gold holdings are required by law as backing for its currency. There may also be cases where the excess purchase of foreign exchange from the Fund is expected to be a temporary condition, so that a country prefers to pledge its gold (just as a country might now use its gold as security for a loan from a foreign central bank). Much the same analysis would apply to the use of free exchange or foreign securities as a special reserve.

While the deposit of government securities or local currency as a special reserve would not in some cases provide the Fund with assets easily disposable for foreign exchange, it would provide the Fund with a margin of collateral against losses arising from the depreciation of a currency, should the country not meet its obligations to the Fund.

In some cases warehouse receipts for staple international commodities would be a suitable type of special reserve. Such receipts could be conveniently deposited as a special reserve by countries producing primary products whose debit balances on current account have arisen from difficulty in selling the usual volume of basic exports. Such warehouse receipts could, if necessary, be disposed of by the Fund for foreign exchange.

It should be noted that a member country has the right to repurchase from the Fund for sale or acceptable foreign exchange, the local currency holdings of the Fund in excess of the country's quota (V-7). It is, therefore, always within the power of a country to reclaim the collateral it has deposited with the Fund by reducing the Fund's holdings of its local currency and securities below the permissible quota.

Question 33

What does the International Stabilization Fund propose to do with currencies of non-member countries after sixty days?

Reply

The authority granted the Fund to buy the currencies of non-member countries (V-9) is, of course, not for the purpose of helping such countries. In fact, it is specifically provided that the resources of the Fund shall be used exclusively for the benefit of the member countries (II-8). For this reason, the Fund is limited in acquiring and holding the currencies of non-member countries. The Fund may not acquire more than $10 million of any non-member currency and must dispose of such currency within 60 days, unless specifically authorized to do otherwise by the Board of Directors.

The only reason for the Fund's purchase of non-member currencies would be to help member countries that had acquired such currencies. The Fund would prescribe appropriate conditions for acquiring non-member currencies from member countries. For example, the member country selling such currencies to the Fund might be required to guarantee the exchange value of the currency sold. In some cases the Fund might buy a non-member country's currency under a repurchase agreement with a member country.

It is expected that the Fund would sell the non-member currencies either under the terms of their acquisition, or to member countries needing such foreign exchange, or on the foreign exchange markets, either for gold or for member currencies.

Question 34

What kind of action is it contemplated that the International Stabilization Fund would recommend to a country whose currency was in scarce supply?

Reply

The draft proposal provides that when the Fund's holdings of the currency and securities of a member country become excessively small in relation to prospective acquisitions and needs for that currency, the Fund is required to render a report embodying an analysis of the causes of the depletion of the Fund's holdings and recommending measures designed to increase the Fund's holdings of that currency (V-4). The representative of the country whose currency is becoming scarce must be a member of the Fund committee appointed to draft the report.

The specific recommendations which the Fund might make to a member country whose currency is in scarce supply would be formulated in accordance with the nature of the existing disequilibrium in the balance of payments position of that country and the forces responsible for its development. A special committee would be appointed to study the problem and to draft a report on the recommendations to be made. It is also provided that the Board member of the member country to whom the recommendations are to be directed would be a member of the Fund committee appointed to draft the report.

No limitation on the scope of such recommendations is provided in the Fund proposal. It would, however, be necessary for the Fund to give full consideration to the effects of its recommendation on the internal economy of the member country to whom the recommendations are made as well as to any constitutional or other legal limitations which might make difficult or impossible positive action on some of the recommendations under consideration.

It may be assumed that such obvious measures as the control of capital movements have already been taken to ease the strain on the exchange position of member countries and the Fund with relation to the scarce currency. In the event that the disequilibrium in the balance of the payments position of a member country was the result of an inflow of capital and not the result of persistent forces operating on current account items, the Fund would undoubtedly make recommendations which looked toward a reversal of this flow. The control of capital inflow is not, however, the primary responsibility of the member country experiencing such inflows, although it may be requested to cooperate with the Fund and with the capital exporting countries in preventing such movements. If capital movements are responsible for a serious drain on the Fund's supply of that currency, the member countries exporting capital to the country whose currency is in short supply could be required by the Fund to take the initiative in restricting such exports.

It may also be assumed that the money markets of the country whose currency is scarce are open to the Fund for the sale of its assets, for the securing of advances, and for the floating of the Fund's own obligations, and that the recommendations of the committee can be worked out without such extreme measures as might be necessary in the absence of an additional supply of a scarce currency. Such an additional supply would provide the member countries with the time needed to work out a more satisfactory balance in international payments with the country whose currency is scarce.

