

December 26, 1973 - 73/144

Statement by the Managing Director
Executive Board Meeting 73/122, December 21, 1973

Representation of China

At the meeting of the Executive Directors on October 29, 1973 I was authorized to communicate informally and confidentially with the People's Republic of China in order to seek clarification of its position with respect to the membership of China in the Fund and participation in the Special Drawing Account. It was understood that the Fund would act in close cooperation with the Bank.

On November 2, 1973, the Deputy Managing Director and Sir Denis Rickett, Vice President of the Bank, met at the Bank/Fund office at the United Nations in New York with Ambassador Wang Jun-sheng representing the People's Republic. The Ambassador was told that the Executive Directors of the Bank and Fund had taken note of the views expressed in the messages of September 24, 1973 from the Minister of Foreign Affairs of the People's Republic of China. The Executive Directors had felt that they needed clarification of those views and had suggested that an informal and confidential approach be made for this purpose. The Ambassador was requested to transmit a message to his Minister asking what was the position of the Government of the People's Republic of China at this time regarding the membership of China in the Bank and Fund, as well as its position with respect to the Bank's affiliates.

In asking the Ambassador to transmit this message to his Minister, Sir Denis and the Deputy Managing Director made the following points:

- (a) The Executive Directors of the Bank and the Fund had considered the cables from the People's Republic of China and had taken a positive attitude toward them;
- (b) The only purpose of the proposed inquiry was to ensure that the interests of the organizations were safeguarded as far as possible;
- (c) Arrangements could be made for further discussions with the People's Republic in any way that was convenient to it.

The Ambassador in response complained of the lengthy and continued recognition of the Taiwan authorities by the Bank and Fund. He believed that the attitude of his Government was made clear in the cables. Nevertheless, he would transmit to his Government the views expressed by Mr. McNamara and Mr. Witteveen, and he would let us know of any response from his Government. Neither we nor the Bank have heard anything further from the People's Republic since that meeting.

I will report to you further as soon as we receive a response from the People's Republic.

Mr. McNamara has made a similar statement to the Bank's Executive Directors on December 18, 1973.

DECLASSIFIED

By: Wanda T. ... Date: 1-3-01

Mr Polak
SECRET **DECLASSIFIED**

November 27, 1973

MEMORANDUM FOR FILES

Subject: People's Republic of China - Meeting with Managing Director and Deputy Managing Director, November 26, 1973

The meeting was attended by Messrs. Gold, Polak, Sturc, Abadjis, Suzuki, Ahrens Dorf, Evensen and Crockett.

The Managing Director said that he thought that the staff should be considering the various issues that would arise in the event that the PRC approached the Fund in order to assume active participation. Such issues would not be only of a legal nature but also would have fundamental implications for the Bretton Woods system in view of the size of the PRC's economy and its political importance as compared to other members with centrally planned economics.

There was some discussion as to the availability of data regarding trade, and gold production, and the meaningfulness of the PRC's exchange rates and changes in such rates, considering for instance the periodic changes in PRC's local currency export prices.

It was noted that the legal problem was not likely to be admission to membership but rather the performance of obligations under the Articles of Agreement by a government newly recognized as the representative of the member. The obligations of cooperation with the Fund were particularly important. Another delicate problem might arise in the context of adjusting the quota for the PRC to an appropriate level, and it was difficult to foresee what stance the PRC might take in the context of monetary reform. The staff noted that basic data for the PRC quota derived from secondary sources had been made available to the Treasurer's Department prior to the Board's discussion of October 29.

The Managing Director suggested that the Asian Department in collaboration with other departments concerned initiate a study that would examine the structure of the PRC's economic and financial system, especially as it relates to world trade and payments, and the implications that this system will have for the Fund should the PRC participate in the Fund's activities.

J. Ahrens Dorf
J. Ahrens Dorf
Assistant Director
Asian Department

cc: Managing Director
Deputy Managing Director
Messrs. Gold, Polak, Sturc, Tun Thin, Woodley,
Abadjis, Suzuki, Evensen and Crockett

CONFIDENTIAL

November 11, 1971

Memorandum

To: ✓ Mr. Polak
Mr. Hebbard
Mr. Savkar
Mr. Sturc
Mr. G. Williams

From: Joseph Gold JG

Subject: Representation of China

The Managing Director has requested me to send to you the attached memorandum for the files and aide-memoire. Please note the very limited circulation that these documents have received because of their sensitivity.



