Mr. Polak

Office Memorandum

Reform

TO : Mr. Altman

DATE: January 22, 1968

FROM : W.O. Habermeier

SUBJECT : Repurchase

A number of general comments and suggestions on Mr. Polak's draft paper of January 16, 1968 appear to be in order:

1. Paragraph 4 of the draft paper underlines the very weak role in recent years of obligatory repurchases in contrast to the preponderance of repurchases under the 1952 Decision. This is not a properly balanced description of the repurchase situation under the Articles. True enough, in the recent past, the main debtors of the Fund have been countries that do not fall under the repurchase obligation of Article V, Section 7(b). But this has not always been so nor should one expect that the present international payment situation will continue to be the same until the Articles are amended the next time. For example, in 1958 repurchases under Article V, Section 7(b) came to 44 per cent of total repurchases made ($539 million) because such countries as Belgium, the Netherlands, Denmark and Japan had repurchase obligations. Should the payments deficit and drawings on the Fund shift one day to EEC countries, this would change the repurchase situation under Article V, Section 7(b) radically.

   For these reasons, I believe that a reference to the situation in earlier years and to the possible impact of changes in the groupings of Fund debtors is truly necessary.

2. The proposal to double the quota limitation is likely to raise serious objections:

   (i) Today, a number of important members actually have quotas which are high in relation to general standards. The U.K. quota has been set comparatively higher than other quotas, one of the main reasons obviously being that the United Kingdom is a reserve center and has high liabilities in its own currency. An increase, therefore, in the quota limitation for repurchase calculations would give the United Kingdom a double protection

   (ii) The suggestion does practically nothing to reduce the inequities of the present system but tends to enlarge them in certain respects. Presently, about thirty-two members having about 52 per cent of total quotas are ineligible to incur a repurchase obligation because of the quota limitation. Using "gross"

reserves, these figures would be reduced to twenty-six members having 12 per cent of Fund quotas. By doubling the quota limitation, the number of members that would not incur repurchase obligations is raised to forty-three having 32 per cent of total quotas. Eleven countries, among them Brazil, Finland, Mexico and Norway, would get an exception although they presently cannot claim one. It should also be observed that the United Kingdom accounts for more than two-thirds of the change on a quota basis

(iii) The general argument that world trade has increased much more than quotas does not appear to be applicable because it is the relation between monetary reserves and quotas that is relevant. No argument can, however, be made that the general relation of quotas to reserve has worsened. On the contrary, it has improved! In 1945 the relationship of member's quotas to members' reserves was about 1:5; today it is 1:3!

(iv) This does not imply a judgment on the adequacy of reserves today in relation to world trade (which has increased since 1945 by about three to four times). However, one should avoid provoking a discussion on the general adequacy of quotas or of reserves just at the moment when countries are preparing for the creation of additional reserve assets. Obviously, the Special Drawing Rights scheme will increase the reserves of those countries that already have comparatively high quotas by a relatively larger amount

(v) If the scheduling of repurchase obligations is adopted, then the two alternatives presently suggested as a compromise for abolishing abatement and for abolishing the net reserve concept cannot easily be combined. Should they, however, be combined in the discussion, it is likely that they would make the compromise unacceptable to the EEC countries

For all these reasons, I strongly feel that the suggestion to change the quota limitation should be dropped. However, it might be useful to retain an alternative policy suggestion in addition to the complete scheduling of accrued repurchase obligation. I would very much favor Mr. Gold's original idea that scheduling should be restricted to the portion of an obligation that would have been abated but for the amendment.

3. On the abatement of amounts that fall due in currencies not acceptable to the Fund, the question arises how these balances should be re-allocated. I feel a tentative answer should be given in the staff paper suggesting abolishment of abatement. One could repeat an earlier staff document which said that "...these amendments could be settled entirely in gold or in currencies acceptable to the

Fund or in some combination of the two." Since this kind of abatement relates exclusively to currencies, it could be argued that reallocation could take place exclusively in currencies and that the principles of the 1962 Decision provided an agreed guide for currencies to be used in repurchases.

4. It may also not be easy to maintain the present position that installments of obligatory repurchases should be paid in gold or convertible currencies as determined by Schedule B. This suggestion looks very impractical as far as the currency part is concerned: schedules may extend over a number of years and may result in small installments and very small amounts in certain non-reserve currencies may result; members may no longer have a particular currency in their reserves at the time the commitment falls due; nor may the Fund be able to accept the particular currency because its holdings may have increased above 75 per cent.

   In view of this, I feel that the currency part of any repurchase obligation could be discharged in line with the policy of currencies that no longer would be abated.

5. As regards the rescheduling of accrued repurchase obligations, it may help the adoption of such a policy if it were suggested in the staff paper when such repayment would start and when it would end. As a practical matter, the installment schedule could not start before final monetary reserve calculations had been made, i.e. no earlier than six months after the end of the Fund's fiscal year. Because of delays in reporting final reserve data, it may sometimes take even longer than that. But final monetary reserve figures could and should be reported earlier and a special note is being prepared on this subject.

   It may be difficult to agree generally on a shorter repayment period than the present limit of five years. However, the staff might suggest that an accrued repurchase obligation would be used to pay off outstanding drawings *pro tanto* and that consequently, repurchase schedules would have to be fitted within the outside limit of three to five years from the time of the earliest drawing to which the repurchase was attributable.

cc: Mr. Polak ✓
Mr. Gold
Mr. Fleming
Mr. Nicoletopoulos

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

January 23, 1968

CABLE ADDRESS
INTERFUND

MEMORANDUM

TO: Mr. Polak ✓
Mr. Gold
Mr. Altman
Mr. Habermeier
Mr. Nicoletopoulos

FROM: J. Marcus Fleming

SUBJECT: Repurchase

It is suggested that a meeting be held on Repurchase at 3 p.m., January 24 to discuss Mr. Polak's draft of January 17 and the various memoranda relating to it that will be circulated today.

Perhaps I might raise a few questions and express a few views of my own on Mr. Polak's draft.

(1) Can we say (p. 2) that the existing sytem of reconstitution as a whole has always been considered satisfactory?

(2) I had thought that at our last meeting it was agreed to make some mention of the possibility of a compromise solution on the liabilities question, viz. that these should be counted on a 50 per cent basis. This is, in my view, not an unsatisfactory half-way house but a better representation of the true liquidity significance of such liabilities than either complete deduction from reserves or nondeduction. I will therefore suggest some words on page 3 to prepare the way and some additional language at the top of page 4 to allude to this possibility.

(3) While I think that some reference should be made to increasing the minimum reserve level, I think the argument should be toned down. After all the 3-5 years rule forces all members to repay whatever the state of their reserves.

(4) There seems to me to be some confusion regarding the scheduling of repurchase obligations under V.7.b and its relation to the scheduling of repurchases of particular drawings. The repurchase obligation under V.7.b is not in principle assigned to any particular drawing. It is allocated to particular drawings in the light of the circumstances at the time the obligation arises. If fulfilment of the obligation were to be scheduled there seems no reason why the allocation should not take place at the time the instalments are paid. In no event could schedules of repayment of particular drawings under the 3-5 year rule be impaired.

If there is to be any scheduling of payments under the V.7.b it should be a short schedule of no more than a year--preferably less, or the whole point of V.7.b will be lost.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

Mr. J. J. Polak

Room 504 F

#1

SM/68/13

January 18, 1968

To: Members of the Executive Board

From: The Secretary

Subject: Gold Tranche, Automaticity, and Conditionality

It is expected that the attached paper, prepared by the staff, will be brought to the agenda of an Executive Board meeting to be held on Friday, January 26, 1968.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

SM/68/13

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Gold Tranche, Automaticity, and Conditionality

Prepared by the Legal and the Research and Statistics Departments

(In consultation with the Treasurer's Department)

Approved by Joseph Gold and J. J. Polak

January 17, 1968

The purposes of this memorandum are two-fold: to examine SM/67/144 ("Reform of the Gold Tranche - Possible Solutions", December 15, 1967) in the light of the discussion at EBM/67/107 (12/20/67), EBM/67/111 and EBM/67/112 (12/29/67), and to consider paragraph 4 of EBD/68/3 ("Suggestions for Certain Reforms in the International Monetary Fund", January 4, 1968).

1. Need to draw and capital transfers

There appeared to be general agreement that the representation that a member now makes under Article V, Section 3(a)(i) should be retained even for requests for a gold tranche purchase. A number of views were expressed in connection with the distinction between needs arising from capital transfers and those from current payments. The following drafts in SM/67/144 reflected no more than the consequential changes required by the proposed automaticity of the gold tranche.

"SECTION 1. Use of the Fund's resources for capital transfers.--

(a) A member may not use the Fund's resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

SEC. 2. Special provisions for capital transfers.--Notwithstanding the provisions of Section 1(a) of this Article, a member shall be entitled to make gold tranche purchases for capital transfers."

These drafts would enable a member to increase the Fund's holdings up to 100 per cent (apart from "excluded" holdings) of the member's quota without the possibility of objection, before or after the event, that this use was to meet a large or sustained outflow of capital. They would raise the level for this purpose from the present 75 per cent and in addition they would eliminate the many difficulties involved in the present text of Article VI, Section 2. The possibility of objecting to a use of the Fund's resources in the credit tranches on the ground that it was to meet a large or sustained outflow of capital would remain. It is felt that there was greater sentiment for this solution in the Board discussions than for the total elimination of the qualification with respect to capital transfers, although no agreement was reached on this or any of the other issues that were debated. During the discussions, it was made clear that the total elimination of the distinction between the two types of use would raise legal and policy issues that go far beyond the redrafting of Article VI, Sections 1 and 2.

2. Challenge

No changes were suggested with respect to the addition of Article V, Section 3(c) as proposed in SM/67/144:

> "A request to buy currency under Section 3(a) of this Article shall not be subject to challenge by the Fund under any provision of this Agreement if the proposed purchase is a gold tranche purchase."

However, the treatment of the principle of freeing requests for gold tranche purchases from challenge must now be considered in relation to paragraph 4 of EBD/68/3, and this is done later in this memorandum.

If the practice were adopted that purchases from the Fund conducted through the General Account should be guided towards the currencies of countries that had abused the right to draw without challenge in the gold tranche by failing to observe the principle of need in Article V, Section 3(a)(i), this could be achieved by an amendment of EB Decision No. 1371-(62/36) "Currencies to be Drawn and to be Used in Repurchases" (Selected Decisions, Third Issue, pp. 33-39) which would add to Chapter II ("Criteria for the Selection of Currencies for Drawings and Repurchases") a final paragraph as follows:

> "In addition to these considerations, the Fund, in selecting currencies for drawings, will take into account the desirability of selecting the currencies of members that have made purchases in the gold tranche without the need required by Article V, Section 3(a)(i)."

No amendment of the Articles would be necessary to give effect to this practice.

3. Charges

In SM/67/144, a redraft of Article V, Section 8(a) was offered which would give the Fund full authority to abolish the service charge or vary it up to one per cent on all transactions or on categories of transactions such as gold tranche or super gold tranche transactions. That redraft, which can be referred to as Alternative A, was:

"The Fund may levy a service charge, uniform for all members and not more than one percent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

In this connection questions were raised as to the extent of the discretion that the Fund should have. The following formulations of Article V, Section 8(a) could give effect to some of the possibilities that were discussed.

Alternative B

"Any member buying the currency of another member from the Fund in exchange for its own currency shall pay, in addition to the parity price, a service charge uniform for all members of not less than one-half percent and not more than one percent, as determined by the Fund, provided that the Fund may reduce the service charge payable on purchases in the gold tranche to less than one-half percent."

Alternative C

"Any member buying the currency of another member from the Fund in exchange for its own currency shall pay, in addition to the parity price, a service charge uniform for all members of not less than one-half percent and not more than one percent, as determined by the Fund, but no service charge shall be paid on gold tranche purchases."

If Alternative A were not accepted, Alternative B would be preferable because it would enable the Fund to levy a charge on the gold tranche, or on the super gold tranche part of it, if the Fund should so decide. This would give the Fund a desirable degree of flexibility.

4. Remuneration

The draft of an Article V, Section 9 included in SM/67/144 read as follows:

> "SEC. 9. Remuneration.--The Fund shall pay quarterly remuneration to a member, at a rate uniform for all members, of not more than [one and one-half] [two] percent per annum on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter. Remuneration shall be paid in a member's own currency."

It should be noted that this draft employs the language "shall pay" and not "may pay". This would require the payment of a rate of remuneration which the Fund determined to be reasonable in the circumstances. Remuneration would be payable even if income was not earned.

The views expressed in the Board debates include the following: the rate of remuneration should be left to the discretion of the Fund; a maximum or a minimum rate should be specified; the rate of remuneration should be related to the rate of interest on holdings of special drawing rights (Article XXVI, Section 3 of the draft amendments); the remuneration should be paid in gold; preferential payments to creditor members should be provided for in conjunction with or in addition to the payment of remuneration.

The following versions of Article V, Section 9 and Article XII, Section 6 would give effect to some of the views:

Discretion

> "SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member at a rate determined by the Fund from time to time, and uniform for all members, on the amount by which seventy-five percent of the member's quota exceeded the average of the Fund's holdings

of the member's currency not in excess of seventy-five percent of quota [during the preceding quarter]."

Maximum or minimum rate

"SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member, at a rate uniform for all members, of not [more than x] [or] [less than y] percent per annum on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota [during the preceding quarter]."

Relation to special drawing rights

"SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member, at a rate equal to the rate of interest payable on holdings of special drawing rights pursuant to Article XXVI, Section 3, on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota [during the preceding quarter]."

If it were decided to create a legal tie between the rate of remuneration and the rate of interest on special drawing rights, an alternative, and perhaps preferable, procedure would be to include the substantive provision with regard to the rate in Article V, Section 9 and include the cross-reference in Article XXVI, Section 3.

Medium of payment

SM/67/144 suggested that remuneration should be paid in a member's own currency. This is the present rule with respect to the distribution of net income under Article XII, Section 6.

It has been proposed that, notwithstanding the medium of payment under that provision, consideration should be given to the payment of remuneration in gold, as a parallel to the payment of charges. According to Article V, Section 8(f),

> "All charges shall be paid in gold. If, however, the member's monetary reserves are less than one-half of its quota, it shall pay in gold only that proportion of the charges due which such reserves bear to one-half of its quota, and shall pay the balance in its own currency."

However, it should be noted that about 75 per cent of the charges on Fund holdings in excess of quota are presently paid in member currencies. Payment of remuneration in gold would reduce the Fund's stock of gold available for replenishment purposes.

Paragraph 9(c) of the General Arrangements to Borrow provides for the payment of interest in gold, as follows:

> "Interest and charges shall be paid in gold to the extent that this can be effected in bars. Any balance not so paid shall be paid in United States dollars."

The present draft of Article XXVI provides for the payment of charges and interest under the new facility in special drawing rights.

If it were decided to pay remuneration in gold, the following sentence could be the last sentence of an Article V, Section 9.

> "Remuneration shall be paid in gold."

This would be in lieu of the sentence: "Remuneration shall be paid in a member's own currency."

Relation between Article V, Section 9 and Article XII, Section 6

SM/67/144 proposed for consideration the following amendment of Article XII, Section 6:

> "SEC. 6. Distribution of net income.--The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserves shall be distributed. Any distribution shall be made to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

The suggestions in the Board's discussions included the retention of a preferential payment for creditor members, either as provided for in the present Section 6, or up to an amount which, together with the remuneration paid to them, would equal a stated percentage on the amount by which 75 per cent of quota exceeded the Fund's average holdings of their currency during a specified period; this preference could be either cumulative or non-cumulative. In addition, it was suggested that net income be placed to reserve automatically whenever it is earned.