This question regarding the Fund's recommendations is not concerned with these intermediate measures but with corrective measures. It is impossible at this point to state specifically what the Fund would recommend in any given situation, since each case would be a problem of its own, involving a large number of variables, and concerning which intensive study would be necessary. If, for example, the disequilibrium stems from an excess of exports over imports which is not likely to correct itself in a reasonable period of time, the Fund might recommend measures for an expansion of imports and a reduction of artificial stimulants to exports if any are operating. Specifically, appropriate recommendations for increasing imports might include a reduction of tariff rates and the encouragement of tourist travel abroad. We believe it would be contrary to the best interests of the members of the Fund to recommend a reduction of exports; but it might be quite proper to recommend that nations eliminate subsidies on exports provided such elimination would make a significant contribution to the adjustment.

When a country shows a persistently favorable balance of payments on current account, it may be that the most appropriate and the most effective means of restoring a balance in its international accounts would be an expansion in its foreign investments. If there are factors prevalent in the country discouraging the flow of private investment to foreign countries, the report might well recommend their correction. The Fund might even recommend measures designed to promote repatriation of foreign funds.

In general, there is little reason to expect that it will be necessary to recommend measures designed to encourage domestic expansion in the country whose currency is scarce. Nevertheless, if such recommendations are needed, they should be made, including recommendations on credit policy, investment policy, and other measures which have a bearing on the level of economic activity and employment within a member country. It is quite possible that efficiency rates of renumeration have fallen and that an upward adjustment should be encouraged.

In extreme cases it may also be desirable to recommend a change in exchange rates for the country whose currency is scarce. An upward change in the foreign exchange value of a currency, however, should be considered only if other measures appear to be inadequate, and only if such a step does not contribute to further deterioration in the general international economic situation. It should be emphasized that what is desired is not merely a reduction in a country's exports, but, remedial action that will correct its balance of payments without generating deflationary forces at home and abroad.

The recommendations of the Fund will unquestionably be given careful consideration. It is in the interests of a country whose currency is scarce to avoid the need by the Fund to allot its holdings of such a currency, and to take measures to obviate the need for such action by the Fund. While the Fund itself cannot correct the situation, it provides a means for facilitating the adoption of appropriate measures by the cooperating member countries.

It should not be overlooked that a disequilibrium in the balance of payments cannot be manifested as a problem peculiar to one country. Whenever the supply of a member country's currency is scarce, this scarcity is likely to be accompanied by excessive supplies of the currencies of other countries. In such cases the responsibility for the correction of the maladjustment is not a unilateral one. It will be the duty of the Fund to make a report not only to the country whose currency is scarce but also to the member countries who are exhausting their quotas too rapidly in accordance with provision V-2-d.

Question 35

What is the purpose of requiring the International Stabilization Fund to apportion a scarce currency?

Reply

As was pointed out in the answer to the previous question, the Fund will make recommendations to a member country whose currency is in scarce supply, with a view to correcting the conditions in its balance of payments relations giving rise to the scarcity of its currency. It is in the interest of such a member country to carry out the Fund's recommendations since otherwise it will be faced with the alternative of reducing its exports and making other undesirable adjustments.

It should be noted that the scarcity of an important currency is likely to be accompanied by an excess in the Fund's holdings of the currencies of other member countries. A disequilibrium in the balance of payments is of necessity not confined to one country; and it is well to recognize that the responsibility for the scarcity of a currency in the Fund need not be primarily that of the country whose currency becomes scarce. We may presume the Fund will study the problem in all its aspects and will make appropriate recommendations to all interested countries.

There can be no assurance that the action of the Fund under V-4 will always be adequate to remedy the situation. The recommendations of the Fund should be given the utmost consideration in the formulation of the monetary, economic, and commercial policies of member countries. The Fund's recommendations will have behind them the enormous force of the world's opinion. Within each country there is certain to be developed a growing recognition of the importance of effective cooperation with other countries through the Fund and in other ways. Even though the Fund's recommendations carry with them no element of compulsion, it will be difficult for any country cognizant of its responsibility to disregard them.

It is to be hoped that the Fund will not find it necessary to utilize provision V-5 on the apportionment of scarce currencies. Ordinarily, the Fund will be able to borrow enough of a scarce currency to meet the needs of member countries during the period in which the recommendations made by the Fund take effect. Nevertheless, it is necessary to establish the basis for the apportionment of a scarce currency if such action should become essential for a limited time.

