SOME EXPLANATORY NOTES TO THE RULES AND REGULATIONS PROVISIONS
ADOPTED BY THE EXECUTIVE BOARD

F. SUBSCRIPTIONS

F-1. According to Article III, Section 3 of the Agreement, the member shall pay its subscription to the appropriate depository. According to Article XIII, Section 2, any one of the five members having the largest quotas is an appropriate gold depository.

From these two provisions one may infer that a member may pay its gold subscription to more than one depository. It may subscribe part at one gold depository and the rest at another or other depositories. The payment to different depositories avoids the inconvenience of a useless transfer of gold from one place to another, when the Fund is entitled to hold its assets in gold in both places.

This is the reason why in the Regulation it is stated that: "a member may pay its gold subscription to the Fund at one or more of the specified gold depositories."

F-2-4. A member subscribes 75% of its quota to the Fund in its own currency. This payment is made in credit account with the Central Bank. But in many countries a credit account with the Central Bank has to be backed by reserves. In this case, either the reserves of the Central Bank should be enlarged in proportion to the credit granted by the Central Bank to the Fund, or the actual amount of currency should be reduced in proportion to the credit granted by the Central Bank to the Fund.

In stating this alternative an important factor is overlooked. There is, in fact, no resemblance between the credit account of the Fund in a Central Bank and the banks' deposit with the Central Bank. When the Fund utilizes its credit account it offers a corresponding increase of gold or foreign currency to the member country. However, as many countries may not accept such logical accounting and may prefer to identify the credit account of the Fund as a common credit account, the Agreement devises a process of maintaining a credit account in a form which is not a bank deposit. Notwithstanding this substitution, the Agreement fixes that a part shall be in deposit. (Article III, Section 5).

It is obvious that this part shall be as small as possible. On the other hand, it was suggested that the Fund might have a weapon to help the country combat inflation if this percentage were increased. Let us suppose that country X has an unfavorable balance of payments, and besides this, inflation has set in. The Fund, in this case, while selling foreign exchange to the member, could require a larger proportion of deposit for the Fund in order to freeze part of the currency in circulation.

To cover these different cases, provisions were written as follows:

"F-2 A member shall pay its currency subscription to the Fund at the designated depository. The member, or its designated fiscal agency with the approval of the member, is authorized to substitute its own non-negotiable, non-interest bearing notes payable to the Fund on demand for that part of the currency subscription which exceeds 10% of the member's quota, and the depository shall hold such notes for the account of the Fund. (AA III-5)

"F-3 The Executive Board may agree to alter the 10% minimum requirement in the case of any country should special circumstances in the opinion of the Executive Board warrant a different percentage.

"F-4 The member is allowed 24 hours in which to replace any sums necessary to maintain the minimum of 10 percent."

H. TRANSACTIONS
(Currency Transactions)

H The expression <u>is developing</u>, used by the Agreement in Article VII, Section 1, is important. It emphasizes the objective of the Fund to follow the transactions among member countries. It is relatively easy for the Fund to note the progress of trade between two members if the debtor has a small quota and the creditor country a large one.

As an illustration, let us assume that Uruguay requests currency from the United Kingdom through the Fund. The quota of the first country is 15 million dollars and for the latter 1300 million dollars. If, according to Article V, Section iii, Uruguay required 25% of her quota, this amount will correspond to less than 3% of the quota of the United Kingdom. In this case there would be no danger of scarcity of the pound in the Fund and the amount as an inflow of purchasing power in the United Kingdom would be of no importance. However, if this case were reversed, and the United Kingdom should request 1% of her quota to buy Uruguayan pesos, this very small percentage would correspond to the entire amount of the peso quota held by the Fund. The request made by the United Kingdom would give no chance either to the Fund to prevent the scarcity of the peso or to Uruguay to take any monetary measures in order to prevent the inflationary consequences of a heavy inflow of purchasing power in the country.

The great advantage of the Fund over the previous movement of gold can be based on the prospective trends of the balance of payments.

According to these trends the Fund may know beforehand the probable request of each currency. The forecast of the balance of payment is not only advantageous to the Fund to avoid scarcity of currencies but has also the great virtue of informing the members in due time of a probable excess of export over import. With this previous information it will be much easier to handle credit control. When an inflow is known beforehand this way, every measure to cancel future additional purchasing power can be settled without any credit restrictions. It is enough to avoid increased expansion. On the other hand, when the inflow is not foreseen, drastic measures must be taken to curb inflation. The inflow might concur with an expansion in progress, which could be restrained if the inflow were expected.

For these two reasons a relationship must be established between the quotas. Such a relationship can be possible only if a lapse of time is permitted before any member is requested to surrender its currency to another member.

The following provision was then included in the Rules and Regulations:

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"When a member expects to purchase from the Fund over any ten day period an unusually large sum of any country's currency (unusually large relative to the Fund's total holdings of that currency), the member agrees to give the Fund as much notice of the proposed transaction as can reasonably be effected."