The suggestion that creditor members should retain the preferred position they now have under Article XII, Section 6 could be made effective by the retention of that provision in its present form, which would then give them a preference in any distribution of net income as well as remuneration under Article V, Section 9.

In view of the range of suggestions, and in order to bring about certain simplifications of practice, the following position might recommend itself. This would be in the nature of a compromise which would recognize the force of the argument that the amendment of Article XII, Section 6 and the adoption of a new Article V, Section 9 should not put the members at present entitled to a preference under Article XII, Section 6 into what might be considered a worse position. The elements of the solution would be these:

(i) All net income would go automatically to the General Reserve. Under the present practice, it goes to General Reserve provisionally at the end of each month (EB Decision No. 753-(58/17), April 14, 1958), but this posting is subject to an annual determination by the Board of Governors. The need for an annual determination by the Board of Governors, whether to retain net income in the reserve or to distribute it, would be eliminated.

(ii) The Board of Governors would have the authority to decide at any time whether to distribute any part of the General Reserve. If the suggestion advanced in SM/67/144 were adopted, this power would apply to the Special Reserve as well.

(iii) No distribution would be made from reserve unless there was first paid from reserve the difference between any remuneration paid under Article V, Section 9 and 2 per cent per annum for each of the five years preceding the proposed distribution. The balance would be paid on "creditor" positions during the five years, in accordance with the formula for calculation in Article V, Section 9, and not solely on the creditor position at the time of the proposed distribution.

If Article V, Section 9 were drafted so as to set the rate of remuneration at 2 per cent per annum, the proposal in (iii) above could be eliminated. If the rate was not set at 2 per cent, the suggestion would be defensible only if it were possible to pay remuneration of 2 per cent. However, the suggestion would still be defensible if the rate were discretionary, provided that if any maximum were adopted it was not less than 2 per cent.

An amendment of Article XII, Section 6 to give effect to the suggestion could be drafted as follows:

"SEC. 6. Distribution of reserves.--The Fund's net income shall be placed to reserve. The Board of Governors may determine at any time what part of the reserves shall be distributed to all members, provided that when any such distribution is made there shall be first distributed to members that were eligible to receive remuneration under Article V, Section 9 during the preceding five years an amount equal to the difference between two percent per annum and any remuneration actually paid. Any distribution beyond that amount shall be made to all members in proportion to their quotas, and payments to each member shall be made in its own currency."

Under this provision, the Fund would not be empowered to make a distribution to creditors from reserves except as a condition precedent to a distribution to all members; and the Fund would then be required to distribute to creditors an amount equal to the whole of the difference between the remuneration actually paid and the remuneration that would have been paid at 2 per cent per annum during the preceding five years.

With an amendment of this kind, Article XII, Section 2(b)(v) would be amended to read:

"Determine the distribution of the reserves of the Fund."

At the moment it reads:

"Determine the distribution of the net income of the Fund."

5. Definition of gold tranche

Three versions of a possible Article XIX (j) were included in SM/67/144, as follows:

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that the Fund

may decide that purchases under specified policies on the use of the Fund's resources and amounts of the Fund's holdings of currency equal to outstanding purchases under these policies shall be excluded for the purposes of this definition."

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that for the purposes of this definition the Fund may decide to exclude purchases and holdings under policies on the use of its resources for compensatory financing of fluctuations in the exports of members."

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota."

No choice was made among these three versions in the Board's discussion of them, although there appeared to be a preference for the first or second as compared with the third.

6. Automaticity and conditionality

Part II (pp. 13-14) of SM/67/99 ("Legal Aspects of the Memorandum Entitled 'Suggestions for Certain Reforms in the International Monetary Fund' (EBD/67/97)", August 2, 1967) dealt with certain features of EBD/67/97, which have now been supplemented by paragraph 4 of EBD/68/3. The latter paragraph is as follows:

"4. Conditionality of use of the Fund Resources

It is the view of the Monetary Authorities of the European Economic Community that taking into consideration the proposals to create special drawing rights and to confirm legally the automaticity of the gold tranche, there would be no justification for extending by way of policies quasi automaticity in the credit

tranches or establishing special facilities of a quasi automatic character. The possibility of such extension should be excluded in the text of the Articles of Agreement by appropriate amendments. This proposal is made without prejudice to the Fund's policy on compensatory financing."

These proposals could be drafted in the form of the following amendments:

(i) Article I (v) could be amended as shown on page 14 of SM/67/99:

"To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, and in accordance with such policies as the Fund may adopt, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." (Words underlined are added)

If it were thought desirable to repeat the reference to policies in Article I (v) in the operational provisions of the Articles, this could be done briefly in a provision which could be an Article V, Section 3 (c):

"The Fund shall adopt policies which will ensure that a member's use of the Fund's resources will be temporary."

(ii) It would then be necessary to provide that all requests for gold tranche purchases would not be subject to challenge and that requests for all other purchases would be subject to challenge and examined to determine their consistency with the provisions of the Articles and the policies mentioned in Article I(v) and Article V, Section 3(c). This could be done as follows by an Article V, Section 3(d):

"A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, with the exception that proposed purchases in the gold tranche shall not be challenged under any provision of this Agreement."

A provision of this kind would be in lieu of the draft provision set forth in section 2 of this memorandum with the purpose of eliminating authority to challenge requests for gold tranche purchases.

The foregoing drafts would not permit the extension of the concept of the overwhelming benefit of any doubt into the credit tranches or any facilities that were regarded as having the same effect.

The adoption of Article V, Section 3(d) as drafted above would mean that even if the first of the three definitions of the gold tranche in section 5 of this memorandum were adopted, any "specified policies" that were "excluded" could not be based on automaticity. That is to say, they could establish Fund policies of a "floating" character but only if those policies would be consistent with the provisions of the Articles and would involve a conditionality based on the concept of a temporary use of the Fund's resources. Requests under these Fund policies would be challengeable, and the Fund would have to exercise this power if there was good reason to do so.

MEMORANDUM

TO: Mr. Gold
Mr. Altman
Mr. Fleming
Mr. Habermeier
Mr. Nicoletopoulos

January 17, 1968

FROM: J. J. Polak

SUBJECT: Repurchase

The attached has been revised in the light of our discussion yesterday. Would you please let me have any comments and an indication whether you think a further meeting would be necessary.

INTERNATIONAL MONETARY FUND

Repurchase

Prepared by the Staff

January 16, 1968

1. In the joint memorandum by five Directors of June 26, 1967 (EBD/67/97) three suggestions were made with respect to the provisions of the Articles that govern repurchase obligations and the calculation of monetary reserves on which they are based. These suggestions were put forward to "ensure the effectiveness and equal application of members' repurchase obligations." The suggestions covered these items:

(a) "Abolishing of the deduction of currency liabilities provided for in Article XIX(e) in calculating the amount of the monetary reserves that form the basis for determining the repurchase obligations."

(b) "Abolishing the abatements in cases of repurchases calculated in currencies which the Fund may not accept;" and

(c) "Including the currencies of nonmember countries that are recognized as convertible by the IMF in the calculation of reserves."

2. The discussion of these proposals in EB 67/75 and EB 68/2 has provided Executive Directors with an opportunity to express views not only with respect to the three particular aspects of repurchase, but also to the general working of the repurchase mechanism under Article V, Section 7(b) and, even more broadly, the working of what might be termed the whole range of reconstitution provisions under the present Articles of Agreement. In this discussion a number of points have been brought forward that may be relevant to the decisions to be taken with respect to the three concrete proposals put forward. These points are listed in paragraphs 3, 4 and 5 below.

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3. In the present Fund there are three basic methods by which a country's position in the Fund is restored or "reconstituted" after it has made a drawing:

(a) Repurchase under Article V, Section 7(b).

(b) Repurchase under the 1952 Decision, which Decision limits outstanding drawings to "the period presumably related to the payments problem for which [the currency] was purchased from the Fund," this period to "fall within an outside range of 3 to 5 years."

(c) Sale of the currency of the country concerned in transactions with other member countries.

4. It has not been suggested that over this period the mechanism of reconstitution as a whole, in which repurchases under Article V, Section 7(b) played only a very small part in recent years, was either inadequate or inequitable. It may be recalled in this connection that the 1952 Decision, under which perhaps as much as two-thirds of reconstitution is taking place currently, reflected to a large extent a desire to correct the same inadequacies and inequities of the repurchase mechanism under Article V, Section 7(b) taken in isolation, to which the proposals under 1(a) and 1(b) are addressed, viz. the facts that (i) reserve centers' (and other countries') net monetary reserves might be below their quota, and that (ii) many countries held their reserves in currencies that the Fund could not accept in repurchase. At the time, sterling and French francs could not be accepted because these currencies were inconvertible; now sterling and dollars cannot be accepted because the Fund holds these currencies in excess of 75 per cent of quota.

5. With respect to the equity of the repurchase mechanism of Article V, Section 7(b) taken by itself, the following views expressed by Executive Directors may be noted.

(a) There appeared to be agreement that:

(i) Elimination of the abatement provision would contribute to the equity of the system.

(ii) The equity could be slightly improved by the inclusion in monetary reserves of appropriate nonmember currencies, although the holdings of these currencies by members have been small.

(b) Differences of view were expressed as to whether the suggested elimination of the deduction of currency liabilities, in particular insofar as it referred to the currency liabilities of reserve centers, would contribute to the equity of the system. Questions were also raised as to the equity of a system that allows deduction of currency balances expressed in the reporting country's own currency, even if these liabilities are de facto quite illiquid (such as PL 480 balances in many countries), while not allowing deduction of short-term liabilities expressed in another member's convertible currency.

(c) The system contains at least one other feature that is difficult to justify, but whose effects have to a large extent been masked by the fact that other factors tended to minimize repurchases under Article V, Section 7(b) in recent years. The Section 7(c) of Article V recognizes a minimum reserve level below which a member's repurchase obligation as calculated under Section 7(b) is not to be discharged. This limit is, however, set at the member's quota—a figure that for practically all members must at present be considered as so low as not to provide a meaningful protection.

6. In the light of the foregoing Executive Directors might want to consider the following courses of action:

(a) To amend the Articles with respect to abatement only. Although there would probably be agreement that this in itself would constitute an improvement, it would still leave the system defective from many points of view including, in the eyes of some Directors, the question of the treatment of currency liabilities.

SUBJECT COPY

(b) To amend the Articles with respect to both abatement and the elimination of the deduction of currency liabilities. Apart from the fact that this would introduce an amendment--that with respect to currency liabilities--on which there are important differences of view, it would also introduce a considerable risk of exposing members to repurchase in conditions where their reserves were too weak to justify this. It is suggested, therefore, that if (b) were adopted it should be accompanied by a further amendment to counteract this undesirable effect.

Two possibilities might be considered for this purpose, as shown in (c) and (d) below.

(c) To raise the level of a member's monetary reserves below which it would not be subject to the repurchase obligation of Article V, Section 7 from its present level, i.e., the member's quota to a higher level, for example, twice the member's quota. * (add)

(d) The introduction of a provision under which the Fund could agree that a repurchase obligation that had accrued could be the subject of a schedule agreed with the Fund for repayment. The period for repayment would not be stated in Articles, but would be left to policy decision. The appropriate period for any schedule would be determined in the light of circumstances; it would in no event exceed the outer limit for temporary use. The agreement would establish the installments in which repurchase would be made; the media of repurchase would be those determined by the provisions of Schedule B. Under this approach any reduction in the Fund's holdings of the currency of the repurchasing member resulting from the sale of that member's currency subsequent to the date of accrual of the repurchase obligation would discharge _pro tanto_ the next installments falling due under a repurchase schedule.

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* This could be justified on the ground that, in comparison to the immediate pre-war period, world trade has increased seven or eight times while Fund quotas have increased about two and one half times since they were set in 1944.

Office Memorandum

TO : Mr. Altman

DATE: January 12, 1968

FROM : W.O. Habermeier

SUBJECT : Draft Paper on Gold Tranche, Automaticity and Conditionality

In regard to the discussion about the medium of payment (page 6 of the draft) two points should be considered:

1. In introducing this item, one could recall the draft provision presently reproduced on page 4 that renumeration should be paid in the member's own currency.

2. The main argument advanced for paying the remuneration in gold was that charges had to be paid in gold but, as is pointed out in the draft paper, this requirement is diluted by the Articles themselves since they allow payment in a member's currency under certain conditions. For reasons of symmetry, therefore, any draft which would require payment of renumeration of gold should be restricted in a similar fashion. The following redraft could possibly replace the present draft on page 7 of Mr. Gold's draft paper:

   "The renumeration shall be paid in gold. Payment may be made in the member's currency to the extent that /members have/ /the same member has/ elected to pay currency in payment of charges."

cc: Mr. Gold
Mr. Polak
Mr. Fleming
Mr. Nicoletopoulos

Office Memorandum

TO : Mr. J. J. Polak

DATE: January 11, 1968

FROM : Joseph Gold JG

SUBJECT : Gold Tranche Paper

Thank you for your note. I have made amendments on the basis of most of your suggestions, but I have some comments.

1. The first sentence after the draft on page 2 of the paper was drafted as it was to indicate that no objection would be taken either before the drawing (by challenge) or after it (by ineligibility).

2. With respect to your fourth paragraph, I have deleted the "at least" before 2 per cent, but the substance of the paragraph on page 9 of the paper seems to me solid in view of the many possibilities that have been discussed for drafting a provision on remuneration. Some of them could make the proposal untenable, and I want to fend off any suggestion that we have overlooked this.

3. I see the point of your last paragraph, but you are reaching out for a quality for the gold tranche that has not been envisaged. What you are referring to is really the possibility of outlawing ineligibility after a gold tranche drawing. It is understood, however, that the sanction of ineligibility will remain. This means that Article V, Section 5 will continue to be applicable. That provision refers to use "in a manner contrary to the purposes of the Fund." Those purposes enabled us by implication to adopt policies, so that the situation is not changed in substance by making that fact explicit.

cc: Mr. Altman
Mr. Fleming

January 11, 1968

MEMORANDUM

TO: Mr. Gold

FROM: J. Marcus Fleming

SUBJECT: Gold Tranche Paper

Page 3: The suggested addition to the "Decision on Currencies to be drawn and to be used in repurchases' reads queerly. What were 'considered' in the 'considerations' mentioned in the Decision were circumstances and aspects of country situations not 'currencies'. I would delete 'consider' and substitute 'take into account the desirability of selecting', or alternatively delete 'currencies ..... that have made purchases' and substitute 'take into account the desirability of undoing the effects of purchases made'.

Page 6: Since it is easier for the special account than the General Account to be sure of being able to balance its accounts I would substitute the 'alternative procedure' mentioned in paragraph 1 for the one you have followed.

Page 9: The words 'from time to time' in line 2 are obscure and the associated words 'during each of the preceding 5 years' in the 8th last line even more so. I suppose it is some sort of averaging that is intended but this is not what the text says.

There are other obscurities in the text. For example, is it possible to make a distribution to creditors that will bridge part of the gap between 2 per cent and the remuneration paid? Again, if distribution is made in two successive years so that there is an overlap between the two 5-year periods does not one have to subtract from the 2 per cent not only 'remuneration', but any 'distribution' previously made to creditors?