The fact that a currency has become scarce is evidence of a distortion in the pattern of trade balances that must be corrected through fundamental adjustments. In the meantime action may have to be taken to limit the demand for a scarce currency. The apportionment of a scarce currency by the Fund and its rationing by the monetary authorities of member countries are one means of promptly limiting the demand and even of helping to correct the disturbances in the pattern of trade balances. In time, the measures recommended by the Fund, if adopted by member countries, would probably have the effect of establishing a more balanced international payments position. Until these measures can be made effective, some direct control is necessary in extreme cases.

The apportionment of scarce currencies by the Fund is probably the most certain means of promptly directing excessive demand away from a member country with a large and persistently favorable balance of payments to other member countries with an unfavorable balance of payments. In a sense such action involves a type of direct control and of bilateralism that should be avoided. It is important, therefore, to bear in mind that apportionment of a scarce currency is regarded as a temporary measure of an emergency character. Under the direction of the Fund, this method of adjusting the demand for a scarce currency to the available supply would be free from dangers of discrimination. Ultimately, of course, it is expected that fundamental adjustments will remove the need for apportioning a currency.

Question 36

May a country to whom the International Stabilization Fund has granted an allocation of a scarce currency restrict imports from the country whose currency has become scarce?

Reply

It is intended that when the Fund's holdings of a currency become scarce steps will first be taken to increase the supply of the scarce currency. Under provision V-4, the Fund is authorized to render a report to the member country embodying an analysis of the causes of the depletion of the Fund's holdings of that currency and making recommendations designed to increase the Fund's holdings of that currency.

The recommendations are likely to be of two types. Some of the recommendations will probably be designed to provide member countries and the Fund with additional amounts of the scarce currency, through encouragement of foreign investment in member countries and through loans or advances to the Fund. Other recommendations will probably be designed to correct the fundamental maladjustment in the balance of payments position of the member countries. It is hoped, of course, that the recommended measures will be effective.

Nevertheless, the Fund must take account of the possibility that whatever measures are taken will not immediately alleviate the scarcity of a currency. Under such circumstances, with a continuing scarcity for a currency, the Fund must adopt measures on its own account to assure the proper use of its limited holdings. The measure provided under the third paragraph of V-5 is the apportionment of the scarce currency.

The technical experts of the United States interpret this provision as applying only to the Fund's holdings of a scarce currency. Member countries would be free to use the scarce currency accruing to them directly to meet their own needs, with the qualification, of course, that half of the increases in their accumulated holdings of such a currency must be offered for sale to the Fund in accordance with provision V-6. Similarly, member countries could utilize their holdings of gold and foreign exchange to supplement the allocation of a scarce currency made to them by the Fund.

The apportionment of a scarce currency by the Fund would take the form of allotting to member countries an amount of scarce currency (to be paid for with local currency and gold, as provided in V-2-a), the Fund taking into consideration the special needs and resources of member countries requesting an allotment. The actual distribution of its allotment by any member country among its importers and other users of a scarce currency would be a matter for the member country to decide.

Obviously, with a limited allotment of a scarce currency, some member countries will find it necessary to restrict the demand of their nationals for such a currency. The decision by the Fund to apportion a scarce currency is in effect an authorization to member countries temporarily to restrict the freedom of exchange transactions in the affected currency. Thus, their action would not be inconsistent with VII-3 in which they undertake not to impose new restrictions except with the Fund's consent. In determining the manner of restricting the demand, and in rationing the limited supply among its nationals, it is believed that the member country should have complete jurisdiction.

Question 38

Will the International Stabilization Fund require all member countries to prohibit or restrict the outflow of capital?

Reply

The purpose of the Fund is to provide, through stability of exchanges and through cooperation in the maintenance of exchanges, the conditions necessary for the restoration and balanced growth of international trade. In accordance with this purpose, it is not intended as a general policy to have the resources of the Fund used to finance substantial outflows of capital from member countries.

The decades of the 20's and the 30's showed that many countries could not withstand the drains on their gold resources resulting from widespread conversion of local currency and flights of capital. Out of this experience has come general recognition that the gold and foreign exchange resources of a country should be reserved primarily for the settlement of international balances on current account. In line with this view, the general policy of the Fund should be to give countries access to the resources of the Fund only when such resources are needed to meet an adverse balance of payments predominantly on current account.

