Mr. White June 14, 1946.

Mr. Brenner

The following comments relate to the redraft sent to you yesterday:

B-1 The phrase in parenthesis is preferable to the reference to currencies specifically related to the member's currency.

B-2 In the second paragraph the reference to "reporting banks" is not clear. There should either be a more specific phrase such as "and banks or other business enterprises engaging in a substantial volume of foreign exchange transactions", or the phrase "reporting banks" should be defined. It may not be wise to require members to obtain reports on a basis determined by the Fund and for this reason the change in wording may be preferred to a definition of reporting banks.

In the fourth paragraph the reference to Article XIV at the end of the sentence appears to be unwarranted. There is nothing in Article XIV which permits a country to postpone assuming the obligations of Article IV, Section 3. Article XIV merely refers to Article VIII, Sections 2, 3 and 4.

B-3 The second sentence seems to be illogical. Factors such as insurance, transportation costs, etc., should be considered in fixing the percentage that the Fund prescribes rather than in considering whether a rate conforms to the prescribed percentage. The sentence might be reworded as follows:

> "In determining the percentage to be prescribed by the Fund from time to time for the currency of each member, any element of insurance, transportation or cabling cost, and any credit risk shall be allowed for, and the member shall be given the benefit of the doubt."

B-6 According to my notes, the 1% variation was not changed. In view of the other provisions, it would appear to be more consistent if this read "by more than a percentage to be prescribed by the Fund from time to time for the currency of each member".

R.B.

INTERNATIONAL MONETARY FUND

June 18, 1946

To: Mr. Brenner

Room 918

Roman L. Horne

FOREIGN EXCHANGE CONTROL BOARD

Ottawa, June 12, 1946

Camille Gutt, Esq.,
Managing Director,
International Monetary Fund,
Washington Hotel,
Washington, D. C.

Dear Gutt,

I have been looking over again the "Notes to be Used as Basis for Drafting and Discussion of Regulations and Rules" and think it may be useful if I let you have my comments on some of the more important points. I am sending this letter in duplicate as you will no doubt wish to pass a copy on to Harry for the use of the Drafting Committee.

I have already had an opportunity of expressing my views orally on the most important issue raised by this document, namely, the proposal that the value date for purchases of exchange should be determined by the quantitative importance of the purchase (items C-8, C-9 and C-10). Fortunately the discussion in the Executive Board revealed that there was not as much difference among us on this question as appeared at first sight. My view of the position is that the quantitative limits within which members may purchase exchange from the Fund have been defined in the Fund Agreement and that it is not open to the Board to refine these definitions. I do not think that we can operate successfully if any particular purchase of foreign exchange from the Fund becomes an application requiring the approval of the Executive Directors so long as a member remains within the quantitative limits set out in the Fund Agreement. In these circumstances, all that the Board can do is declare it ineligible to use the Fund's resources under Article V, Section 5 on the ground that it is using them in a manner contrary to the purposes of the Fund or under one of the other articles governing ineligibility to use the Fund's resources. If, however, a country is failing in any respect to fulfil its obligations under the Fund Agreement, that in itself constitutes ground for a declaration of ineligibility and the fact that it wishes to purchase an unusually large amount of exchange at one particular time is not a particularly relevant consideration. In other words, as I argued at the Board meeting, the factors which the Fund must take into account in declaring a member ineligible or limiting its use of resources -- which is the only <u>formal</u> action the Board can take -- are essentially qualitative factors, quantitative limits having already been determined in the Fund Agreement itself. It has occurred to me (and I know that Bolton, too, had some such thought in mind) that

it might be possible to meet the substance of the position which Harry took in the discussion of this question, without doing violence to any important principle, by providihg that all exchange transactions with the Fund should have a rather long value dating, e. g., five or seven days. The long value dating would provide time to have a pretty good look at a member's situation to see whether it was in fact fulfilling its obligations under the Fund Agreement. It would, however, be clearly understood that crediting on the value date would be automatic if the member were within the quantitative limits specified in the Agreement and had not been ruled ineligible to make further purchases of exchange for some other reason. Executive Directors would be kept informed of the position from day to day, including outstanding purchases of exchange not yet credited to members' accounts. Requests for exchange would, however, not be referred to them for decision so long as the member was in good standing. If the Managing Director thought that a country was requesting a peculiarly large amount or appeared to be building up foreign exchange balances unduly, he might very well communicate informally with the member and raise some questions or express some doubts. That, however, is not at all the same thing as a formal query from the Board.