Pages 11-13: I expect I am a voice crying in the wilderness, but I think it is appalling

(a) to introduce temporary use explicitly into the Articles at a time when policy would indicate the wisdom of giving a more flexible rather than a less flexible interpretation to temporariness, if we are to promote greater stability in balance of payments situations, and

(b) to base Fund conditionality exclusively on the maintenance of a revolving fund.

Avoidance of automaticity is only loosely connected with assurance of temporary use. The former is not as you assume a necessary condition of the latter. For example, rigid average holding conditions provide an assurance of temporary use without involving conditionality. Moreover, Fund conditionality of the right kind is based on far more important considerations than that of enabling the Fund to get its money back--namely, those referred to in Article I.

cc: Mr. Polak
Mr. Altman

MEMORANDUM

January 11, 1968

To: Mr. Polak
Mr. Altman

From: Joseph Gold

Subject: Repurchase

I have read Mr. Polak's memorandum of January 11, and I assume that all reasonable ideas for the solution of the dilemma on repurchase are now in order.

I would like to advance the following idea on the assumption that it is reasonable.

(i) The proposals that abatement and the deduction of currency liabilities be eliminated are reasonable and should be accepted.

(ii) Any repurchase obligation that accrues would be the subject of a schedule agreed with the Fund under which repayment would be completed within a temporary period. The period would not be stated in the Articles, but left to policy as at present.

(iii) The agreement would establish the installments and the media of repurchase with respect to any portion of an obligation that would have been abated but for the amendment.

(iv) Any reduction in the Fund's holdings resulting from the sale of a member's currency would discharge pro tanto the next installments falling due under a repurchase schedule.

(v) Repurchase agreements would continue to be made as at present when the rate of charge reaches a certain level to the extent that repurchase agreements were not already in existence.

cc: Mr. Fleming
Mr. Habermeier

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

January 11, 1968

CABLE ADDRESS
INTERFUND

MEMORANDUM

TO: Mr. Polak

FROM: J. Marcus Fleming *JMF*

SUBJECT: Repurchase

As regards the suggestions made in your draft staff paper;

(c)(ii) seems to me objectionable on grounds that a member is entitled to know well in advance whether a repurchase obligation will be enforced or not.

(c)(iii) without (b) is admittedly inferior to (a). (c)(iii) with (b) is the sort of thing we might have done at a time when we were anxious to avoid amending articles. In present circumstances it seems to me inferior to (a) which would give more satisfaction to the Europeans, and is clearer from a legal standpoint.

(c)(i) is open to the objection that the removal of the only clearly expressed repurchase obligations in the Articles might weaken the legal case for repurchase arrangements imposed by policy. More substantively, the three-to-five-year rule gives no adequate safeguard against excessive drawings. At the very least it would be necessary to utilize the Fund's currency policy--for which the legal justification is none too strong--to reverse, at least in part, excessive or improper drawings.

My own preference is for (a), but I would not object to mentioning (c)(i) (with the additional gloss about reversal transfers) and (c)(iii) as alternatives.

cc: Mr. Gold
Mr. Altman
Mr. Habermeier
Mr. Nicoletopoulos

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBD/68/3

January 4, 1968

To: Members of the Executive Board

From: The Secretary

Subject: Suggestions for Certain Reforms in the International Monetary Fund

Attached is a further memorandum from Mr. van Campenhout to the Managing Director relating to the suggestions for certain reforms in the Fund made by the European Economic Community in April 1967.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

EBD/68/3

January 3, 1968

To: The Managing Director

From: André van Campenhout

Subject: Memorandum Relating to Suggestions for Certain Reforms in the International Monetary Fund

On behalf of Messrs. Lieftinck, vom Hofe, Plescoff, Palamenghi-Crispi and myself, I am sending you herewith a memorandum completing our memorandum of June 22, 1967, relating to suggestions for certain reforms in the IMF described in the report of the Monetary Committee of the European Economic Community of April 11, 1967, which was circulated on June 26, 1967 (EBD/67/97).

It would be appreciated if you would circulate this memorandum to the members of the Executive Board.

Memorandum relating to suggestions for certain reforms in the International Monetary Fund

We refer to our memorandum of June 22, 1967, concerning proposals contained in the Report of the Monetary Committee of the European Economic Community of April 11, 1967. What follows completes the list of the proposals contained in the above-mentioned memorandum which are considered essential by the Monetary Authorities of the European Economic Community. Our memorandum of the 22nd June and the present one should be considered as the basis of our discussions with regard to the proposals of the European Economic Community.

Points 1, 2 and 3 of the present memorandum concern decisions affecting international liquidities and should in our view be covered by the same majority as the decision to allocate special drawing rights under the proposed new facility.

Point 4, which concerns the conditionality of the use of the Fund resources, completes paragraph II-A (Use of the Fund Resources - Conditions for drawings within the credit tranches) of our memorandum of June 26th and should be discussed together with it.

Point 5 which concerns interpretation of the Articles of Agreement, is of a procedural nature and self-explanatory.

1. Increases of quotas

Proposals for general increases of quotas, special adjustments of quotas connected with those proposals, and associated conditions, particularly concerning gold payments, should be made by a majority of 85 per cent of the total voting power of the membership of the Fund.

No changes are proposed with regard to requests for the adjustment of individual quotas not connected with proposals for general increases of quotas.

2. Uniform changes in par values

Article IV, Section 7, should be amended as follows:

(a) The decision to make a uniform proportionate change in the par values of the currencies of members should be made by a majority of 85 per cent of the total voting power.

(b) The proviso that "each such change is approved by every member which has ten per cent or more of the total of the quotas" should be eliminated.

3. Maintenance of the gold value of the Fund's assets

Article IV, Section 8(d). The words "by a majority of 85 per cent of the total voting power" should be added to the phrase "unless at the time when such a change is proposed the Fund decides otherwise".

4. Conditionality of use of the Fund Resources

It is the view of the Monetary Authorities of the European Economic Community that taking into consideration the proposals to create special drawing rights and to confirm legally the automaticity of the gold tranche, there would be no justification for extending by way of policies quasi automaticity in the credit tranches or establishing special facilities of a quasi automatic character. The possibility of such extension should be excluded in the text of the Articles of Agreement by appropriate amendments. This proposal is made without prejudice to the Fund's policy on compensatory financing.

5. Interpretation of the Articles of Agreement

It is considered that Article XVIII of the Articles of Agreement which provides that questions of interpretation of the Articles of Agreement can be decided by simple majority of the Executive Directors and, on appeal, by the same majority of the Board of Governors, is not quite adequate. Matters of interpretation affect important rights and obligations of member countries and it is felt that minorities should be protected in a way more in line with traditionally accepted procedures. It is suggested that this could be achieved by allowing members who would not be satisfied with the decisions taken in accordance with the present procedures, to have recourse, in the last resort, to the procedures provided for in Article XVIII (c) with regard to disagreements arising between the Fund and a member which has withdrawn or between the Fund and any member during the liquidation of the Fund. To that end, Article XVIII (c) should be amended accordingly and the words "whose decision shall be final" in Article XVIII (b) should be deleted.

January 3, 1968

Reform

MEMORANDUM

TO: Mr. Gold

December 11, 1967

FROM: J. J. Polak

SUBJECT: Participation Clause Instead of Change in Voting Requirement for General Quota Increases

Please see the revised version of the memorandum. I am glad to know that you are not talking about an 85 per cent participation clause.

I have dropped the statement that such a clause would be worse than changing the voting requirement but I have not changed my mind on the substance of this. And I would hope that the non-Six would not be so silly as to be willing to accept a harsher provision for the mere reason of avoiding "a shift in the formal power structure"--as if an 85 per cent participation clause were anything but a shift in the formal power structure.

MEMORANDUM

TO: Mr. Gold December 11, 1967

FROM: J. J. Polak

SUBJECT: Participation Clause Instead of Change in Voting Requirement for General Quota Increase

The basic concept of trying to work via a participation clause has the attraction that it completes the Articles rather than changes them. I would suggest that in exploring this possibility we approach it on an 80 per cent not an 85 per cent basis. In this connection, the point to be noted is that the Six don't need 15 per cent of quotas to establish their veto. Their share in quotas is considerably higher than in votes--they have 17.96 per cent of quotas. To allow a veto right to 15 per cent of quotas would give the veto not merely to the Six but to various combinations of four of them (for example, Germany, France, Italy, Belgium). An 80 per cent of quota participation clause would give the Common Market countries effective control in various circumstances:

(a) As long as the Chinese don't participate in any general quota increase--their percentage is 2.43 per cent;

(b) provided they can get the Swedes and the Swiss on their side. The Swedish quota is 1.07 per cent and that of Switzerland ought to be about 1.5 per cent.

(c) If they are willing to increase their quotas by a much more moderate amount than would be necessary to give them 85 per cent of votes. The amount involved would be about 2 per cent of present quotas or a little over $400 million, which is much more doable. Moreover, if they wanted to combine (b) and (c) and rely only on the Swiss, they could easily reach the number by a quota increase of less than $200 million. If, finally, they were willing to rely on China for at least the next general quota increase, they could wait with any special quota increase for themselves until that occasion.

If all else fails one could still see the possibility of a compromise on 82.5 per cent participation which would completely cover the EEC without any of the above.

cc: Managing Director
Deputy Managing Director

Office Memorandum

TO : Mr. J. J. Polak

DATE: December 8, 1967

FROM : Joseph Gold JG

SUBJECT : Participation Clause Instead of Change in Voting Requirement for General Quota Increases

I agree with the basic point that you make in your memorandum of December 8, 1967 to me. However, I should like to make two qualifications.

a) Your memorandum could give the impression that I suggested or supported an 85 per cent participation clause. Actually, in my discussion with Mr. van Campenhout I had a feeling that a lower percentage might suffice, and I avoided any mention of 85 per cent. You might like to take a look at your note from this point of view.

b) I do not really agree with you that nothing would be gained in any circumstances by a participation clause if the figure had to be 85 per cent. What I have been addressing myself to has been the avoidance of a proposal on voting because it is this shift in the formal power structure which causes difficulty. If it should prove possible for the Six to convince the membership as a whole that a controlling figure of 85 per cent was inevitable, it might still be easier to reach a settlement if this 85 per cent took the form of a participation clause rather than a new voting majority. This, of course, does not mean to suggest that in my mind a lower percentage would not be preferable if one could get away with it.

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

MEMORANDUM

TO: Mr. Gold

December 8, 1967

FROM: J. J. Polak

SUBJECT: Participation Clause Instead of Change in Voting Requirement for General Quota Increases

The basic concept of trying to work via a participation clause has the attraction that it completes the Articles rather than changes them.

However, if the figure had to be 85 per cent, I think nothing is gained compared to changing the voting requirement for quotas to 85 per cent. The new figure would be just as hard to swallow for the non-Six countries and it would, in fact, constitute an even harsher limitation.

In the first place the Six don't need 15 per cent of quotas to establish their veto. Their share in quotas is considerably higher than in votes--they have 17.96 per cent of quotas. To allow a 15 per cent of quotas vote would give the veto not merely to the Six but to various combinations of four of them (for example, Germany, France, Italy, Belgium).

Secondly, if one has to swallow the 85 per cent pill it would be better to take it in the first round and continue with the kind of participation percentages we have used heretofore. There is no reason to believe that at least the more sensible people in the Six are enamored by the 85 per cent number as such. Both van Lennep and van Campenhout said the opposite to me--what they are interested is is effective control, not in antagonizing the rest of the membership unnecessarily.

I would suggest, therefore, that we explore the participation clause on an 80 per cent basis. This would give the Common Market countries effective control in various circumstances:

(a) As long as the Chinese don't participate in any general quota increase--their percentage is 2.43 per cent;

(b) provided they can get the Swedes and the Swiss on their side. The Swedish quota is 1.07 per cent and that of Switzerland ought to be about 1.5 per cent.

(c) If they are willing to increase their quotas by a much more moderate amount than would be necessary to give them 85 per cent of votes. The amount involved would be about 2 per cent of present quotas or a little over $400 million, which is much more doable. Moreover, if they wanted to combine (b) and (c) and rely only on the Swiss, they could easily reach the number by a quota increase of less than $200 million. If, finally, they were willing to rely on China for at least the next general quota increase, they could wait with any special quota increase for themselves until that occasion.

If all else fails one could still see the possibility of a compromise on 82.5 per cent participation which would completely cover the EEC without any of the above.

cc: Managing Director
Deputy Managing Director

Mr. Polak

Mr. Henry [illegible]

The Managing Director

Joseph Gold

November 17, 1967

File: Fund Reform

I attach for your approval one of the two legal papers which we promised at EBM/67/81 in connection with further discussions of the gold tranche.

cc: The Deputy Managing Director
Mr. Polak
Mr. Altman
Mr. Hebbard

Legal Aspects Relating to the Payment of Remuneration on the Super Gold Tranche

Prepared by the Legal Department

Approved by Joseph Gold

November 16, 1967

Introduction

Staff Memorandum 67/99 (August 2, 1967) discussed certain legal aspects of the payment of "interest" on super gold tranche positions (pp. 11-12). At EBM/67/81, a further paper on this subject was promised which would take into account the discussion at that meeting and at the meetings in which the distribution of net income was considered (EBM/67/62, 67/63, 67/68, and 67/74).

Terminology

It is recommended that if any amendment were to be adopted which would provide for a fixed return on super gold tranche positions, the word "interest" should be avoided. According to normal legal usage, "interest" accrues on a debt and not on a subscription to capital. Currency and gold subscriptions to the Fund are owned by the Fund, and they do not constitute current debts of the Fund to members. Indeed, most of the Fund's currency holdings are in the form of non-negotiable, non-interest bearing notes or similar obligations under Article III, Section 5, and to that extent, therefore, members are indebted to the Fund in the sense that these notes or similar obligations do not eliminate the members' obligations to provide currency and members must encash the notes or obligations on demand.

Therefore, when the Fund receives currencies and uses them in transactions, even when super gold tranche positions emerge as a result, the Fund is

receiving or using its own assets and "interest" is not payable. A more adequate term would be "remuneration".

Remuneration

If it were decided to pay a remuneration on super gold tranche positions, it would seem advisable to do this by adding a provision entitled "Remuneration" as Section 9 to Article V. It would then follow a provision entitled "Charges" which deals with certain payments to the Fund. It is assumed that any new provision would deal with the payment of remuneration as an expense of the Fund. That is to say, it would be payable whether or not the income of the Fund covered all Fund expenses including the remuneration paid to holders of super gold tranche positions. For this reason, it would be preferable that the provision for this remuneration should not take the form of an amendment of Article XII, Section 6.

Discretionary rate

In SM/67/99, page 12, the possibility was envisaged of minimum and maximum annual rates of remuneration (or interest as it was there called), and a determination by the Fund each year of the rate that was to be paid. If this course were followed, or if there should be a discretion as to the rate without any prescribed minimum and maximum, it would be necessary to consider whether, on the analogy of Article XII, Section 6, the Board of Governors should make the determination, annually or at other intervals, of the rate to be paid. If there were no discretion as to rate, the question whether determination of the rate should be a power that the Board of Governors should be unable to delegate would not arise. If there should be a discretion and the power to establish the rate was to be reserved to the Board of Governors, this could be done by adding a sub-paragraph (ix) to Article XII, Section 2(b).

It should be noted, however, that the exercise of the Fund's discretion to fix the various charges payable by members is not reserved to the Board of Governors. The determination of the rates for periodic charges on the Fund's holdings of currencies in excess of quota can be changed by the Executive Directors by a three-fourths majority of the total voting power (Article V, Section 8(e)). The service charge on exchange transactions (Article V, Section 8(a)) and handling charges on gold transactions (Article V, Section 8(b)) can be varied by a majority of votes cast by the Executive Directors. It is also relevant that the power to agree to pay interest on loans under Article VII, Section 2(i), including the power to agree on the particular rate, has been delegated to the Executive Directors.