It would be incorrect to assume that most capital exports are prohibited under the Fund's provisions or that the policy of the Fund with respect to capital exports requires the maintenance of exchange controls or exchange restrictions in all or even the majority of cases. A careful examination of the Fund proposal will reveal that most capital exports can probably take place freely, and only in a minority of cases will exchange restrictions have to be imposed. The conditions under which capital exports may take place freely are described in the following paragraphs:

1. Capital exports of any type can take place freely from countries with a favorable balance on current account.

It is recognized that there will be many countries in need of foreign capital for reconstruction and development after the war, and that there will be some countries whose international economic position will permit them to export capital. The provision of capital under these conditions can contribute to the balanced growth of international trade. Most of the capital exports of this type are likely to be from countries with a credit balance of payments on current account, and serve to help maintain monetary stability. It is one of the purposes of the Fund to facilitate the resumption of such international lending by restoring confidence in the greater stability of exchange rates, and in the greater freedom from injurious restrictive exchange practices.

The only limit on the free outflow of capital from a country experiencing a favorable balance on current account might be the case where a country has been previously experiencing an unfavorable balance and had sold the Fund more of its currency than the Fund found it desirable to keep. In that event, the Fund might prefer to have the country employ part of its favorable balance of payments to repurchase some of the Fund's holdings for its currency before or pari passu with the country's undertaking significant amounts of capital exports. In fact, provision V-6 is intended to do this.

2. Some countries experiencing an unfavorable balance of payments on current account could regard with complete equanimity an efflux of capital of any character, because their holdings of gold and foreign exchange are entirely adequate to meet all likely drains. For example, the United States could permit very substantial and continued capital exports for a long time even if its balance of payments turned unfavorable on current account. There are doubtless a number of other countries which could permit capital exports under these circumstances, either because the unfavorable balance of payments on current account is small relative to their foreign exchange resources, or the volume of capital outflow is small compared to the unfavorable balance on current account.

3. Also, a country having an unfavorable balance of payments on current account could freely permit foreign investments, or capital exports if at the same time it was itself a recipient of capital inflow. It usually happens that a country is at the same time both an importer of capital and an exporter of capital. Sometimes both inflow and outflow of capital may be of long term character. For example, British firms may be building branch plants in South America or Africa, at the same time that Americans are investing in British securities, newly issued or held by residents of the United Kingdom. Frequently, the capital inflow may be predominantly of short term character and the outflow predominantly of long term character.

The significant drain on foreign exchange resources on capital account is the drain on net capital account, though it is also true that attention must be paid to the predominant character of the inflow or outflow. The movement of what may be classified as short term capital has different significance in different countries and at different periods. Nevertheless, it is not to be assumed that a country with an unfavorable balance of payments on current account could not continue to purchase foreign exchange from the Fund unless it curtailed its capital exports. A country could continue indefinitely having large gross capital flows and small net flows.

4. All countries could permit capital exports such as are reflected, even with a moderate lag, wholly or chiefly in exports of goods or services. It has been a common practice in the past, and there is no reason to expect that it will cease in the future, for some foreign loans to be tied to exports in such a way that the granting of the loan is accompanied sooner or later by a net export of goods and services almost of the same magnitude as the loan.

The mechanism of adjustment of international accounts does not always, or even usually, operate smoothly or rapidly enough to translate a net export of capital to a net flow of goods and services (unless the foreign investment is "tied" to export of goods). If it did, obviously capital flows would not present a problem distinct from balances on current account. But it would be an error to overlook the fact that the mechanism of adjustment does operate quickly and smoothly to some extent. The rapidity of operation differs greatly with the countries affected, the period, the magnitudes involved, the make-up of the international accounts, the phase of the business cycle, and other factors.

Countries with limited foreign exchange resources making loans to other countries should be very reluctant to make loans in excess of the amount absolutely needed to finance the additional exports effectuated directly or indirectly by the loan. The borrowing countries should be equally reluctant to burden their balance of payments unnecessarily by borrowing more for a particular project than is required to pay for the imports necessary for that project, making due allowance for secondary effects of the borrowing. Countries with scarce foreign exchange resources should rarely borrow abroad merely for the purpose of domestic financing.

5. Finally, even where a country has an unfavorable balance of payments and inadequate foreign exchange resources, the Fund would not be disturbed by capital exports from that country if the amount were small or if the Fund did not have large holdings of that country's currency, or if the capital exports were sporadic or of brief duration. It is only when the capital exports are (a) net, (b) large, (c) sustained, and (d) are motivated chiefly by the desire for speculative profit or the avoidance or evasion of high taxes, that the Fund is likely to require a restriction of capital exports as a condition for receiving continuing aid from the Fund.

The flow of capital from one country to another seeking political and economic security, or speculative profit is frequently undesirable. Such flows are particularly disturbing when they take place from countries with a debit balance of payments to countries with a credit balance of payments on current account. Such flows serve to disturb monetary stability and it is not the purpose of the Fund to facilitate such capital movements.