Office Memorandum

CONFIDENTIAL

TO : The Files

FROM : Joseph Gold *JG*

SUBJECT : China

DATE: November 10,
1971

On the instructions of the Managing Director, Mr. Southard and I spoke to all twenty executive directors, or their alternates, and in one case a technical assistant, during the period Wednesday, November 3 to Tuesday, November 9, 1971. Together, we saw Mr. Brand, Mr. Bryce, Mr. Caranicas, Mr. Dale, Mr. de Vries, Mr. Hsu, Mr. Mitchell, Mr. Satow, Mr. Schleiminger, Mr. van Campenhout, and Mr. Viénot. Mr. Southard alone saw Mr. Brofoss, Mr. Kafka, Mr. Massad, and Mr. Ugueto. I spoke to Mr. Al Atrash, Mr. Barattieri, Mr. Omwony, Mr. Prasad, and Mr. Yaméogo.

I. Each of the people with whom we spoke was given a copy of the attached aide-mémoire and was told that he could use it in his relations with the members which appointed or elected him or his director. The framework in which the paper was presented is as follows. The problems for the international financial organizations were not the same as the problems for the United Nations. If the Fund were to follow the U.N. solution of regarding the government of the People's Republic of China (hereinafter referred to as the P.R.) as representing the present member instead of the government of the Republic of China (hereinafter referred to as the R.C.), the following difficulties might arise:

(a) According to the necessary logic of the solution, the P.R. would have to assume the obligation to repurchase the outstanding gold tranche purchase made by the R.C., and indeed would have a contingent obligation to repurchase down to 75 per cent of quota.

(b) The P.R. would be required to perform all the other obligations of the Articles, such as the obligations to provide economic data, consult, and seek approval for exchange practices inconsistent with the Articles unless approved.

(c) The P.R. might not have the necessary legislation to enable it to perform its obligations under (a) and (b) above. It was noted in particular that the P.R. obviously had no legislation to back up the acceptance of participation in the Special Drawing Account.

There was no way of knowing in advance whether the P.R. was capable of or willing to perform obligations under (a) and (b) above, and any inquiry might be rebuffed as irrelevant if the U.N. view that the question was one of representation and not membership were followed.

It was not easy to see how, as a logical or legal matter, assurances on the performance of obligations could be insisted on as a condition precedent to the recognition of a government.

A further problem was noted. If the P.R. were recognized in the Fund by analogy to the U.N. decision, it might be a wholly passive member, taking no part in the activities of the Fund. This could complicate the attainment of special majorities in the Fund, and notably the 85 per cent of total voting power which was required for many decisions involving special drawing rights. China had almost 2 per cent of the existing voting power, and the nonexercise of it would have the effect of a negative vote.

If the U.N. solution were applied, and the P.R. failed to fulfill its obligations to the Fund, whether under (a) or (b) above, the Fund would be faced with a choice between two possible responses. It might find it necessary to declare the P.R. ineligible and then proceed to compulsory withdrawal. Therefore, the U.N. precedent might avoid one political problem at the cost of provoking an even worse political problem. The alternative reaction would be to ignore the violations, but that would create indignation among other members, which traditionally have insisted on the formal equality of members and therefore equal treatment in the Fund.

If it were accepted that the P.R. should not be substituted automatically for the R.C., it followed that the P.R. should be in a position in which it had the choice of applying for membership. If it applied, it might be assumed that it was willing to perform the obligations of the Articles, and there could be the normal discussion of the legislative or other legal steps necessary to enable it to perform the obligations. It could also be assumed that it would not be a passive member.

The presentation to the directors, therefore, went on to examine the ways in which the P.R. could be required to apply for membership if it wished. The first of these would be a finding that in the course of time the membership of "China" in the Fund had become the membership of the R.C., or more properly the international entity governed by the R.C. It was on this point in particular that the second part of the aide-mémoire was relevant.

Paragraph 1 set forth the outline of the Fund's relations with China, and paragraph 2 marshalled the facts which would be helpful to a finding that the R.C. had become the member in the Fund. Paragraph 2B listed the facts that could be troublesome in arriving at the conclusion. It was explained to directors that paragraph 2 was not a recommendation, but was an attempt to see what the foundation of fact could be if there were a determination, essentially political in character, to maintain the present membership of the R.C.