Presumably, the reason why the power to distribute net income under Article XII, Section 6 has been reserved to the Board of Governors whereas the power to vary charges and pay interest on loans may be and has been delegated to the Executive Directors is that the first of these powers was regarded as involving a distribution of part of the Fund's assets. Nevertheless, there would be no reason of a legal character that would require a power to determine the rate of remuneration to be reserved to the Board of Governors.

At the moment, decisions with respect to net income have retrospective effect. They determine the way in which the net income of a financial year that has already ended shall be dealt with. If the analogy of charges under Article V, Section 8 is followed, the decisions could be given prospective effect. In short, determinations as to the rate of remuneration could apply to the last financial year or to the next year or until a decision was taken to make a new rate operative. Moreover, it is not essential that remuneration would have to be payable in yearly amounts. For example, remuneration could be paid quarterly.

Calculation

It is assumed that if remuneration were paid on the super gold tranche, it would be paid on the basis of an average position during a base period, for example the preceding year or quarter. Article XII, Section 6 provides for a distribution of net income "on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year." This is not easy language to understand in the context of the Articles. In SM/66/130 (December 15, 1966) the view of this language which was recommended was that:

> "Average holdings are calculated by adding the holdings on each day during the year that they are at or below the 75 per cent level and dividing the total by the total number of days in the year. Holdings above the 75 per cent level on any day are assumed to be at that level." (P. 18)

It was pointed out that this technique was comparable to the one adopted in connection with the payment of periodic charges on the "average daily balances of its currency held by the Fund in excess of its quota" under Article V, Section 8(c). If a new provision were adopted for the purpose of paying a remuneration on super gold tranches, it would be useful to adopt clearer language to give effect to this technique of calculation.

The last conclusion in SM/66/130 (P. 19) could apply to the calculation under a new provision as a matter of administration without the necessity for express language:

> "The Fund's No. 2 Accounts up to 1/100 of one per cent of quota should be excluded from the calculation of average holdings, but this exclusion in itself should not qualify a member for a preferential distribution. A member should qualify, however, even if the reduction in average holdings is solely the result of the Fund's use of the member's currency for administrative expenditures."

Available Resources

If remuneration were payable under an amendment of the Articles, it would be payable whether or not the Fund's income were adequate to cover it. The General Reserve could be made available if the Fund's income was inadequate without any of the limitations with respect to the distribution of net income under Article XII, Section 6, which were explained in SM/66/130. Moreover, if the Fund's income were not sufficient in any year to cover all of the expenses of the Fund, including the expenses of paying the remuneration, administrative expenses would be charged first against the Special Reserve (Selected Decisions, p. 115).

Draft Language

The following draft would give effect to some of the ideas mentioned above. Naturally, there would be modifications in this draft if other policy choices were made:

"SEC. 9. Remuneration.--The Fund shall pay (annual)(quarterly) remuneration to a member, at a rate uniform for all members, (of not more than ___ percent per annum) on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding (year)(quarter). Remuneration shall be paid in a member's own currency."

Amendment of Article XII, Section 6

With an amendment such as the one indicated above, it would become necessary to amend Article XII, Section 6, somewhat along the following lines:

"SEC. 6. <u>Distribution of net income</u>.--The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. Any distribution shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

With this language, the same difficulties might arise in connection with the meaning of "net income" and the use of the General Reserve that were discussed in SM/66/130. Without any other change in the language of Article XII, Section 6, "net income" would continue to be the net income solely of the year for which a distribution was made. If, however, it were thought desirable to make the General Reserve available for distribution for any year, the language could read:

"The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserve shall be distributed."

If it were decided to make the Fund's Special Reserve available for distribution, that could be done by substituting "reserves" for "reserve" in the foregoing text.

MEMORANDUM

TO: Mr. Gold
Mr. Altman

January 11, 1968

FROM: J. J. Polak

SUBJECT: Repurchase

I attach a draft of a staff paper on repurchase. As you will note this paper provides considerable guidance, while leaving to Directors a wide latitude of options, all of which would presumably be acceptable to us.

cc: Mr. Fleming
Mr. Nicoletopoulos
Mr. Habermeier

SUBJECT COPY

DRAFT
JJP:Jan. 10, 1968

Repurchase

Prepared by the Staff

In the joint memorandum by five Directors of June 26, 1967 (EBD/67/97) three suggestions were made with respect to the provisions of the Articles that govern repurchase obligations and the calculation of monetary reserves on which they are based. These suggestions were put forward to "ensure the effectiveness and equal application of members' repurchase obligations." The suggestions cover these items:

1. (a) "Abolishing of the deduction of currency liabilities provided for in Article XIX(e) in calculating the amount of the monetary reserves that form the basis for determining the repurchase obligations."

(b) "Abolishing the abatements in cases of repurchases calculated in currencies which the Fund may not accept;" and

(c) "Including the currencies of nonmember countries that are recognized as convertible by the IMF in the calculation of reserves."

2. The discussion of these proposals in EB 67/__ and EB 68/__ has provided Executive Directors with an opportunity to express views not only with respect to the three particular aspects of repurchase, but also to the working in general of the repurchase mechanism under Article V, Section 7(b) and, even more broadly, the working of what might be termed the whole range of reconstitution provisions under the present Articles of Agreement. In this discussion a number of points have been brought forward that may be relevant to the decisions to be taken with respect to the three concrete proposals put forward. These points are listed in paragraphs 3, 4 and 5 below.

3. In the present Fund there are three basic methods by which a country's position in the Fund is restored or "reconstituted" after it has made a drawing:

(a) Repurchase under Article V, Section 7(b).

(b) Repurchase under the 1952 Decision, which Decision limits outstanding drawings to "the period presumably related to the payments problem for which [the currency] was purchased from the Fund," this period to "fall within an outside range of 3 to 5 years."

(c) Sale of the currency of the country concerned in transactions with other member countries.

The relative role of these three mechanisms of reconstitution in the past 5 years has been as follows:

	Millions of dollars	Per Cent
(a)		
(b)		
(c)		
Total		100

4. It has not been suggested that over this period the mechanism of reconstitution as a whole, in which, as indicated in the preceding paragraph, repurchases under Article V, Section 7(b) played only a very small part, was either inadequate or inequitable. It may be recalled in this connection that the 1952 Decision, under which over two-thirds of reconstitution takes place now, reflected to a large extent a desire to correct the same inadequacies and inequities of the repurchase mechanism under Article V, Section 7(b), to which the proposals under 1(a) and 1(b) are addressed, viz. the facts that (i) reserve centers' (and other countries') net monetary reserves might be below their quota, and that (ii) many countries hold their reserves in currencies that the Fund could not accept in repurchase.

5. With respect to the equity of the repurchase mechanism of Article V, Section 7(b) taken by itself, the following views expressed by Executive Directors may be noted.

(a) There was no agreement that the suggested elimination of the deduction of currency liabilities, in particular insofar as it referred to the currency liabilities of reserve centers, would contribute to the equity of the system.

(b) There appeared to be agreement on the following points:

(i) Elimination of the abatement provision would contribute to the equity of the system.

(ii) The equity could perhaps be slightly improved by the inclusion in monetary reserves of certain nonmember currencies, although the holdings of these currencies by members in recent years have been small and might have been even smaller if such holdings had counted for the purpose of calculating monetary reserves.

(iii) The repurchase system under Article V, Section 7(b) and Schedule B contains many other features that have a serious bearing on the equity of this mechanism.

(iv) The system puts a heavy administrative burden on members and on the Fund.

6. In the light of the foregoing it would appear that there are a number of possible courses of action open.

(a) It could be decided to amend the Articles with respect to abatement. Although there would probably be agreement that this in itself would constitute an improvement, it would still leave the system defective from many points of view including, in the eyes of some Directors, the question of the treatment of currency liabilities. Whatever the views of Directors as to the merits of

SUBJECT COPY

this latter point, it might be felt to be inappropriate to amend the repurchase mechanism in either one or two aspects if it were not clear that after amendment the mechanism would make an important and equitable contribution to the general problem of reconstitution in the Fund.

(b) It should be noted further that if the only change to be made to the repurchase mechanism were the abolition of abatement, substantially the same effect could be obtained, without amendment, by the application of the provisions of the 1952 Decision. It would be sufficient for this purpose for the Board to decide that a member that would have incurred an obligation to repurchase under Article V, Section 7(b) but for the abatement provision, would be considered as having overcome, at least to that extent, the payments problem for which it had purchased currency from the Fund. The member would then have to make a repurchase under Section 2(a) of the 1952 Decision as soon as the calculations of its repurchase obligation under Article V, Section 7(b) indicated that it was in that position.

(c) To some extent as an alternative to (a), a decision could be taken with respect to Article V, Section 7(b) as a whole. Any of the following proposals could be justified by the evidence presented:

(i) Deletion of Article V, Section 7(b) and the corresponding Schedule from the Articles of Agreement.

(ii) Amendment of this Article in such a way as to authorize Executive Directors, before the end of any fiscal year, to suspend its provisions with respect to that year-end.

(iii) Leaving the provisions as they are, with or without a supplementary decision on abatement as indicated in paragraph 6(b) above.

SUBJECT COPY

(d) In the event that the Fund decided to follow either (c)(ii) or (c)(iii), this decision might be accompanied by a request for a thorough study by the staff of the workings of the repurchase mechanism.

7. If the decision were along the lines of 6(c)(i) or (ii) attention would have to be given to the fact that the repurchase provisions under the 1952 Decision of holdings apply only to drawings, and not to holdings in excess of 75 per cent of a member's quota that might arise otherwise, in particular from currency subscriptions in excess of 75 per cent of quota and payment of charges in the member's own currency. This aspect is not, however, of great quantitative importance.

MEMORANDUM

TO: Mr. Gold

January 11, 1968

FROM: J. J. Polak

SUBJECT: Gold Tranche Paper

I have only a few comments on this paper, these are put forward tentatively inasmuch as I did not attend the Board Meeting on this subject.

On page 2, I could see room for some improvement in draft in the long paragraph starting on line 4. In the third line of that paragraph I would suggest replacing "without objection: by "without the possibility of objection." In the next sentence, given the fact that the old Section 2 has been entirely eliminated, rather more sweeping language than "certain improvements" would seem to be appropriate. In the following sentence I would prefer "The possibility of objecting to a use of the Fund resources in the credit tranches on the ground that --------" Finally, in the next sentence it is not quite clear what there was greater sentiment for than what.

In the bottom half of page 6 one important additional argument should be introduced, namely the use of a member's own currency in Article XII, Section 6, for which the new provision is to a large extent a substitute.

The first full paragraph on page 9 introduced the absurd idea of a minimum rate of 2 per cent. It is true that the approach discussed here is incompatible with the maximum rate of less than 2 per cent but this is so obvious as hardly to require mention. I wonder whether the whole paragraph could not be deleted.

At the top of page 12 I am a little concerned about the introduction of policies in the broad power of the purposes, and without any restriction; I am not clear whether the effect of this on the status of the gold tranche is fully neutralized by the mere statement that there shall be no challenge of requests for gold tranche drawings. Since we have made it abundantly clear that the absence of challenge does not prevent the Fund from questioning the propriety of the drawing after the event, and indeed undoing it, I don't see that these provisions would preclude the Fund from introducing any kind of conditionality of gold tranche drawings it wanted, as long as the member's observation of this conditionality were only policed after the event.

cc: Mr. Altman
Mr. Fleming

Reform of the Fund

INTERNATIONAL MONETARY FUND

January 10, 1968

TO : Mr. J. J. Polak

FROM: Joseph Gold

SUBJECT: Gold Tranche, Automaticity, and Conditionality

I attach the draft of a new paper on this subject.

cc: Mr. Altman
Mr. Fleming

Gold Tranche, Automaticity, and Conditionality

Prepared by the Legal and the Research
and Statistics Departments

Approved by Joseph Gold and J. J. Polak

January 1968

The purposes of this memorandum are two-fold: to examine SM/67/144 ("Reform of the Gold Tranche - Possible Solutions", December 15, 1967) in the light of the discussion at EBM/67/107 (12/20/67) and EBM/67/111 and EBM/67/112 (12/29/67), and to consider paragraph 4 of EBD/68/3 ("Suggestions for Certain Reforms in the International Monetary Fund", January 4, 1968).

1. Need to draw and capital transfers

There appeared to be general agreement that the representation that a member now makes under Article V, Section 3(a)(i) should be retained even for requests for a gold tranche purchase. A number of views were expressed in connection with the distinction between needs arising from capital transfers and those from current payments. However, the following drafts in SM/67/144 reflected ~~reflected~~ no more than the consequential change required by the proposed automaticity of the gold tranche.

"SECTION 1. Use of the Fund's resources for capital transfers.--

(a) A member may not use the Fund's resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

SEC. 2. Special provisions for capital transfers.--Notwithstanding the provisions of Section 1(a) of this Article, a member shall be entitled to make gold tranche purchases for capital transfers."

These drafts would enable a member to increase the Fund's holdings up to 100 per cent (apart from "excluded" holdings) of the member's quota without objection, before or after the event, that this use was to meet a large or sustained outflow of capital. They would raise the level for this purpose from the present 75 per cent and in addition they would introduce certain improvements in the present text of Article VI, Section 2. The possibility of objecting that a use of the Fund resources in the credit tranches was to meet a large or sustained outflow of capital would remain. It is felt that there was greater sentiment for this solution in the Board discussions, although no agreement was reached on this or any of the other issues that were debated. During the discussions, it was made clear that the total elimination of the distinction between the two types of use would raise legal and policy issues that go far beyond the redrafting of Article VI, Sections 1 and 2.

2. Challenge

No changes were suggested with respect to the addition of Article V, Section 3(c) as proposed in SM/67/144:

"A request to buy currency under Section 3(a) of this Article shall not be subject to challenge by the Fund under any provision of this Agreement if the proposed purchase is a gold tranche purchase."

However, the treatment of the principle of freeing requests for gold tranche purchases from challenge must now be considered in relation to paragraph 4 of EBD/68/3, and this is done later in this memorandum.

If the practice were adopted that purchases in the General Account should be guided towards the currencies of countries that had abused the right to draw without challenge in the gold tranche by failing to observe the principle of need in Article V, Section 3(a)(i), this could be achieved by an amendment of EB Decision No. 1371-(62/36) "Currencies to be drawn and to be used in repurchases" (Selected Decisions, Third Issue, pp. 33-39) which would add to Chapter II ("Criteria for the selection of currencies for drawings and repurchases") a final paragraph as follows:

> "In addition to these considerations, the Fund, in selecting currencies for drawings, will consider the currencies of members that have made purchases in the gold tranche without observing the principle of need embodied in Article V, Section 3(a)(i)."

No amendment of the Articles would be necessary to give effect to this practice.

3. Charges

In SM/67/144, a redraft of Article V, Section 8(a) was offered which would give the Fund full authority to abolish the service charge or vary it up to one per cent on all transactions or on categories of transactions such as gold tranche or super gold tranche transactions. That redraft was:

> "The Fund may levy a service charge, uniform for all members and not more than one per cent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

In this connection questions were raised as to the extent of the discretion that the Fund should have. The following formulations of Article V, Section 8(a) could give effect to some of the possibilities that were discussed.