For convenience I also summarize here my views on the second main question we discussed at the Board meeting, namely, the question of exchange controls. Here I feel that the Research Division of the Fund should investigate and inform itself in regard to the regulations and character of each control but that rigid and elaborate provisions for supplying detailed information should not at this time be incorporated in the rules and regulations.

My more detailed comments are as follows:

A-1. "All relevant facts" in the first sentence should be either defined or omitted. Perhaps we might ask for the information enumerated in Article VIII, Section 5 for a period of several years preceding the date of application.

A-3. I suppose it is assumed that the Executive Directors shall recommend whether an application should be approved or rejected; it might be as well to make this clear.

A-5. The report on quotas should be submitted initially to the Executive Directors rather than to the Board of Governors.

A-6. The second sentence might involve the Fund in substantial loss. A member could pay in gold to the full extent of its quota and get U.S. funds at $35 an ounce. When the Fund needed U.S. funds it would have to pay the handling charge of ¼ of 1% on its sales of gold in New York. In addition it would have to pay the transportation charge on the movement of gold from gold depositories other than New York.

B-8. The drafting of the second sentence should be reconsidered. I imagine that the 1½% refers to a 30-day period and includes 1% for the permitted spread from parity for spot transactions under Article IV, Section 3(i), and ½% as the maximum charge for 30 days' forward protection. It would be simpler to draft in terms of differences from spot rates rather than differences from parity. As regards the extent of the margin permitted for forward transactions, the figure of ½ of 1% per month seems high to us (in Canada the forward premium both purchasing and selling is 1/16 of 1% per month), but I can well imagine that a smaller spread might cause embarrassment in certain countries.

B-8. To be consistent with the Articles of Agreement, the last line should read "its contention that the purpose of the change is to create a fundamental disequilibrium."

B-9, B-10, B-11. I think that the provisions regarding action by the Fund in cases where the Fund has to be consulted but has no right to object should be very carefully considered. Our aim should be to encourage members to be in touch with the Fund before changing their exchange rates by assuring them: (a) that they will get a speedy expression of opinion from the Fund if we wish to express an opinion at all, and (b) that their intention to change will be a most closely guarded secret. In other words, I feel that our provisions should be such that it is practical for members to "play ball" with the Fund. They will find it most painful to advise the Fund of their intention to change the rate and then wait a number of days for concurrence or objection. They will naturally fear that a leak will take place. If one single leak does occur, then the efficacy of the Fund will be irreparably damaged.

If this view is correct, then several things should be considered:

(a) We should consider eliminating the provision in the last sentence of B-10 that the opinion of the Fund should be given within 72 hours of the proposal and possibly providing instead that the opinion of the Fund shall be given on the same day as it is requested.

(b) We should consider special provisions to ensure secrecy in the event of consultation by members regarding their desire to change an exchange rate.

(c) We should consider authorizing the Managing Director or a very small committee of the Executive Directors to express the opinion of the Fund on the advisability of a change which falls within the unilateral power of a member. After all, the Fund has no right to object to such a change and long discussion by all members of the Board is hardly needed. I repeat that our main purpose should be to encourage members to consult with the Fund, rather than acting on their own and informing the Fund, by creating conditions which make it really practical for them to consult.

B-14, B-15, B-16. I do not see how the Fund can ask for as much as 20 days to declare its opinion on a proposed change in rate. It would be virtually impossible to maintain secrecy for this length of time.

B-19. I think the word "needed" should be changed to "desirable."