Until, however, the Fund considers a continuation of capital exports of that character and under those conditions to be injurious, no restrictive action over capital exports need be taken by the country exporting capital. It is only when the Fund deems it undesirable to continue to sell foreign exchange to the country in question, unless its capital exports are curtailed, that the latter must seek ways of curtailing undesirable forms of capital exports. In some cases, the country may be able to do without the necessity of imposing exchange controls and restrictions. When it cannot do so, then the country will have to restrict the flow of capital through the exercise of carefully imposed exchange controls. The existence of the Fund should make resort to such restrictions less urgent and less frequent.

A proper evaluation of this aspect of the Fund's powers can be made only against alternative courses. It would be quite erroneous to assume that in the absence of the Fund, countries could permit uncontrolled capital outflow of any character at all times. Restriction of capital movements is, of course, not a novel practice. One needs only to recall the history of the last 20 years to make clear that controls over capital movements were adopted in a large number of countries even though no such institution as a Fund existed.

It should be clear that under any circumstances the Fund does not of itself require that any country impose control over capital exports unless and until the member country wishes to purchase excessive amounts of foreign exchange from the Fund and then only if they are regarded as in the general interest of the Fund and its members.

In summary, it is clear that the Fund does not expect a member country to use exchange provided by the Fund exclusively for current account purposes. So long as the exchange purchased from the Fund is used to meet an adverse balance of payments predominantly on current account, the Fund would regard a member country as fulfilling its obligations. No definite proof would be required that the resources of the Fund are being used predominantly for current account. The Fund would expect to utilize reports on the balance of payments and on capital movements. Although such reports would not always be complete and accurate, they should be sufficient to reveal a substantial and continued outflow of capital. Only when the resources of the Fund are used to finance capital movements of this character would the Fund require a member country, as a condition for the sale of additional exchange, to restrict the outflow of capital.

The regulatory devices a member country might use are discussed more fully in the reply to the next question.

Question 39

What provision must be made by countries that are members of the International Stabilization Fund to control capital movements if this should become necessary?

Reply

The International Stabilization Fund proposal provides for the control of capital movements by member countries in two ways.

First, member countries have the right to control capital exports when such control is regarded by them as desirable. This control is strengthened by the fact that other member countries, upon recommendation by the Fund, have the duty of cooperating with member countries seeking to control capital exports, by refusing to permit capital imports from such countries and by other appropriate measures.

Second, under certain conditions, discussed in the reply to the previous question, the Fund itself may require that member countries control capital exports. It may be presumed that member countries will take the necessary steps, including in some instances supervision of the exchange market, to assure their capacity to fulfill the above obligations. The manner in which member countries organize and control their exchange markets is not prescribed by the Fund. It is a matter for each country to decide. Presumably, organization and control would differ from country to country depending upon the nature of a country's exchange market, the state of its monetary reserves, its balance of payments position, and the position of its currency in the Fund.

In some countries, particularly those not purchasing exchange from the Fund, no elaborate system of government organization and control of the exchange market will be necessary in order to assure fulfillment of their cooperative obligation to members of the Fund.

As a minimum, each country would certainly set up a system for collecting information on its balance of payments position and on capital movements. The receipt of such information would be helpful to the proper functioning of the Fund. Even though it never becomes necessary for a country to prevent a flight of capital, it may be necessary upon recommendation of the Fund to cooperate with other member countries in controlling capital movements. Such cooperative measures might appropriately include a refusal to accept or permit acquisition of deposits, securities, or investments by nationals of any member country imposing restrictions on the export of capital except with the permission of the government of that country and the Fund. Member countries, on recommendation of the Fund, might also undertake to make available to the Fund or to the government of any member country full information on all property, deposits, securities, and investments of the nationals of that member country.

To supply this current information, most countries will have to have at all times an adequate system of reporting capital movements. This is not to be confused with exchange controls. They are quite different. The United States for many years has had a reporting system for capital movements, but not until the outbreak of the war were any restrictions imposed on the transfer of funds. The only countries that might find it necessary to adopt exchange controls are those whose foreign exchange resources do not permit a free and continued export of capital.

Apart from the arrangements for providing the Fund with data on capital movements, there are no measures that must be taken by member countries in anticipation of a possible need for controlling capital movements. It is a matter for each country to decide whether, while imposing no restrictions on current transactions, it wishes to establish or retain any administrative supervision over foreign exchange transactions. The Fund does not require member countries either to control capital movements or to supervise them, unless and until such member countries make considerable use of the resources of the Fund.