Alternative A

"Any member buying the currency of another member from the Fund in exchange for its own currency shall pay, in addition to the parity price, a service charge uniform for all members of not less than one-half percent and not more than one percent, as determined by the Fund, provided that the Fund may reduce the service charge payable on purchases in the gold tranche to less than one-half percent."

Alternative B

"Any member buying the currency of another member from the Fund in exchange for its own currency shall pay, in addition to the parity price, a service charge uniform for all members of not less than one-half percent and not more than one percent, as determined by the Fund, but no service charge shall be paid on gold tranche purchases."

4. Remuneration

The draft of an Article V, Section 9 included in SM/67/144 read as follows:

"SEC. 9. Remuneration.--The Fund shall pay quarterly remuneration to a member, at a rate uniform for all members, of not more than [one and one-half] [two] percent per annum on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter. Remuneration shall be paid in a member's own currency."

It should be noted that this draft employs the language "shall pay" and not "may pay".

The views expressed in the Board debates included the following: the rate of remuneration should be left to the discretion of the Fund; a maximum or a minimum rate should be specified; the rate of remuneration should be related to the rate of interest on holdings of special drawing rights (Article XXVI, Sections 3 and 4 of the draft amendments); the remuneration should be paid in gold; preferential payments to creditor members should be provided for in conjunction with or in addition to the payment of remuneration.

The following versions of Article V, Section 9 and Article XII, Section 6 would give effect to some of the views:

Discretion

"SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member at a rate determined by the Fund from time to time, and uniform for all members, on the amount by which seventy-five percent of the member's quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter."

Maximum or minimum rate

"SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member, at a rate uniform for all members, of not [more than x] [or] [less than y] percent per annum on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter."

Relation to special drawing rights

"SEC. 9. Remuneration.--The Fund shall pay [quarterly] remuneration to a member, at a rate equal to the rate of interest payable on holdings of special drawing rights pursuant to Article XXVI, Section 3, on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter."

If it were decided to create a legal tie between the rate of remuneration and the rate of interest on special drawing rights, an alternative procedure would be to include the substantive provision with regard to the rate in Article V, Section 9 and include the cross-reference in Article XXVI, Section 3.

Medium of payment

SM/67/144 suggested that remuneration should be paid in a member's own currency. However, it has been proposed that consideration should be given to the payment of remuneration in gold, as a parallel to the payment of charges. According to Article V, Section 8(f)

"All charges shall be paid in gold. If, however, the member's monetary reserves are less than one-half of its quota, it shall pay in gold only that proportion of the charges due which such reserves bear to one-half of its quota, and shall pay the balance in its own currency."

As a result of the second sentence of this provision, 75 per cent of the charges on Fund holdings in excess of quota presently collected is paid in member currencies.

Paragraph 9(e) of the General Arrangements to Borrow provides for the payment of interest in gold, as follows:

> "Interest and charges shall be paid in gold to the extent that this can be effected in bars. Any balance not so paid shall be paid in United States dollars."

The present draft amendments on special drawing rights provides for the payment of charges and interest in rights.

If it were decided to pay remuneration in gold, the following sentence could be the last sentence ~~could be the last sentence~~ of an Article V, Section 9.

> "Remuneration shall be paid in gold."

<u>Relation between Article V, Section 9 and Article XII, Section 6</u>

SM/67/144 proposed for consideration the following amendment of Article XII, Section 6:

> "SEC. 6. <u>Distribution of net income</u>.--The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserves shall be distributed. Any distribution shall be made to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

The suggestions in the Board's discussions included the retention of a preferential payment for creditor members, either as provided for in the present Section 6, or up to an amount which, together with the remuneration paid to them, would equal a stated percentage on the amount by which 75 per cent of their quota exceeded the Fund's average holdings of their currency during a specified period; this preference could be either cumulative or non-cumulative. In addition, it was suggested that net income be placed to reserve automatically whenever it is earned.

The suggestion that creditor members should retain the preferred position they now have under Article XII, Section 6 could be made effective by the retention of that provision in its present form, which would then give them a preference in any distribution of net income as well as remuneration under Article V, Section 9.

In view of the range of suggestions, and in order to bring about certain simplifications of practice, the following position might recommend itself. This would be in the nature of a compromise which would recognize the force of the argument that the amendment of Article XII, Section 6 and the adoption of a new Article V, Section 9 should not put the members at present entitled to a preference under Article XII, Section 6 into what might be considered a worse position. The elements of the solution would be these:

(i) All net income would go automatically to the General Reserve. Under the present practice, it goes to General Reserve provisionally at the end of each month (Decision No. 753-(58/17), April 14, 1958), but this posting is subject to an annual determination by the Board of Governors. The need for an annual determination by the Board of Governors, whether to retain net income in the reserve or to distribute it, would be eliminated.

(ii) The Board of Governors would have the authority to decide at any time whether to distribute any part of the General Reserve. If the suggestion advanced in SM/67/144 were adopted, this power would apply to the Special Reserve as well.

(iii) No distribution would be made from reserve unless there was first paid from reserve the difference between any remuneration paid under Article V, Section 9 and 2 per cent per annum for each of the five years

preceding the proposed distribution. The balance would be paid on the "creditor" position from time to time during the five years, in accordance with the formula for calculation in Article V, Section 9, and not solely on the creditor position at the time of the proposed distribution.

If Article V, Section 9 were drafted so as to give creditor members an assured remuneration of at least 2 per cent per annum, the proposal in (iii) above could be eliminated. If they were not given an assured remuneration of 2 per cent, the suggestion would be defensible only if it were possible to pay remuneration of 2 per cent. However, the suggestion would still be defensible if the rate were discretionary, provided that if any maximum were adopted it was not less than 2 per cent.

An amendment of Article XII, Section 6 to give effect to the suggestion could be drafted as follows:

"SEC. 6. Distribution of reserves.--The Fund's net income shall be placed to reserve. The Board of Governors may determine at any time what part of the reserves shall be distributed, provided that there shall be first distributed to members that were eligible to receive remuneration under Article V, Section 9 during each of the preceding five years an amount equal to the difference between two percent per annum and any remuneration actually paid. Any distribution beyond that amount shall be made to all members in proportion to their quotas, and payments to each member shall be made in its own currency."

With an amendment of this kind, Article XII, Section 2(b)(v) would be amended to read:

"Determine the distribution of the reserves of the Fund."

At the moment it reads:

"Determine the distribution of the net income of the Fund."

5. Definition of gold tranche

Three versions of a possible Article XIX (j) were included in SM/67/144, as follows:

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that the Fund may decide that purchases under specified policies on the use of the Fund's resources and amounts of the Fund's holdings of currency equal to outstanding purchases under these policies shall be excluded for the purposes of this definition."

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that for the purposes of this definition the Fund may decide to exclude purchases and holdings under policies on the use of its resources for compensatory financing of fluctuations in the exports of members."

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota."

No choice was made among these three versions in the Board's discussion of them, although there appeared to be a preference for the first or second as compared with the third.

6. Automaticity and conditionality

Part II (pp. 13-14) of SM/67/99 ("Legal Aspects of the Memorandum Entitled 'Suggestions for Certain Reforms in the International Monetary Fund' (EBD/67/97)", August 2, 1967) dealt with certain features of EBD/67/97, which have now been supplemented by paragraph 4 of EBD/68/3. The latter paragraph is as follows:

> "4. Conditionality of use of the Fund Resources
>
> It is the view of the Monetary Authorities of the European Economic Community that taking into consideration the proposals to create special drawing rights and to confirm legally the automaticity of the gold tranche, there would be no justification for extending by way of policies quasi automaticity in the credit tranches or establishing special facilities of a quasi automatic character. The possibility of such extension should be excluded in the text of the Articles of Agreement by appropriate amendments. This proposal is made without prejudice to the Fund's policy on compensatory financing."

The proposals may be summarized, therefore, in this way:

(a) Express mention should be made in the Articles of the Fund's authority to ensure that the use of the Fund's resources is in conformity with the Articles and is temporary.

(b) There should be no extension of automaticity into the credit tranches.

If these proposals were to be accepted, they could be made effective by the following amendments:

(i) Article I(v) could be amended as shown on page 14 of SM/67/99:

"To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, and

in accordance with such policies as the Fund may adopt, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

(Words underlined are added)

If it were thought desirable to repeat the effect of the two insertions in Article I(v) in the operational provisions of the Articles, this could be done briefly in a provision which could appropriately be Article V, Section 3(c):

"The Fund shall adopt policies which will ensure that a member's use of the Fund's resources will be temporary."

(ii) It would then be necessary to provide that all requests for gold tranche purchases would not be subject to challenge and that requests for all other purchases would be subject to challenge and examined to determine their consistency with the provisions of the Articles and the policies mentioned in Article I(v) and Article V, Section 3(c). This could be done as follows by an Article V, Section 3(d):

"A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, except that proposed purchases in the gold tranche shall not be challenged under any provision of this Agreement."

A provision of this kind would be in lieu of the draft provision set forth in section 2 of this memorandum with the purpose of eliminating authority to challenge requests for gold tranche purchases.

The adoption of Article V, Section 3(d) as drafted above would imply that even if the first of the three definitions of the gold tranche in section 5 of this memorandum were adopted, any "specified policies" that were "excluded" would not be based on automaticity. That is to say, they could establish Fund policies of a "floating" character but only if those policies would be consistent with the provisions of the Articles and would involve a conditionality that would ensure a temporary use of the Fund's resources. Requests under these Fund policies would be challengeable, and would have to be challenged for good reason.

MEMORANDUM

TO: Managing Director — January 10, 1968

FROM: J. J. Polak

SUBJECT: Reform of the Fund

Mr. van Campenhout, with whom I happened to sit at lunch, told me that he had had the Directors of the Ten for dinner last night to discuss with them reform of the Fund.

The Directors talked, of course, in their personal capacity but as such they seemed to agree on the following:

(a) They had no objection to the 85 per cent provision for quotas, although they saw some difficulty how the related decisions could also be brought under the 85 per cent rule.

(b) With respect to the two decisions on uniform changes in par values, they preferred to go to 90 per cent rather than 85 per cent. This could be presented as a restriction on the provision and would at the same time avoid the elimination of the present U.K. veto.

(c) On the question of interpretation, which I believe was treated much more lightly, the other Directors were willing to agree to the theoretical merit of a possibility of appeal, but I gather that they were not happy with the concrete proposal.

(d) As regards repurchase there was agreement that the Six had raised some fair questions, but I gather no clear view as to what the proper solution was. The Six themselves, according to Mr. van Campenhout, seemed more interested in having an acknowledgment of their propositions than in the precise answer that is given to the difficulties they had mentioned.

Mr. van Campenhout indicated further to me that his dinner for the Ten was only the first step in bringing the members of the Board together "as a Club;" he intends to have similar contacts with non-Ten members.

cc: Deputy Managing Director
Mr. Gold

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

Mr. J. J. Polak

Room 504 F

#1

EBD/68/3

January 4, 1968

To: Members of the Executive Board

From: The Secretary

Subject: Suggestions for Certain Reforms in the International Monetary Fund

Attached is a further memorandum from Mr. van Campenhout to the Managing Director relating to the suggestions for certain reforms in the Fund made by the European Economic Community in April 1967.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

January 3, 1968

To: The Managing Director

From: André van Campenhout

Subject: Memorandum Relating to Suggestions for Certain Reforms in the International Monetary Fund

On behalf of Messrs. Lieftinck, vom Hofe, Plescoff, Palamenghi-Crispi and myself, I am sending you herewith a memorandum completing our memorandum of June 22, 1967, relating to suggestions for certain reforms in the IMF described in the report of the Monetary Committee of the European Economic Community of April 11, 1967, which was circulated on June 26, 1967 (EBD/67/97).

It would be appreciated if you would circulate this memorandum to the members of the Executive Board.

Memorandum relating to suggestions for certain reforms in the International Monetary Fund

We refer to our memorandum of June 22, 1967, concerning proposals contained in the Report of the Monetary Committee of the European Economic Community of April 11, 1967. What follows completes the list of the proposals contained in the above-mentioned memorandum which are considered essential by the Monetary Authorities of the European Economic Community. Our memorandum of the 22nd June and the present one should be considered as the basis of our discussions with regard to the proposals of the European Economic Community.

Points 1, 2 and 3 of the present memorandum concern decisions affecting international liquidities and should in our view be covered by the same majority as the decision to allocate special drawing rights under the proposed new facility.

Point 4, which concerns the conditionality of the use of the Fund resources, completes paragraph II-A (Use of the Fund Resources - Conditions for drawings within the credit tranches) of our memorandum of June 26th and should be discussed together with it.

Point 5 which concerns interpretation of the Articles of Agreement, is of a procedural nature and self-explanatory.

1. Increases of quotas

Proposals for general increases of quotas, special adjustments of quotas connected with those proposals, and associated conditions, particularly concerning gold payments, should be made by a majority of 85 per cent of the total voting power of the membership of the Fund.

No changes are proposed with regard to requests for the adjustment of individual quotas not connected with proposals for general increases of quotas.

2. Uniform changes in par values

Article IV, Section 7, should be amended as follows:

(a) The decision to make a uniform proportionate change in the par values of the currencies of members should be made by a majority of 85 per cent of the total voting power.

(b) The proviso that "each such change is approved by every member which has ten per cent or more of the total of the quotas" should be eliminated.

3. Maintenance of the gold value of the Fund's assets

Article IV, Section 8(d). The words "by a majority of 85 per cent of the total voting power" should be added to the phrase "unless at the time when such a change is proposed the Fund decides otherwise".

4. Conditionality of use of the Fund Resources

It is the view of the Monetary Authorities of the European Economic Community that taking into consideration the proposals to create special drawing rights and to confirm legally the automaticity of the gold tranche, there would be no justification for extending by way of policies quasi automaticity in the credit tranches or establishing special facilities of a quasi automatic character. The possibility of such extension should be excluded in the text of the Articles of Agreement by appropriate amendments. This proposal is made without prejudice to the Fund's policy on compensatory financing.

5. Interpretation of the Articles of Agreement

It is considered that Article XVIII of the Articles of Agreement which provides that questions of interpretation of the Articles of Agreement can be decided by simple majority of the Executive Directors and, on appeal, by the same majority of the Board of Governors, is not quite adequate. Matters of interpretation affect important rights and obligations of member countries and it is felt that minorities should be protected in a way more in line with traditionally accepted procedures. It is suggested that this could be achieved by allowing members who would not be satisfied with the decisions taken in accordance with the present procedures, to have recourse, in the last resort, to the procedures provided for in Article XVIII (c) with regard to disagreements arising between the Fund and a member which has withdrawn or between the Fund and any member during the liquidation of the Fund. To that end, Article XVIII (c) should be amended accordingly and the words "whose decision shall be final" in Article XVIII (b) should be deleted.

January 3, 1968

MEMORANDUM

TO: Mr. Gold
Mr. Altman

January 4, 1968

FROM: J. J. Polak

SUBJECT: Repurchase

I have set down in the attached notes some very provisional ideas as to the possible content of a policy paper on repurchase.

I should like to have your reaction to this at your convenience.

SUBJECT COPY

JJP:Jan. 4, 1968

Repurchase and Related Questions—Possible Contents of Policy Paper

1. The central issue to be born in mind is that there are three ways to restore a country's position after drawing, not one:

(a) Repurchase under Article V, Section 7.

(b) Repurchase under the 1952 Decision.

(c) Sale of the currency of the country concerned in transactions with other members.

An appraisal of the system and any proposals for reform should be based on consideration of all three methods of reconstitution.