A second course which would require the P.R. to apply for membership as a new member if it wished would be the voluntary withdrawal of the R.C. We had had no indication that the R.C. would be willing to take that step, but it was not inconceivable that it might wish to withdraw if it became apparent that it was about to lose its status in the Fund. A notice of withdrawal would be effective immediately. It was our view that an effective notice could be given by a government with which the Fund was dealing up to the point at which the Fund withdrew its recognition. An organ of the Fund, however, might overrule this legal opinion if some other solution was preferred.

We rejected two other theoretical courses. One would be the compulsory withdrawal of the R.C. under Article XV. This was not feasible because there was no failure on the part of the R.C. to fulfill any of the obligations of the Articles. The other course would be a finding that the R.C. was no longer an entity capable of membership in the Fund. Once again the facts would not support such a conclusion. The R.C. was a distinct territory, maintaining its own economy, possessing its own currency, conducting its own foreign affairs, and not under the authority of any other entity, a concept which was important for the Fund as indicated in Article XX, Section 2(g).

II. With one exception, no executive director expressed the views of the Governments which appointed or elected him. The exception was Mr. Mitchell, who said that his Government had instructed him to follow the U.N. line, but to take no initiative to raise the issue in the Fund. He intended, however, to point out to his authorities the special problems which would arise in the Fund as a result of a U.N. solution. Almost every director openly expressed the concern he would feel about a U.N. type of solution, although most of them cautioned that they could not speak for their authorities at this time. They stressed that the decision was likely to be taken by Foreign Offices and not Treasuries or Central Banks, and it would be difficult for the Foreign Offices to distinguish between the U.N. and the Fund. Some emphasized, therefore, that it would be necessary to dwell on the political and not the financial problems that would follow from the automatic recognition of the P.R. as the member. There was a virtually unanimous reaction that there should be no haste in raising the matter in the Fund, and we were assured that they were not about to take any initiative unless they received some instruction. This was the attitude even of directors who were appointed or elected by members that had been in the vanguard in promoting the cause of the P.R. in the U.N.

There was nevertheless a feeling that the situation was by no means under control. Any member government might raise the issue at any time. It might even be raised by the P.R., for example by sending a message to the Fund appointing a governor. We were asked how such an appointment would be handled. We replied that from a legal point of view it should be regarded as a nullity while we were still recognizing the R.C. But the Managing Director would have to place the message and

his draft reply on the agenda of the Executive Directors. Some directors expressed the view that, with good fortune, it might be possible to avoid the issue until the next meeting of the Board of Governors, but it would be most unlikely that it would not arise then as a question of credentials as it had at the Annual Meetings of 1950 through 1954.

III. Many directors wanted to know what was the competence of the two organs of the Fund in resolving the issue. We replied that, in part, this would depend on the way in which the problem arose. For example, the question of credentials at Annual Meetings had been decided by the Board of Governors itself. It could not be said, however, that the Board of Governors would have exclusive jurisdiction of the issue. The admission of new members was a reserved power, but this provision had been applied literally, and all other questions of membership had been within the province of the Executive Directors under the delegation of authority to them. The leading, but by no means the only, example had been the amalgamation and then the splitting asunder of Egypt and Syria when the United Arab Republic was formed and then dissolved.

We were asked whether the Executive Directors could transfer to the Board of Governors any question that was placed on their agenda. Some of them stressed that they were elected by countries among which there was a division of opinion, so that in any event they might have to abstain if the Executive Directors were compelled to take a decision. ^{1/} We felt that there was no great difficulty in an appeal to the Board of Governors from a decision of the Executive Directors. For example, a governor might place the item on the agenda of the Board of Governors. There might be more of a difficulty if the Executive Directors were to refuse to take a decision, and agreed to pass the problem to the Board of Governors to be decided there as a matter of first and final instance. The relevant texts in the Articles and By-Laws might be read to mean either that the Executive Directors can get a decision from the Board of Governors on any issue or that this authority is confined to the exercise of the reserved powers of the Board of Governors. We leaned in favor of the former view, but the ambiguity might be one of the devices by which one or more members might try to slow down the process of final decision.

In connection with the organ which might take decisions, the question of majorities was raised. Whether the question arose in the Executive Directors or the Board of Governors, a decision would be taken by a majority of the votes cast. Therefore, abstentions would be irrelevant. A number of directors had made calculations based on the voting in the U.N. and a range of assumptions.