C-4, C-5, C-6, E-3. I think that the question of the rates at which the Fund will deal in gold is one that should be gone into very carefully by a special committee of gold and foreign exchange traders. If such a committee is set up, I would try to arrange for Mr. Turk, the head of the Foreign Exchange Department of the Bank of Canada, to be available should that be desired. My present feeling is that the Fund should take as the basis of its thinking that gold is worth $35 an ounce in New York and that the price in other centres should be based on the New York price less transportation and handling charges. So far as original quota payments are concerned, I suppose that we shall have to say that gold is worth $35 an ounce at any depository and take the loss on the subsequent transportation to New York. But our subsequent purchases of gold should make allowance for transportation and handling charges. The questions involved are very technical and complicated and merit the attention of a special committee to assist the head of the Operations Division.

C-7. I assume that the telegraph request referred to in this article is to be filed once and for all and not each time a member wishes to purchase exchange.

C-12. The effect of this may be to encourage members to enter unnecessary transactions with the Fund since it will cost them nothing to reverse them after a short period. However, if this is regarded as constituting a service to members, perhaps there is no reason why we should object to it.

C-13. This looks like an attempt to place an unrefined version of the repurchase provisions on a monthly basis. I doubt whether it lies within our power to include a provision of this sort.

C-17. I suppose "exceed" should be "reached" both times the word occurs.

C-19. There is no committee on transactions.

C-24. This looks as though it is intended that each exercise by a member of its right to purchase exchange from the Fund takes the form of an application to be submitted to the Executive Directors for their approval. It is clear from the discussion that this is not intended and C-24 should consequently be modified.

D-12. There is no obligation on members to consult with the Fund if their exchange controls are limited to the control of capital movements. Apart from this general comment I believe, as indicated above, that this whole section on exchange control requires very substantial modification.

D-30. There may be some inconsistency between the first sentence of this article and Article VII, Section 3, paragraph (b) of the Fund Agreement. The first sentence of D-30 reads as though members are under some obligation to consult with the Fund on the temporary limitations they propose to impose on exchange transactions in a scarce currency. The second sentence of the article in the Fund Agreement I have mentioned reads, "Subject to the provisions of Article IV, Sections 3 and 4, the member shall have complete jurisdiction in determining the nature of such limitations, but they shall be no more restrictive than is necessary to limit the demand for the scarce currency to the supply held by or accruing to the member in question; and they shall be relaxed and removed as rapidly as conditions permit." I think it clear that the Fund should keep itself informed regarding the restrictions which members do in fact impose in the event of a currency being declared scarce but the use of the expression "consult" should be avoided.

D-31, D-32, D-33. These paragraphs should also be carefully considered from the point of view of their consistency with the Fund Agreement.

E-1. I do not understand this at all.

E-5, E-6. It would appear that the intention is to collect the service charge of $\frac{3}{4}$ of 1% at the time the transaction is entered into. It might be as well to make this clear.

F-2. This should be considered along with the other gold questions referred to above. If this provision is followed, the Fund will take a loss on all sales of gold in New York except gold originally deposited there.

F-9. I would prefer not to provide for this in the regulations.

F-10. Some provision is necessary to safeguard the secrecy of certain information provided by members. It should not be a rule that the data collected from all members should be published.

F-15. The "etc." in the first sentence will, of course, have to be defined.

F-16. If this is followed, the unfortunate Managing Director will never be able to take a holiday.

G-5. It is not clear to me what contingency is contemplated in this article which would involve a decision of the Fund to postpone exchange transactions or prescribe new conditions once an agreement on initial par value has been reached.

G-11. It is not clear to me how this fits in with the transitional period arrangements.

H-7, H-8. These sections seem to me to be rather inappropriate for inclusion. By-laws provide that Executive Directors travelling on the business of the Fund shall be paid their expenses and I should be inclined to rest on that. No special authority is needed to authorize Executive Directors or officers of the Fund to advise members.

H-9. This section is obscure.

H-10. Like the provision regarding the publication of a bulletin refferred to above, I would prefer to let experience determine whether any particular studies should be published and not specifically provide for it in the regulations.

There will no doubt be a number of other points that occur to me on a subsequent reading but I thought that it might be useful for you to have these observations at the present time.

Yours sincerely,

/s/

L. Rasminsky