Some countries, foreseeing the need for control of capital movements, might require prior notification on international transactions in order to keep close control of their exchange position by scrutiny of international transactions. Such scrutiny of exchange transactions would not be in conflict with the obligations of the member country under provision VII-3 unless it were used in fact as a device to impose exchange restrictions on current international transactions in the guise of a control of the export of capital. Since the imposition of restrictions on current international transactions would be contrary to the obligations of a member country, it may be presumed that the Fund would make representations to member countries if such scrutiny of exchange transactions were used contrary to the purposes of the Fund.

Still other countries may find it desirable to set up a licensing system to assure an effective control over capital movements. Thus a country might require that all foreign exchange must be bought and sold through licensed dealers. No exchange need then be sold unless the purchaser showed proof that the foreign exchange was needed for the purchase of goods and services or the payment of interest and dividends or other payments of a non-capital nature; and the delivery of foreign exchange receipts would be required of exporters and other recipients of funds from abroad. Banks and other institutions licensed to engage in foreign exchange operations might not be permitted to increase their foreign exchange holdings or holdings of other foreign assets beyond an amount necessary to carry on their normal business operations. The government might require that any additional amounts of foreign exchange acquired by banks and by other licensed dealers be sold to the central bank or the exchange authority.

Presumably in some countries effective control could be assured only through an official monopoly of exchange transactions. There is no provision in the Fund proposal that would bar a country from instituting a monopoly of exchange transactions, provided that such techniques are not administered to restrict current international transactions without the consent of the Fund. It is not with administrative techniques but with policies that the Fund is primarily concerned.

It is not contemplated that control of international capital transactions or of exchange transactions generally will be exercised directly by the Fund. On the contrary, it is expected that in many countries the usual channels for buying and selling exchange will continue to be utilized. Within the provisions set forth in the proposal, the Fund will sell to member governments such foreign exchange as they may require to meet an adverse balance of payments predominantly on current account. The manner of channeling into the exchange market the foreign exchange sold by the Fund is a matter for each member country to decide. While in the ordinary course of events the Fund would not scrutinize exchange transactions, it may be expected that the Fund may require assurances in some instances that the exchange sold by the Fund is in fact intended to meet an adverse balance of payments predominantly on current account. In the main, however, the Fund's decision would be based on information revealed by the balance of payments of the country in question rather than by supervision over its foreign exchange transactions.

Our conclusions with respect to the control of capital movements may be summarized as follows:

1. All countries must have machinery for adequate reporting of capital movements by type and totals with geographical breakdowns.

2. A number of countries will find it necessary from time to time to maintain some form of supervision over foreign exchange transactions.

3. Some of these countries will have to impose restrictions at one time or another on the outward movement of certain types of capital.

4. The Fund itself will never exercise authority as an agency controlling exchange transactions in any member country.

Question 40

What are the purposes of the provision permitting the International Stabilization Fund to lend local currency to a member country?

Reply

The provision permitting local currency loans (V-13) is primarily intended to facilitate cooperation between the Fund and the monetary authorities of member countries. It should be noted that when such loans are made they must be for a period of one year or less, so that they remain essentially short-term loans. A further limitation on such loans is that they may not exceed 75 percent of the local currency holdings and they may not be made at all when the local currency holdings of the Fund are less than 20 percent of the quota.

This provision is of particular significance to some American republics with high and rigid reserve requirements for currency issues and central bank deposits. The special problems of such countries are discussed more fully in the next question.

Where high and rigid reserve requirements are specified by law, even the local currency requirements for membership in the Fund can be met only by securing additional gold reserves. It would be possible, of course, to finance the cost of membership through borrowing in the local money market if such facilities were available. The interest cost on loans is likely to be high in such countries. Furthermore, borrowing for this purpose could cause pressure on the monetary system, as the funds would be immobilized until used by the Stabilization Fund.

A loan by the Fund to the member country of part of the local currency contribution to the Fund would obviate the need for resorting to high cost borrowing. In time, the loan could be repaid to the Fund out of the tax revenues of the country. And as the monetary reserves of the country grow, the repayment of the loan could be made without adverse effects on the monetary system. Because of the short period nature of the loan, it would be possible for the Fund to realize on the loan at maturity or by discounting whenever the Fund needs such local currency in its operations. When such a country has a favorable balance of payments, the banking system is likely to find itself with adequate reserves and would be better prepared to discount the loan at a moderate rate.