IV. Some executive directors, including those who were personally in favor of a solution which would put the P.R. in a position of having to apply for membership, expressed their concern with the size of the

^{1/} In discussions with Mr. Southard, Mr. Kafka had first said that he would abstain. Later, he had said that he would vote according to the final majority view, on the basis of weighted voting, in his electorate, after informing the majority of the position of the minority.

present quota should there be a disposition to maintain the membership of the R.C. ^{2/} We agreed that the present quota was far too large for the R.C. as a discrete entity, although we pointed out that the R.C. had never taken advantage of any general quota increase or accepted an allocation of special drawing rights. The issue of quota was even more complex, however. For example, if the P.R. applied for new membership, its quota based solely on the general reviews, without adjustment for any special increase which it might substantiate, would be approximately \$1.4 billion. This would be the fifth largest quota in the Fund and take precedence over the quota of Japan.

We felt that an application by the R.C. for the reduction of quota at this time was impractical even if there were to be any disposition to apply for an adjustment. It was unthinkable that a majority of 80 per cent of the total voting power could be assembled. It was equally unlikely that the Bank could find a majority of 75 per cent of total voting power to maintain the membership of the R.C. in the Bank if its membership in the Fund were to cease. We advanced the thought that the R.C. might be willing to give the Managing Director an undertaking that it would apply for a reduction of quota at any time that he thought that this might be appropriate. It was remotely possible that if at some future date the dust had settled, an application to reduce the quota might have a fighting chance.

Another problem which was mentioned in the discussions was the claim of the R.C. to the whole territory of China. We conceded that this might be a problem, but we tended to think that this was a political question that was not within the Fund's purview, and that the R.C. might be induced quite readily to forebear from making any such claim in the Fund. There have been other irredentist movements among members but we had not busied ourselves with them.

A few directors mentioned some small discomfort which they would feel with the use of the word "China" in the title of two potential members, but we thought that the problem of nomenclature was no more than minimal.

V. It was made clear in the discussions with directors that we would hope to get the reactions of Governments through them within a period of about a month, but that we were applying no pressure.

VI. The final meeting was with Mr. Hsu. He too was given a copy of the aide-mémoire and a full oral report of our contacts with other directors. We made special mention of the problems of territorial aspirations, quota, and nomenclature. He offered no comment on these topics. He stated, however, that he had been informed by his Government that it was their wish to remain in the Fund. We clarified for him, as

^{2/} Mr. Yaméogo was adamant in insisting on a reduction in quota. He sees this as a contribution to problems of the size and structure of the Executive Directors.

we had for many other directors, that no matter what happened in connection with the problem under discussion, he would be entitled to retain his seat in the Executive Directors until his term expired. He said, however, that if the U.N. solution were adopted, he would probably resign.^{3/} He understands that if he were to resign before the P.R. came in, there would be a rump election with probably a Filipino elected as executive director.

^{3/} He informed us that Mr. Watanabe had decided, personally he thought, to go on making disbursements to the R.C. under loan agreements entered into by the Asian Development Bank, in which the R.C. is a debtor. He promised us a copy of a document in connection with this decision.

cc: The Managing Director
The Deputy Managing Director

CONFIDENTIAL

November 2, 1971

Aide-Memoire

1. The following is an outline of the Fund's relations with China:

(a) Membership

China joined the Fund on December 27, 1945 as an original member. On March 29, 1946, it paid to the Fund one one-hundredth of one per cent of its quota in accordance with Article XX, Section 2(d) of the Articles of Agreement. Since December 1949, the relations with China have been conducted through the Central Bank of Taiwan.

The first two governors and the first executive director for China were appointed before the move to Taiwan. Since December 1949 the Taiwan government, acting on behalf of the Republic of China (hereinafter referred to as the Republic), appointed all the governors for China, and until the 1960 Annual Meeting it also appointed the executive directors for China. At that meeting, the Republic participated in the election of executive directors for the first time, as it no longer held one of the five largest quotas of the Fund.

Czechoslovakia challenged the right of the Chinese delegation to speak on behalf of China at the Fifth through the Ninth Annual Meetings of the Board of Governors held in 1950 through 1954. These challenges were consistently defeated, and since 1954, when Czechoslovakia withdrew from the Fund, that right has not been challenged again.

(b) Quota and subscription

China's original quota in the Fund of \$550 million has not been changed in any of the Fund's general reviews of quotas, nor has there been a request for an upward or downward adjustment of the quota. When China's quota was calculated at Bretton Woods, the economy of the undivided territory was taken into account.