2. The first method has never worked in a fully satisfactory way for more reasons than those brought out in the Report of the Deputies of the Six.

3. A serious attempt was made to revise the system in 1951-52 but the final decision was to introduce a new system on top of it in the form of the three to five year limit incorporated in the 1952 Decision.

4. The first system works now even less satisfactorily than in 1952 as neither dollar nor sterling are acceptable in repurchase. The system produces practically no repurchases. Insofar as it is inequitable as among members, it is not that it favors reserve centers but rather that while it is practically inoperative in general it occasionally catches some member, and that on account of some special change in its reserves.

5. The third method has much increased in importance; it is believed to be good enough to do the whole job in the SDR scheme.

6. As a basic appraisal of the whole scheme it can be said to be mostly equitable. The two deficiencies of the first method about which the Common Market countries are particularly concerned could be eliminated by the operation of the third method; as a matter of fact the third method probably already works in such a manner as not to give any advantage to reserve centers. While the changes proposed by the EEC countries would probably improve the equity of the first method, they would still not make it a satisfactory system by itself, and any other oddities would remain.

7. If anything is to be done to the "reconstitution mechanism" of the General Account—one wonders whether it would not be more satisfactory to put the mechanism of Article V, Section 7 out of operation, at least for as long as the dollar is not usable in repurchase. Short of deleting the whole provision from the Articles, would it be possible to assume or introduce a power for the Executive Directors to suspend the mechanism for one year at a time, whenever they were of the opinion that the results of this mechanism would not be equitable?

SUBJECT COPY

The Managing Director January 4, 1968

Joseph Gold

Repurchase

Mr. Polak and I have had a word together about his memorandum to you of January 4 and agreed that I should send you these notes.

I believe that it would be premature to suggest positions on repurchase at the moment, but it would be useful to indicate that some may be forthcoming. Accordingly, I would suggest a statement by you at the opening of the meeting which could run along the following lines:

"The Executive Directors will be resuming today their discussion of one of the aspects of the reforms of the Fund which have been proposed in Mr. van Campenhout's memorandum of June 26, 1967. The subject is Repurchase and you have had two staff studies, largely of a technical character. There has been a preliminary discussion of these papers, and it seems to me useful if the Board could explore the matter further today. We could take up again any outstanding technical questions and the Executive Directors might begin to express their reactions on the policy aspects. However, I would assume that we are not likely to reach any consensus today on whether there should be any amendments of the repurchase provisions of the Articles and, if so, what they should be. The discussion today would help the staff and enable them to prepare a memorandum along the lines of the most recent memorandum connected with the gold tranche. That is to say, the memorandum could set forth possible solutions in a comprehensive and integrated manner. That document could be the basis of the next discussion. I am sure that you would not expect me to give any date for the appearance of the new paper, but the staff will proceed with it as rapidly as possible."

Cc: Mr. Polak
Mr. Altman
Mr. Hebbard

JG:rk

MEMORANDUM

TO: Managing Director January 4, 1968

FROM: J. J. Polak

SUBJECT: Repurchase

I believe we should give the Board some early guidance on what we believe to be a reasonable solution of this aspect of reform of the Fund. This can probably not be done at the beginning of tomorrow's meeting, but you might say either at the beginning of that meeting or after the discussion has worn itself out, that you or the staff will be putting forward some policy views.

cc: Mr. Gold
Mr. Altman

The Files

Joseph Gold

Reform of the Fund

December 22, 1967

I have had two conversations with Mr. van Campenhout yesterday and today about the status of the Common Market's proposals for the reform of the Fund. He informed me that the Common Market's proposals continue to include those set out in the attachment to his memorandum of June 22, 1967 to the Managing Director (EBD/67/97 of June 26, 1967). These related substantially to the gold tranche, Article VI, and repurchase. These matters have already been studied in staff memoranda, and suggested solutions have been offered with respect to the gold tranche. The further items, the study of which is regarded as "essential" by the Common Market are as follows:

1) The definition of the zone of automaticity for the future. In this connection, the compromise worked out with Mr. van Campenhout in lieu of an 85 per cent voting majority stands. However, there are still some suggestions for minor redrafting by one or two of the Common Market Executive Directors. Mr. van Campenhout thinks that he can reach final agreement with them in a few days.

2) An 85 per cent majority should be required for a decision on general increase in quotas, and the same majority should apply to associated matters such as gold subscriptions and, presumably, special increases that are connected with a general review.

3) An 85 per cent majority should be required for a uniform proportionate change in par values under Article IV, Section 7, and for the waiver of the maintenance of the gold value of the Fund's assets under Article IV, Section 8(d). The "10 per cent" countries would be deprived of their veto.

4) There should be some means of appeal to an outside tribunal by an aggrieved member after an interpretation has been adopted by the Board of Governors. I gathered that there is little steam behind this last proposal except on the part of the French.

Mr. van Campenhout will submit a further memorandum to the Managing Director in which he will state the essential proposals. He will delay this for a few days because there appear to be conflicting instructions on whether the new list is to be submitted in substitution for the lengthy list of suggestions contained in the Monetary Committee's

original memorandum dated April 11, 1967 (circulated as a buff document on April 19, 1967). If that were done, there would still be some general reservation of the right to bring forward other topics. The alternative procedure would be for Mr. van Campenhout to submit his new memorandum without saying that it was in substitution for the Monetary Committee memorandum. Under this alternative, the earlier memorandum would quietly be forgotten if the negotiations succeed.

cc: The Acting Managing Director
Mr. Schweitzer
Mr. Polak, Mr. Fleming
Mr. Altman, Mr. Habermeier
Mr. Sturc, Mr. Finch
Mr. Hebbard
Mr. Whittome

Clearcopy Onion Skin
25% COTTON

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

December 22, 1967 - 67/52

Reform of Fund

December 22, 1967

TO: Members of the Executive Board

FROM: The Secretary

SUBJECT: Service Charges on Drawings in Gold and Credit Tranches

In response to several questions raised in Executive Board Meeting 67/107 on December 20, 1967, the following information is provided (in millions of U.S. dollars):

Fiscal Years Ending April 30	Income from ½% Service Charges on Drawings In			Gross Income	Column (2) In Per Cent of Column (5)	Column (4) In Per Cent of Column (5)
	Gold Tranches	Credit Tranches	Total			
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1958	1.0	2.3	3.3	23.6	4	14
1959	0.2	1.1	1.3	27.2	1	5
1960	0.1	0.7	0.8	21.0	1	4
1961	1.5	1.4	2.9	14.6	10	20
1962	3.2	8.0	11.2	33.1	10	34
1963	0.9	2.0	2.9	31.0	3	9
1964	1.8	1.3	3.1	36.4	5	9
1965	5.2	4.3	9.5	47.7	11	20
1966	3.0	11.1	14.1	81.3	4	17
1967	3.6	1.7	5.3	89.6	4	6
1968*	0.5	2.6	3.1	85.9	1	4

* Seven months ended November 30, 1967 converted to twelve months basis.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/67/144

December 15, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Reform of the Gold Tranche--Possible Solutions

The attached memorandum with respect to reform of the gold tranche is circulated for consideration by the Executive Directors at the meeting of the Executive Board tentatively scheduled for Wednesday, December 20, 1967.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Reform of the Gold Tranche--Possible Solutions

Prepared by the Legal and the Research and Statistics Departments

Approved by Joseph Gold and J. J. Polak

December 15, 1967

In SM/67/41 the staff examined the legal aspects of the reform of the gold tranche, and in SM/67/99, SM/67/133, and SM/67/135 it dealt with the legal aspects of the specific suggestions for such reform that were contained in the memorandum submitted by Mr. van Campenhout on behalf of a number of Executive Directors on June 26, 1967 (EBD/67/97). The present memorandum represents an attempt on the part of the staff to indicate choices among the solutions which are legally possible so as to arrive at a reasonable and consistent set of provisions. The earlier memoranda should be consulted for detailed discussions of the variant drafts.

1. Need to draw

Mr. van Campenhout's Memorandum contains the following suggestions:

> "I-A. Members eligible to use the Fund's resources would have the right to draw within the limits of their gold tranche position only in case of need and not for the sole purpose of changing the composition of their reserves. ...
>
> II-C. If the de jure automaticity of the gold tranche is accepted, Article VI, Section 2, ceases to be applicable and a simplification in the text of Article VI, Section 1, might be envisaged."

As indicated in SM/67/99, the first suggestion reflects the present legal position under the concept of "presently needed" in Article V, Section 3(a)(i). Accordingly, no amendment would be required in order to confine gold tranche purchases to cases of need except to the extent that this may be necessary because of the ambiguity in the language of Article VI, Section 2. As pointed out in SM/67/135, a possible interpretation of that provision, although not a plausible one, is an interpretation that would permit purchases in the gold tranche, in the circumstances specified in that provision, to be made without need on the part of the purchasing member.

In order to make it clear beyond any doubt that a member may not use the Fund's resources even in the gold tranche without need, and in order, at the same time, to eliminate the distinction between needs arising from capital transfers and those from current payments in relation to gold

tranche purchases as defined above, the best course of action would seem to be to amend Sections 1(a) and 2 of Article VI as follows:

"SECTION 1. Use of the Fund's resources for capital transfers.--

(a) A member may not use the Fund's resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

SEC. 2. Special provisions for capital transfers.--Notwithstanding the provisions of Section 1(a) of this Article, a member shall be entitled to make gold tranche purchases for capital transfers."

It should be pointed out that these amendments are based on the assumption that a definition of the gold tranche would be included in the Articles. This topic is considered below in part 5 of this memorandum.

The amendments indicated above are based on the assumption that it is not desirable to abolish the distinction between capital transfers and current payments for the purposes of all uses of the Fund's resources including those in the credit tranches. The proposed amendments (a) would remove the legal obstacles to the use of the Fund's resources in the gold tranche to meet capital transfers, while leaving unaffected the power of the Fund to call for a limitation of the outflow of capital in connection with the use of the Fund's resources in the credit tranches, and (b) would make it clear that the Fund's resources may be used, even in the gold tranche, only in case of need and not for the sole purpose of changing the composition of the using member's reserves. In addition, the amendments would make the criterion of need for purchases in the gold tranche similar to the criterion proposed for the use of special drawing rights under the new facility. The basic rule for the use of these rights is set forth as follows in the proposed amendments for the establishment of the facility based on special drawing rights.

"In transactions among participants, a participant will be expected to use its special drawing rights only to meet balance of payments needs or in the light of developments in its total

gross reserves and not for the sole purpose of changing the composition of such reserves. The Fund shall specify the components of gross reserves for the purposes of this and other provisions of this Agreement." [Article XXV, Section 2(a)]

2. Challenge

Mr. van Campenhout's Memorandum contained the following suggestions:

"I-A. ... In no case would the Fund have authority to prevent such a drawing. This applies to the Fund's right to challenge the representation envisaged in Article V, Section 3, whatever the legal basis of the right to challenge.

B. In view of A above, the representation in respect of drawings within the gold tranche could be eliminated."

Amendments that would give effect to these suggestions have been indicated in paragraphs 13 and 15 of SM/67/99 (pp. 7 and 8). Under the first of these amendments the obligation of members to make the representation required under Article V, Section 3(a)(i) would be retained even for purchases in the gold tranche. The second is based on the assumption that the representation would be eliminated. For the reasons given in SM/67/99, it is felt that it would be preferable to retain the representation. Accordingly, the Articles could be amended by adding the following provision to Article V, Section 3 as Section 3(c):

"A request to buy currency under Section 3(a) of this Article shall not be subject to challenge by the Fund under any provision of this Agreement if the proposed purchase is a gold tranche purchase."

This amendment of the Articles would eliminate the right of prior challenge in respect of purchases in the gold tranche, thereby according them, in this respect, treatment similar to the treatment that will be accorded to transactions in special drawing rights. Under Article XXV, Section 2(b) of the proposed Amendment:

"... The use of special drawing rights will not be subject to prior challenge on the basis of the expectation in (a) above, but the Fund may make representations to a participant that fails to fulfill the expectation and may designate the participant under Section 5 of this Article to provide currency to the extent of the failure to fulfill the expectation. A participant that persists in failing to fulfill this expectation shall be subject to Article XXIX, Section 2(b)."

If it were considered desirable, the principle of guiding drawings in the General Account towards the currencies of countries that have abused the right to draw without challenge in the gold tranche by failing to observe the principle of need enunciated in Article V, Section 3(a)(i) could be introduced into the policies of the Fund on currencies to be drawn.

3. Charges

Mr. van Campenhout's Memorandum contains the following suggestion:

> "The charges provided for in Article V, Section 8(a) would be abolished." (I-E. first sentence)

So long as transactions between the Fund and its members take place at par, some service charge may be necessary to obviate the arbitrage profits that could arise from purchasing currencies that are at a premium in the market and repurchasing, sooner or later, with currencies that are at or below par or with gold. The service charge fulfills two other functions: discouraging drawings for which the need is trivial or slight, and providing income to the Fund. Complete abolition of the service charge might make it difficult to pay a reasonable rate of remuneration to members whose currencies the Fund holds in amounts smaller than three-fourths of their quotas or even lead to an increase in charges. For these reasons it is worth considering, as suggested in paragraph 21 on p. 11 of SM/67/99, the possibility of increasing the discretionary authority of the Executive Directors and enabling, but not obliging, them to reduce or eliminate the service charge for all gold tranche purchases. This could be achieved by an amendment of Article V, Section 8(a), which would remove the lower but not the upper limit of the service charge as follows:

> "The Fund may levy a service charge, uniform for all members and not more than one per cent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

As pointed out on page 11 of SM/67/99, this amendment, if adopted, would give the Executive Directors the power to decide to eliminate the service charge for all gold tranche purchases or for super gold tranche purchases only. Furthermore, under this amendment the charge could, if necessary, be reintroduced or increased after reduction, without the need for any further amendment.

4. Remuneration

Mr. van Campenhout's Memorandum contains the following suggestion:

"The super gold tranche positions would bear interest (within maximum and minimum limits that might be specified)." [I-E. second sentence]

This suggestion was examined in SM/67/99 (pp. 11-12), which indicated how the Articles could be amended to give effect to the suggestion. The question of the payment of a return to members on the amounts by which the Fund's holdings of their currencies are below seventy-five per cent of their quotas was discussed at EBM/67/62, 67/63, 67/68, 67/74, and 67/75, and another memorandum, SM/67/133 was circulated examining the subject further in the light of the discussion at these meetings.

The principal advantage of the payment of a remuneration to members whose currency is held by the Fund in an amount less than seventy-five per cent of quota, as compared to the distribution of net income under Article XII, Section 6 is as follows. A distribution of net income is restricted in amount to the net income of the year with respect to which the distribution is made, and, therefore, it may not be payable with respect to years of low net income, but remuneration is an expense that is payable even if this results in a negative net income for the year. Remuneration payments therefore can be made more uniformly from year to year. This does not mean, however, that remuneration can be set with impunity at a level which, taking one year with another, leads to net losses and forces the Fund to trench deeply on its reserves. It would seem prudent, therefore, to make the payment of remuneration discretionary rather than mandatory, and consequently to refrain from laying down any minimum level for such payments. This result could be achieved by adding, as suggested in SM/67/133, a provision as Section 9 to Article V, as follows:

"SEC. 9. Remuneration.--The Fund shall pay quarterly remuneration to a member, at a rate uniform for all members, of not more than [one and one-half][two] percent per annum on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding quarter. Remuneration shall be paid in a member's own currency."