The need for this provision will also be felt whenever such a country has an unfavorable balance of payments. If a country has a high reserve requirement against currency or central bank deposits, an adverse balance of payments, even with the Fund in operation, could lead to a severe monetary stringency resembling the effects of an export of gold. While the Fund could engage in operations to offset such developments, the absence of an organized money market may require that this be done through loans of local currency.

The principal purpose of provision V-13 is to provide a means of cooperating with national monetary authorities in the coordination of the Fund's operations with the domestic monetary situation. While it would be possible for member countries to modify unduly restrictive aspects of their monetary laws, nevertheless, provision should be made for flexible compensatory operations by the Fund in cooperation with the monetary authorities of the member country.

It is not the purpose of this provision to offer budgetary aid to a member country. The ordinary business of the Fund consists of stabilization operations rather than loan operations. No member country can finance a budgetary deficit through stabilization operations with the Fund, since it can acquire foreign exchange from the Fund only by purchase with local currency. While the Fund may lend local currency to a member country, such action would be taken exclusively in cooperation with the monetary authorities in order to relieve pressure on the monetary system. The form in which such loans would be made would give assurance that they are not being devoted to budgetary uses.

Short-term loans of local currencies of member countries to the governments of the respective countries would not involve a greater risk than holding the local currencies themselves. It is also clear that the Fund would suffer no inconvenience by making such loans. Loans of local currencies would not be made unless the Fund had a surplus of such currencies beyond any conceivable needs during the period of the loans.

Question 42

Does the provision that member countries shall adopt appropriate legislation or decrees to facilitate the activities of the International Stabilization Fund require a member country to accept the recommendations of the Fund?

Reply

The Fund proposal contains a number of provisions permitting or requiring it to make recommendations on monetary or economic policy to member countries. Thus, provision VII-6 permits the Fund to state its views and requires member countries to consider the Fund's views on any existing or proposed monetary or economic policy, the effect of which would be to bring about, sooner or later, a serious disequilibrium in the balance of payments of other countries. More specifically, when a member country is making undesirable use of its permissible quota, the Fund may place such conditions as it deems necessary upon additional sales of foreign exchange to that country (V-2-d). Also, when the Fund's holdings of the currency and securities of a member country become scarce, the Fund is required to recommend to the member country measures designed to increase the Fund's holdings of its currency (V-4).

These provisions are all regarded as of a recommendatory rather than a mandatory character. A member country fulfills its entire obligation when it gives consideration to the views and the recommendations of the Fund. It is not intended that the Fund shall have authority to compel member countries to take the courses of action which it may from time to time recommend. It is believed that a more constructive relationship between the Fund and a large group of member countries will result from the influence of international opinion represented by the Fund than from any attempt to transfer responsibility for ultimate decisions on national policy to the international group.

In line with this attitude we interpret provision VII-8, under which member countries are required to adopt appropriate legislation or decrees to facilitate the activities of the Fund, to apply only to the operations of the Fund, not to its recommendations. The technical measures of cooperation, without which the Fund could hardly carry on its operations, include action by the member countries to make contributions to the Fund, to designate Directors and alternates, to authorize transactions between Treasuries and Central Banks and the Fund, to permit the holding of deposits and securities for the Fund, and similar measures.

There are a great many matters in which the Fund's policy requires for its accomplishment the adoption of new measures or the change of old measures by member countries. Recommendations of this character should be regarded neither as qualifications nor as illustrations of the rule (VII-8) requiring member countries to take the action that is essential for technical cooperation.

One important clause under which the Fund would make such policy recommendations is V-2-d, where countries are pursuing policies that result in large and undesirable adverse balances in their current international accounts. Under these circumstances, the Fund may inform a member country what measures may be necessary to correct such a situation. While the Fund cannot compel a member country to adopt such measures, the Fund can refuse to sell foreign exchange for the currency of the country except under the conditions it prescribes. There is no obligation, however, for a country to adopt such measures or to acquire exchange under these conditions unless it so wishes.

Another important clause under which the Fund would make such policy recommendations is V-4 when countries are pursuing policies that result in large and undesirable favorable balances in their current international accounts. Where such policies have resulted in a depletion of the Fund's holdings of the currency of a country, the Fund is obligated to render a report to the member country embodying an analysis of the causes of the depletion of the Fund's holdings and recommending measures designed to increase the Fund's holdings of that currency. It is further provided that member countries agree to give immediate and careful attention to such recommendations. This provision does not create an obligation to put into effect the recommendations of the Fund. In the opinion of the technical experts of the United States it is not desirable to impose such an obligation. It is to be hoped, of course, that a member country will not only consider the recommendations of the Fund, but wherever possible will also put such recommendations into effect.