The Republic paid its subscription in full in 1970. In order to determine what portion of the subscription should be paid in gold and what portion in the member's currency, the Fund was required by the Articles to take into account the net official holdings of gold and U.S. dollars which the Central Bank of China held on September 12, 1946, i.e., before the move to Taiwan on December 8, 1949.

The Republic made a gold tranche purchase on October 20, 1971 for an amount equivalent to its gold tranche. The Fund's holdings of new Taiwan dollars equal 100 per cent of quota. The Republic made the usual representation with respect to repurchase within three to five years.

(c) Par value

In 1945, China had one main currency and two subordinate currencies. The main currency was the Chinese yuan and the subordinate ones were those of Manchuria and Taiwan. The currency used for all purposes in the Republic is the new Taiwan dollar (NT\$). After the year 1949, no mention of the Chinese yuan has been made in relations with the Fund.

On June 23, 1970, the Republic communicated the rate of exchange of the currency prevailing on the 60th day before the entry into force of the Articles of Agreement, i.e., on October 28, 1945. In its communication, the Republic also notified the Fund that it regarded the rate of exchange as unsatisfactory as the basis for an initial par value and proposed that the initial par value of its currency be NT\$40 per US\$1 of the weight and fineness in effect on July 1, 1944. The Fund agreed to this proposed par value on September 4, 1970.

(d) Special Drawing Account

The Republic is a participant in the Special Drawing Account. The instrument of acceptance was deposited on December 30, 1969. It was signed by the Minister of Foreign Affairs of the member and stated that "...the Government of the Republic of China undertakes all the obligations of a participant in the Special Drawing Account in accordance with the laws and regulations of the Republic of China.... China's Government has taken all necessary steps to enable it to carry out these obligations."

The Republic notified the Fund on December 30, 1969 that it did not wish special drawing rights to be allocated to it under the decision for the first basic period, and that it reserved the right to request the Fund to terminate the effect of that notification with respect to the second and third allocations.

(e) Consultations

The Fund has had consultations under Article XIV with the Republic since 1952. In the reports prepared by the Fund regarding its consultations and in the related decisions taken by the Executive Directors, only the economic situation of the Republic has been considered.

(f) Payment restrictions imposed on China by the United States and Cuba

In 1952 the United States and Cuba imposed restrictions on the making of certain payments and transfers which involved Mainland China and nationals of China residing in Mainland China. The Executive Directors concluded at that time that Mainland China was still part of the member recognized by the Fund. The Fund took the position that Article VIII, Section 2(a) applied and not Article XI, which would have been applicable if the Fund had considered Mainland China as nonmember territory.

2. The Fund is legally entitled to make its own findings on membership questions. The facts involving the Fund's relations with the Republic which would entitle it to find that the Republic has become the member are set forth in A below. These facts would have to be balanced against those set forth in B below.

A. (i) The par value of the currency was established in 1970 with respect to the new Taiwan dollar.

(ii) The currency subscription was paid in the Republic's currency and the Fund has accepted nonnegotiable noninterest-bearing notes payable in that currency.

(iii) Neither the Republic nor any other member of the Fund has been required by the Fund to comply with the obligations imposed by Article IV, Sections 3 and 4 of the Articles with respect to transactions involving the currency of the People's Republic of China.

(iv) The economic information which the Fund has been receiving under Article VIII, Section 5, from the member has dealt only with the economy of the Republic.

(v) The annual Article XIV consultations have dealt only with the economic situation of the Republic.

(vi) The exchange and restrictive system in force in the People's Republic of China has not been taken into account by the Fund.

(vii) The enabling legislation of the Republic was the basis for its participation in the Special Drawing Account.

(viii) Since December 1949, the Republic has been appointing the governor for the member. After 1949, the Republic also appointed the executive director until the 1960 election when the Republic lost this right. Since 1960, the Republic has participated in the elections of the executive directors.

(ix) The Republic has engaged in an exchange transaction with the Fund which is still outstanding and subject to repurchase.

B. (i) The quota of \$550 million is larger than would be justified in respect of the Republic alone.

(ii) The decision taken by the Fund with respect to the payments restrictions imposed by the United States and Cuba against Mainland China.

(iii) The payment of one one-hundredth of one per cent of China's quota was made before the Nationalist Government moved to Taiwan.