As indicated in SM/67/133, with an amendment such as the one set forth above, it would become necessary to amend Article XII, Section 6. It is felt that the following amendment of that provision, which would make available for distribution the Fund's Special as well as General Reserve, should be considered:

"SEC. 6. Distribution of net income.--The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserves shall be distributed. Any distribution shall be made to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

5. Definition of gold tranche

In SM/67/99 (pp. 4-5), it was explained that for certain purposes the concept of the gold tranche has been somewhat changed as a result of paragraph 10 of Executive Board Decision No. 2192-(66/81) of September 20, 1966 on the compensatory financing facility. Accordingly, it was suggested that a definition of the gold tranche be added to Article XIX on Explanation of Terms. One of the formulations offered in SM/67/99 (p. 7) was the following:

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that the Fund may decide that purchases under specified policies on the use of the Fund's resources and amounts of the Fund's holdings of currency equal to outstanding purchases under these policies shall be excluded for the purposes of this definition."

This formulation would permit the exclusion of purchases and holdings under the compensatory financing facility and purchases and holdings under any other policies on the use of the Fund's resources establishing "floating" facilities. Under an alternative formulation (p. 8), the exclusion of purchases and holdings that would be permitted would be confined to those under policies on compensatory financing. This read as follows:

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that for the purposes of this definition the Fund may decide to exclude purchases and holdings under policies on the use of its resources for the compensatory financing of fluctuations in the exports of members."

There is a third possibility, that is, to revise paragraph 10 of Executive Board Decision No. 2192-(66/81) so that the compensatory financing facility "floated" only in relation to the credit tranches. Under paragraph 10 of Executive Board Decision No. 2192-(66/81), the Fund applies its tranche policies to requests by a member as if the Fund's holdings of the member's currency were less than its actual holdings of that currency by the amount of any drawings outstanding under the compensatory financing facility. If this aspect of the compensatory financing policy were revised as indicated here, it would apply only with respect to the Fund's holdings of a currency above 100 per cent of quota. In that event, the definition of the gold tranche could be as follows:

"(j) Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota."

It would be possible to avoid the inclusion of a definition altogether by reformulating all of the amendments referred to in parts 1 to 4 of this memorandum so that they referred to the quota level for the Fund's holdings of a currency.

6. Consequential changes

The reforms in the gold tranche referred to in this memorandum may call for certain consequential changes in the Fund's decisions or practices. Thus:

(a) Consistently with what is said on pp. 16-17 of SM/67/41 and page 9 of SM/67/99, no amendments of Article XX, Section 4(d)(ii) and Article II, Section 2 and of the pertinent provisions of Membership Resolutions are suggested that would accord pre-par value transactions in the gold tranche the same legal automaticity as would apply to other gold tranche transactions. A suggestion for a change in the last sentence of paragraph (b) of Executive Board Decision No. 1678-(64/22), of April 22, 1964, would have to be made in due time.

(b) Any necessary modification of the provisions of the General Arrangements to Borrow would also be suggested in due time (SM/67/41, p. 18 and SM/67/99, p. 9).

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

Reform - JJP

CABLE ADDRESS
INTERFUND

MEMORANDUM

TO: Mr. Polak

December 13, 1967

FROM: J. Marcus Fleming JMF

I am afraid that I was unable to persuade the lawyers to put in anything about the right to draw for the purpose of conversion. They argued, with some force I thought, that the issue arose not with respect to the drawings on the gold tranche but with respect to the drawings on the credit tranches, and was to this extent irrelevant to the subject matter of the paper. Moreover, they felt that it would provoke a great deal of discussion that was unnecessary in view of the fact that they themselves were prepared to maintain that the right to draw for conversion purposes was legally well established. As a matter of fact, Mr. Gold appeared to be prepared to carry the point even further than I myself would care to see it carried, in that he would allow the United States to draw because of a bilateral conversion demand even though it might itself, on balance, be accumulating reserves. My own feeling is that we would do well to avoid debate on this subject, which might lead the lawyers to make somewhat rash statements.

However, I reserved your position fully and said that you might wish to raise the matter with Management.

Mr. J. Marcus Fleming

December 13, 1967

Joseph Gold

Reform of the Fund: Gold Tranche and Conditionality

You are unhappy and dissatisfied because you read "temporary" to mean as soon as possible. In the Fund, however, we use "temporary" to mean "the period reasonably related to the payments problem" for which the member draws, provided, of course, that the period does not go beyond three to five years. "Temporary" gives enough scope for the choice of the appropriate conditions.

cc: The Managing Director
The Deputy Managing Director
Mr. Polak

Mr. Gold

December 12, 1967

J. Marcus Fleming

Reform of the Fund: Gold Tranche and Conditionality
Your Memorandum for Files of December 11, 1967

I do not feel very happy about your preference for Version II of a proposed Article V, Section 3(c) over Version I or about the fact that Mr. van Campenhout's proposal now adopts Version II in preference to (c) of Version I.

The reason for my unhappiness lies in dissatisfaction with the reason which you give in favor of Version II at the foot of page 1 of your memorandum, where you say that "conditionality [is] implicit in temporary use." While it may be true that some conditionality is required to implement temporary use it is not true that all conditionality is based on this consideration. An objective of conditionality of at least equal importance is that of avoiding resort to "measures destructive of national or international prosperity." Economically speaking, we cannot get round the fact that the purpose of providing financial assistance through Fund resources is to enable countries to <u>avoid</u> a premature elimination of their statistical payments deficit--an elimination which could be achieved only by measures such as restrictions, unemployment, etc., that are destructive of prosperity. The conditionality most appropriate to the use of Fund resources must therefore include the avoidance of such measures though it may also include other measures designed to ensure that a more satisfactory equilibrium is restored at a later date.

cc: Managing Director
Deputy Managing Director
Mr. Polak ✓

Mr. Palak

(Reform)

Confidential

December 11, 1967

MEMORANDUM FOR FILES

Subject: Reform of Fund - Gold Tranche and Conditionality

The following is a circumstantial account of recent developments in this field. At Mr. van Campenhout's request, the details of "national" positions should be kept confidential.

On December 8, Mr. van Campenhout telephoned to say that his German and French colleagues were dissatisfied with an amendment of Article I (v) which did not refer to conditionality (SM/67/99, p. 14). I told him that the draft of the amendment on page 14 seemed to me to be complete but if some elaboration was required, the second insertion could read: "and in accordance with such policies as the Fund may adopt to ensure that the use of its resources will be consistent with the provisions of the Fund."

Later in the day, he telephoned to say that his colleagues felt that there should be some reference to conditionality in the body of the Articles. He suggested that we meet Monday morning to see what could be done in this respect. We met early on December 11th, and he showed me two texts, one of which had been telephoned to Mr. vom Hofe from Bonn. It proposed inserting in Article V, Section 3 some reference to the requirement that a member should have policies consistent with the provisions and appropriate to restore equilibrium in its balance of payments if a proposed purchase would increase the Fund's holdings above 100 per cent of quota, but the Fund could waive this requirement by an 85 per cent majority. Mr. van Campenhout told me that much of the German thinking on amendment was colored by the distaste for the compensatory financing facility. The second draft was prepared by Mr. Mentré and was along similar lines except that it did not contain any waiver provision.

I pointed out certain technical flaws in the two drafts and showed Mr. van Campenhout three versions of a possible Article V, Section 3(c) which in each case would be followed by Section 3(d) as in my Memorandum for the Files of December 5, 1967. These three versions are attached. I told Mr. van Campenhout that they were not set forth in any order of preference. My first preference would be to amend Article I (v) only, and as suggested in SM/67/99, p. 14. My second preference would be an expanded amendment of Article I (v). If that too failed, then II of the three drafts attached, coupled with an amendment of Article I (v) as shown in SM/67/99, p. 14, would be my third choice. In short, II would be preferable to versions I and III of Section 3(c). It had the enormous advantage that the concept of the temporary use of the Fund's resources was already established by an Article XVIII interpretation, and conditionality was implicit in temporary use.

Mr. van Campenhout said that he shared my views.

I reminded him that the definition of the gold tranche was an important question that must not be overlooked. It raised the difficult question, already discussed in the legal memoranda, whether the definition should confine excluded holdings to the compensatory financing facility or should give a general authority to exclude holdings from the determination of the gold tranche. In short, would the compensatory financing facility be the only one that could "float" in the future? I gathered that the Common Market Executive Directors had not yet concentrated on this question.

Later in the morning, Mr. van Campenhout telephoned to say that he had not been able to speak to the French Executive Director, but he had convinced Mr. Lieftinck and half convinced Mr. vom Hofe that the German draft should not be pursued, and that one of the proposals outlined above should be considered. On further thought, Mr. van Campenhout felt that he preferred I in the attached drafts, so as to avoid the risk that some people might think that it was confined to the repurchase provisions, although he acknowledged the force of my case for II.

Conclusion

After lunch, Mr. van Campenhout informed me that he had persuaded his colleagues, who had agreed that he should cable the Monetary Committee with a unanimous proposal as follows:

(i) Article I (v) as amended on p. 14 of SM/67/99 with no further amendment, so that it will read:

"To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, and in accordance with such policies as the Fund may adopt, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." (Words underlined are added)

(ii) Version II of a proposed Article V, Section 3(c):

"The Fund shall adopt policies which will ensure that a member's use of the Fund's resources will be temporary."

(iii) The draft of what will be Article V, Section 3(d) as set forth in my Memorandum to the Files of December 5, 1967:

"A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, provided that proposed purchases in the gold tranche shall not be challenged under any provision of this Agreement."

Mr. van Campenhout has told his colleagues that I have collaborated with him on the technical aspects of these texts, but that neither Management nor staff is taking any policy position on them.

I told him that he had done a remarkable job of persuasion and that I would recommend the texts to the Managing Director if the decision is to deal with conditionality in the Articles.

Joseph Gold
General Counsel
and
Director, Legal Department

cc: Managing Director
Deputy Managing Director
Mr. Polak
Mr. Fleming

JG:rk

I.

(c) The Fund shall adopt policies which will ensure that a member's use of the Fund's resources will be temporary and in all other respects in accordance with the provisions of this Agreement.

(d) A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, provided that proposed purchases in the gold tranche shall not be challenged under any provision of this Agreement.

II.

(c) The Fund shall adopt policies which will ensure that a member's use of the Fund's resources will be temporary.

III.

(c) A member's use of the Fund's resources shall be temporary and in all other respects consistent with such policies as the Fund may adopt in connection with the use of its resources.

CONFIDENTIAL

The Files

December 8, 1967

Joseph Gold

Reform of the Fund

Mr. van Campenhout has informed me that his colleagues among the Executive Directors have agreed with him on a letter to Mr. van Lennep which will recommend the text on the demarcation of automaticity as quoted on page 3 of my Memorandum to the Files of December 5, 1967. He has run into one problem with Mr. Plescoff, however, on the insertion of the following words in Article I (v) which were advanced as a possibility in SM/67/99, p. 14 in order to cope with the insistence of the Monetary Committee (France ?) on some express mention of conditions:

> "To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, and in accordance with such policies as the Fund may adopt, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." (Words underlined are added.)

Mr. Plescoff feels that this language needs to be amplified in some way, presumably to refer explicitly to conditions. Mr. van Campenhout is still trying to talk him out of this and into the acceptance of the language as set out above, but he is not confident that he will succeed. Mr. Plescoff has also told me independently that the language as drafted above is not sharp enough.

cc: The Managing Director
The Deputy Managing Director
→ Mr. Polak
Mr. Fleming

Mr. Polak

Reform of Fund

Confidential

December 5, 1967

MEMORANDUM FOR FILES

Subject: Other Reforms of the Fund: Conversation with Mr. van Campenhout

I had a lengthy conversation with Mr. van Campenhout today which had two purposes: (a) to get from him a more detailed report on the Rome Meeting of the Monetary Committee and (b) to discuss with him the possibility of an amendment of the Articles which would confine automaticity to the gold tranche. The discussion of the Rome Meeting was as follows:

1. It was agreed there that an eighty-five per cent majority should be required for quota adjustments but only in connection with general reviews of quotas. However, this would include individual increases that were part of the same exercise. I asked Mr. van Campenhout whether anyone had discussed the idea of a participation clause instead of a new special majority. He said that this had not come up, but he liked the idea and thought that it might be an eventual compromise.

2. There was agreement that an eighty-five per cent majority should be required for the extension of automaticity into the credit tranches, but this idea would not be pursued if it proved feasible to draft a satisfactory amendment of the Articles that would limit automaticity to the gold tranche under some suitable definition of the gold tranche. He had said that he would be in touch with me in order to see if this was possible, and he has to report back to the Monetary Committee on this topic as soon as possible.

3. France advanced the proposal that Article IV, Section 1 should be amended so that it would contain no reference to the U.S. dollar. Italy replied that it would then be necessary to substitute a unit, which presumably would have to have the same gold content as the dollar. France objected to this. Belgium intervened to say that it preferred a unit of account in any event. The issue has been left open for the Ministers to decide. Meanwhile, it has occurred to Mr. van Campenhout that elimination of the dollar might entail other amendments of the Articles, and I pointed out that there might be difficulties under past Membership Resolutions and the domestic legislation of a number of countries. I have promised to give him a note on this matter.

4. It was proposed that Article IV, Section 7 should be deleted but this was opposed on the ground that if the United States should contemplate ceasing to buy and sell gold, Article IV, Section 7 might provide a more orderly procedure for the world at large. In the result, it was agreed that Article IV, Section 7 should be retained but without the veto for the "ten per cent countries" and that an eighty-five per cent majority should be required for a uniform proportionate change of par values and for the waiver of the maintenance of gold value under Article IV, Section 8(d).

5. France proposed that an eighty-five per cent majority should be required for the adoption of policies relating to gold, including subscriptions on quota increases and investments. It was agreed that the question of gold subscriptions on general increases in quotas would be treated as part of the quota exercise and, therefore, the eighty-five per cent majority would be required. In other words, that majority would be necessary under the rubric of general quota adjustments and not gold policy in general. On investments, Mr. van Campenhout said that he had convinced the Monetary Committee to rely on an implied power exercisable in the interests of the Fund rather than an explicit legitimation of investment exercisable in the interest of members. Although the continuing legality of the present investment program was questioned by some, it was agreed that the problem should be raised as one of policy in due time and not as a part of the reform of the Fund.

6. France is strong in support of some special procedure for interpretation but has given up the proposal of an eighty-five per cent majority. Germany is divided on the question, but I gather on the whole opposed. Mr. van Campenhout says that the other countries are not interested one way or the other. I gather that he is himself active in support of some reform. Many vague ideas are being canvassed but there is concern that any new step might seriously inhibit the Fund. Any new procedure would somehow have to be confined to a "pure" point of interpretation, and it might be available only as an appeal from the Board of Governors itself. Mr. van Campenhout spoke against appeals to any existing international court but seems to favor the <u>ad hoc</u> tribunal of Article XVIII (c), although he recognizes that one could have incompetent arbitrators. Another idea is that after appeal to a tribunal, the tribunal could send the matter back to be reconsidered by the Executive Directors, or the Board of Governors could take the advice of some outside tribunal before making its own decision. (An oddity of this whole affair is that the dissatisfaction of the few critics of the present situation seems to involve the absence of the codification of present practices rather than the interpretative process which has brought about those practices.) Mr. van Campenhout says that it is quite possible that the subject will be abandoned, and he recommends that we should forget about it for the time being.

7. The idea of a special committee of Governors has been abandoned.

8. All other ideas advanced originally by the Monetary Committee are probably dead, but it may be that France will want to make some formal fight for them in the last ditch. Mr. van Campenhout recommends that as a practical matter we forget about them for the time being.