These provisions (V-2-d, V-4) may be regarded as specific illustrations of provision VII-6, which imposes a general obligation upon member countries to give consideration to the views of the Fund on any existing or proposal policy that would seriously affect the balance of payments of other countries. Although the Fund may express its views to any member country whenever it believes the policies of the country will disturb the international economic situation, no country is obligated to give effect to the recommendations of the Fund by adopting appropriate legislation or decrees. How far a country will implement the recommendations of the Fund is entirely for the country's executive and legislative authorities to decide.

Question 43

What are the purposes of the provisions requiring more than a majority vote to authorize action by the International Stabilization Fund?

Reply

There are very few provisions requiring more than a majority to authorize action by the Fund. In all cases, the requirement is for the purpose of safeguarding the resources of the Fund or safeguarding the interests of member countries on matters affecting their national policies.

The ordinary business of the Fund would be undertaken by the management in accordance with the provisions of the Fund and the regulations prescribed by the Board of Directors. For the most important operations of the Fund, no positive action by the Board is needed at all. For sales of exchange to member countries within the permissible quota, where the exchange is needed to meet an adverse balance of payments predominantly on current account, no prior approval of the Board is required.

In those instances where approval of the Board is needed, either directly or through committees, all ordinary transactions of the Fund require only a simple majority vote. The following important operations are included in this category:

1. Sale of exchange to a member country in excess of the permissible quota (V-2-b).

2. Determining the conditions for the sale of additional exchange where a country is exhausting its quota too rapidly (V-2-d).

3. Sale of exchange for a transfer of capital where the Fund's holdings of a member currency have not reached 150 percent of the quota (V-3).

4. Report to a member country whose currency in the Fund is becoming scarce (V-4).

5. Allocation among member countries of a Fund's holdings of scarce currency (V-5).

6. Purchase by the Fund of increments of gold or foreign exchange acquired by member countries (V-6).

7. Purchase of blocked balances (V-8).

8. Purchase and sale of non-member currencies in excess of $10 million or to be held more than sixty days (V-9).

9. Sale of member country obligations owned by the Fund (V-11).

10. Obtaining rediscounts and advances from central banks (V-11).

11. Approval of capital exports control where cooperation of member countries is requested (VII-4).

12. Approval of any bilateral clearing arrangements and similar practices (VII-5).

It would appear from the above that the Fund can unquestionably engage in all transactions necessary for the ordinary conduct of its business without prior approval or with the approval of only a majority of the member votes.

There are a number of matters of an extraordinary character involving the safeguarding of the resources of the Fund and of member countries and matters of the highest policy which are reserved for decision by a larger than majority vote of the Board. It is felt that this requirement is necessary to assure member countries that the resources of the Fund will not be used contrary to the purposes of the Fund. It is also felt that on policy questions of far-reaching importance, a safeguard against hasty and unwarranted action is needed in the form of a favorable vote larger than a majority.

There are three provisions requiring more than a majority vote for certain types of action:

1. Changes in the quota formula require a four-fifths vote. The purpose of this requirement is to assure member countries that having joined the Fund with assurance of their relative position within the Fund, they will not be confronted with a change in the quota formula which will seriously affect their status. This is the more important because many countries will contribute large resources to the Fund the use of which will depend in part upon the relative position of countries within the Fund.

2. A change in the gold value of the unitas can be made only with the approval of 85 percent of the member votes. Because a change in the local currency price of gold can have far-reaching effects upon a member country, it is thought essential to require almost unanimous approval for such action. The only purpose of this provision is to assure the major countries

that no change in the gold value of their currencies will be made without their consent.

3. Sales of exchange to facilitate a capital transfer, where the Fund's holdings of the currency and securities of a country exceed 150 percent of its quota, require a three-fourths vote for their approval. As stated before, the resources of the Fund should be available primarily for sale to countries requiring foreign exchange to meet adverse balances predominantly on current account. Where the exchange is to be used to facilitate a capital transfer by a country that has already made considerable use of the resources of the Fund, it seems reasonable to require that such a transaction be clearly in the general interest. The approval of three-fourths of the member votes would give this assurance.

It is a mistake to think that the requirements for an extraordinary majority on three types of action will seriously affect the work of the Fund. The fact is that the Fund could operate fully effectively without any need being felt for a decision on a matter requiring more than a majority vote.

It is possible that further examination and discussion may indicate the feasibility of providing other safeguards so that some provisions now requiring more than a majority vote may be modified in this respect.