9. Mr. van Campenhout expects that it will be necessary to have a further discussion with the Monetary Committee, after which he will produce a further memorandum addressed to the Managing Director.

On the proposal that automaticity be confined to its present scope in lieu of a special majority for any possible future extension of automaticity, I told Mr. van Campenhout that I personally thought that this might be a successful compromise, but I did not know the views of management. I told him that I had tried many versions of a text, and the one which appealed to me as the simplest and most effective was the following, which would be included in Article V, Section 3:

"A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, provided that proposed purchases in the gold tranche shall not be challenged under any provision of this Agreement."

Mr. van Campenhout said this provision made a very great appeal to him, and he would almost certainly recommend it to Mr. Van Lennep, the Chairman of the Monetary Committee. The following points were made in our discussion of the provision:

(i) He asked whether I contemplated that the reference to policies would continue to appear in the proposed amendment of the purposes as suggested on page 14 of SM/67/99. I replied that we could follow that course or not, and it did not seem important to me which course we adopted. He said that the solution that he would like would be to amend the purposes as suggested and then give body to that amendment of the purposes by reference to policies in the foregoing draft provision.

(ii) Mr. van Campenhout said that if the staff preferred to retain the representation for gold tranche purchases, he would not oppose that solution. I told him that to the best of my knowledge the staff did wish to retain the representation as an "adequate safeguard."

(iii) We agreed that compensatory financing purchases were not an automatic facility.

Joseph Gold
General Counsel
and
Director, Legal Department

cc: Managing Director
Deputy Managing Director
Mr. Polak
Mr. Fleming

JG:hk

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

Reform of Fund

FOR AGENDA

Mr. J. J. Polak

Room 504 F

#1

SM/67/135

December 1, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Legal Aspects of the Memorandum Entitled "Suggestions for Certain Reforms of the International Monetary Fund" - Use of Gold Tranche for Capital Transfers

The attached memorandum is the second of the two legal papers promised at Executive Board Meeting 67/75 in connection with further discussions of the gold tranche.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Legal Aspects of the Memorandum Entitled "Suggestions for Certain Reforms of the International Monetary Fund"-- Use of Gold Tranche for Capital Transfers

Prepared by the Legal Department

Approved by Joseph Gold

November 30, 1967

At EBM/67/75, Mr. van Campenhout stated that the Memorandum addressed by him to the Managing Director on June 22, 1967 and the attachment thereto (EBD/67/97) should not be understood as suggesting the total abolition of the distinction between difficulties resulting from capital transfers and other payments difficulties in connection with the use of the Fund's resources. The suggestion in the Memorandum should be understood to be that the distinction would not apply to purchases within the gold tranche. A supplementary legal paper on this subject was promised.

Under the present Articles, the use of the Fund's resources is not permitted to meet a large or sustained outflow of capital, except in the circumstances set out in Article VI, Section 2, which reads as follows:

> Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired.

In order that a member may avail itself of the benefits of that provision, the Fund's holdings of the member's currency must have been below 75 per cent of quota for an immediately preceding period of six months. Moreover,

under the second sentence, a purchase by a member may not increase the Fund's holdings of the member's currency above 75 per cent of its quota. Again, a member may purchase other members' currencies only if the Fund's holdings of them are above 75 per cent of quota and would not be reduced below that level. In short, the purchases for capital transfers permitted by Article VI, Section 2 are those that reduce the levels of the currencies purchased toward the 75 per cent level and increase the level of the purchasing member's currency toward 75 per cent.

Article VI, Section 2 contains certain ambiguities, not the least of which results from the words "any purpose, including capital transfers" at the end of the first sentence. As a result of these words, it is not clear whether the provision is confined to purchases for capital transfers or goes beyond this purpose. In addition, because these words are followed by a clause that speaks only of capital transfers in introducing the second sentence, the scope of the limitations set forth in the rest of that sentence is unclear.

If the suggestion mentioned in the first paragraph of this memorandum were adopted, Article VI, Section 2 would become inappropriate in so far as capital transfers were concerned. Even if the provision goes beyond capital transfers and embraces purchases made because of other payments difficulties, it would cease to have any obvious usefulness in the light of other possible reforms associated with the gold tranche unless it were understood to allow purchases to be made without need on the part of the purchasing member. In order to sustain the interpretation that Article VI, Section 2 permits purchases without need, it would be necessary to conclude that purchases may be made under that provision without reference to and independently of Article V, Section 3(a). If it were concluded, however, that all purchases are governed by Article V, Section 3(a), as well as by such other provisions as are relevant, it would follow that the purchases permitted by Article VI, Section 2 must involve a need, although it could be a need associated with capital transfers.

If it is assumed that the latter interpretation is correct, or that it would be undesirable to permit purchases without need under any amendments relating to the gold tranche that may be adopted, the question arises whether the best course for giving effect to the suggestion mentioned in the first paragraph of this memorandum would be the abrogation of Article VI, Section 2. It is recommended that this course should not be followed because it would create a gap in the Articles. It is true that this could be eliminated by re-numbering Section 3, but this might produce confusion in future references to what used to be Section 2. It would be possible to avoid disturbance to the structure of Article VI by a less radical revision of Section 1(a) than would have to be made if Section 2 were abrogated. Accordingly, the following amendments of Sections 1(a) and 2 of Article VI would be preferable. An amendment of Section 2 could also eliminate the obscurities in the present text that have been noted.

SECTION 1. Use of the Fund's resources for capital transfers.--
(a) A member may not use the Fund's resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

[Present text:

"SECTION 1. Use of the Fund's resources for capital transfers.--
(a) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund."]

SEC. 2. Special provisions for capital transfers.--A member that has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a) shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for capital transfers if the purchases do not have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above its quota.

[Present text:

"SEC. 2. Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not

been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired."]

The proposed text of Section 2 could be further simplified by deleting the reference to ineligibility and the four provisions under which it may occur. The reference is not necessary because ineligibility would prevent the use of the Fund's resources without express mention. It is true that the ineligibility provisions are referred to in Article V, Section 3(a)(iv), but it might be argued that the reference is redundant there also. In any event, the reference to ineligibility in Article V, Section 3(a)(iv) is a good reason for eliminating the reference to it in an amended Article VI, Section 2. This formulation would be adopted on the basis of the understanding that requests to purchase in accordance with Article VI, Section 2 would also be governed by Article V, Section 3(a). On this basis, the amended text of Section 2 could be:

"SEC. 2. Special provisions for capital transfers.--A member shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for capital transfers if the purchases do not have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above its quota."

If the Articles were amended to include a definition of gold tranche purchases as discussed in paragraphs 13 *et seq*. of SM/67/99, the text could read:

"SEC. 2. Special provisions for capital transfers.--Notwithstanding the provisions of Section 1(a) of this Article, a member shall be entitled to make gold tranche purchases for capital

transfers."*

A possible amendment which is not recommended is that Article VI, Section 1(a) should continue as at present but that Article VI, Section 2 should contain a definition of "net use" as a use beyond the gold tranche. This solution would not be desirable because "net use" has become entrenched in popular parlance as use beyond the super gold tranche. There would be no point in introducing a possible conflict between this usage and a new term of art.

None of the possible amendments discussed in this memorandum would call for the amendment of Article VI, Section 1(b).

*In this and the preceding draft language, the words "notwithstanding the provisions of Section 1(a) of this Article" could be deleted because the words "except as provided in Section 2 of this Article" appear in the draft language of an amended Section 1(a). It may be thought, however, that the cross-references in the two clauses would make the position clearer.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR
AGENDA

Mr. J. J. Polak

Room 504 F

#1

SM/67/133

November 30, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Legal Aspects Relating to the Payment of Remuneration on the Super Gold Tranche

The attached memorandum on legal aspects relating to the payment of remuneration on the super gold tranche is one of two legal papers promised at Executive Board Meeting 67/75 in connection with further discussions of the gold tranche.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

INTERNATIONAL MONETARY FUND

Legal Aspects Relating to the Payment of Remuneration on the Super Gold Tranche

Prepared by the Legal Department

Approved by Joseph Gold

November 29, 1967

Introduction

Staff Memorandum 67/99 (August 2, 1967) discussed certain legal aspects of the payment of "interest"on super gold tranche positions (pp. 11-12). At EBM/67/75, a further paper on this subject was promised which would take into account the discussion at that meeting and at the meetings in which the distribution of net income was considered (EBM/67/62, 67/63, 67/68, and 67/74).

Terminology

It is recommended that if any amendment were to be adopted which would provide for a fixed return on super gold tranche positions, the word "interest" should be avoided. According to normal legal usage, "interest" accrues on a debt and not on a subscription to capital. Currency and gold subscriptions to the Fund are owned by the Fund, and they do not constitute current debts of the Fund to members. Indeed, most of the Fund's currency holdings are in the form of non-negotiable, non-interest bearing notes or similar obligations under Article III, Section 5, and to that extent, therefore, members are indebted to the Fund in the sense that these notes or similar obligations do not eliminate the members' obligations to provide currency and members must encash the notes or obligations on demand.

Therefore, when the Fund receives currencies and uses them in transactions, even when super gold tranche positions emerge as a result, the Fund is receiving or using its own assets and "interest" is not payable. A more adequate term would be "remuneration".

Remuneration

If it were decided to pay a remuneration on super gold tranche positions, it would seem advisable to do this by adding a provision entitled "Remuneration" as Section 9 to Article V. It would then follow a provision entitled "Charges" which deals with certain payments to the Fund. It is assumed that any new provision would deal with the payment of remuneration as an expense of the Fund. That is to say, it would be

payable whether or not the income of the Fund covered all Fund expenses including the remuneration paid to holders of super gold tranche positions. For this reason, it would be preferable that the provision for this remuneration should not take the form of an amendment of Article XII, Section 6.

Discretionary rate

In SM/67/99, page 12, the possibility was envisaged of minimum and maximum annual rates of remuneration (or interest as it was there called), and a determination by the Fund each year of the rate that was to be paid. If this course were followed, or if there should be a discretion as to the rate without any prescribed minimum and maximum, it would be necessary to consider whether, on the analogy of Article XII, Section 6, the Board of Governors should make the determination, annually or at other intervals, of the rate to be paid. If there were no discretion as to rate, the question whether determination of the rate should be a power that the Board of Governors should be unable to delegate would not arise. If there should be a discretion and the power to establish the rate was to be reserved to the Board of Governors, this could be done by adding a sub-paragraph (ix) to Article XII, Section 2(b).

It should be noted, however, that the exercise of the Fund's discretion to fix the various charges payable by members is not reserved to the Board of Governors. The determination of the rates for periodic charges on the Fund's holdings of currencies in excess of quota can be changed by the Executive Directors by a three-fourths majority of the total voting power (Article V, Section 8(e)). The service charge on exchange transactions (Article V, Section 8(a)) and handling charges on gold transactions (Article V, Section 8(b)) can be varied by a majority of votes cast by the Executive Directors. It is also relevant that the power to agree to pay interest on loans under Article VII, Section 2(i), including the power to agree on the particular rate, has been delegated to the Executive Directors.

Presumably, the reason why the power to distribute net income under Article XII, Section 6 has been reserved to the Board of Governors whereas the power to vary charges and pay interest on loans may be and has been delegated to the Executive Directors is that the first of these powers was regarded as involving a distribution of part of the Fund's assets. Nevertheless, there would be no reason of a legal character that would require a power to determine the rate of remuneration to be reserved to the Board of Governors.

At the moment, decisions with respect to net income have retrospective effect. They determine the way in which the net income of a financial year that has already ended shall be dealt with. If the analogy of charges under Article V, Section 8 is followed, the decisions could be given prospective effect. In short, determinations as to the rate of

remuneration could apply to the last financial year or to the next year or until a decision was taken to make a new rate operative. Moreover, it is not essential that remuneration would have to be payable in yearly amounts. For example, remuneration could be paid quarterly.

Calculation

It is assumed that if a remuneration were paid on the super gold tranche, it would be paid on the basis of an average position during a base period, for example the preceding year or quarter. Article XII, Section 6 provides for a distribution of net income "on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year." This is not easy language to understand in the context of the Articles. In SM/66/130 (December 15, 1966) the view of this language which was recommended was that:

> "Average holdings are calculated by adding the holdings on each day during the year that they are at or below the 75 per cent level and dividing the total by the total number of days in the year. Holdings above the 75 per cent level on any day are assumed to be at that level." (P.18)

It was pointed out that this technique was comparable to the one adopted in connection with the payment of periodic charges on the "average daily balances of its currency held by the Fund in excess of its quota" under Article V, Section 8(c). If a new provision were adopted for the purpose of paying a remuneration on super gold tranches, it would be useful to adopt clearer language to give effect to this technique of calculation.

The last conclusion in SM/66/130 (p. 19) could apply to the calculation under a new provision as a matter of administration without the necessity for express language:

> "The Fund's No. 2 Accounts up to 1/100 of one per cent of quota should be excluded from the calculation of average holdings, but this exclusion in itself should not qualify a member for a preferential distribution. A member should qualify, however, even if the reduction in average holdings is solely the result of the Fund's use of the member's currency for administrative expenditures."

Available Resources

If remuneration were payable under an amendment of the Articles, it would be payable whether or not the Fund's income were adequate to cover it. The General Reserve could be made available if the Fund's income was inadequate without any of the limitations with respect to the distribution of net income under Article XII, Section 6, which were explained in SM/66/130. Moreover, if the Fund's income were not sufficient

in any year to cover all of the expenses of the Fund, including the expenses of paying the remuneration, administrative expenses would be charged first against the Special Reserve (Selected Decisions, p. 115).

Draft Language

The following draft would give effect to some of the ideas mentioned above. Naturally, there would be modifications in this draft if other policy choices were made:

"SEC. 9. Remuneration.--The Fund shall pay (annual)(quarterly) remuneration to a member, at a rate uniform for all members, (of not more than ____ percent per annum) on the amount by which seventy-five percent of its quota exceeded the average of the Fund's holdings of the member's currency not in excess of seventy-five percent of quota during the preceding (year) (quarter). Remuneration shall be paid in a member's own currency."

Amendment of Article XII, Section 6

With an amendment such as the one indicated above, it would become necessary to amend Article XII, Section 6, somewhat along the following lines:

"SEC. 6. Distribution of net income.--The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. Any distribution shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

With this language, the same difficulties might arise in connection with the meaning of "net income" and the use of the General Reserve that were discussed in SM/66/130. Without any other change in the language of Article XII, Section 6, "net income" would continue to be the net income solely of the year for which a distribution was made. If, however,

it were thought desirable to make the General Reserve available for distribution for any year, the language could read:

"The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserve shall be distributed."

If it were decided to make the Fund's Special Reserve available for distribution, that could be done by substituting "reserves" for "reserve" in the foregoing text.

MEMORANDUM

TO: Mr. Phillips November 29, 1967

FROM: J. J. Polak

SUBJECT: Your Memorandum on International Monetary Reform

I read this paper with very much pleasure and I have only a few marginal comments to make.

On page 1 I would doubt that one could say that the GAB has filled the lack of reserves. All it has done is to make possible certain Fund transactions which the Fund might otherwise find it difficult to finance. Its main purpose, to permit large transactions by the U.S., has never been tested.

On page 5 under (c) the suggested addition to quotas was GAB commitments rather than actual creditor positions.

In the second line on page 11, I notice your use of the word "aprobadas." You will recall that a point was made of not saying "approved" but "concurred." Is there no equivalent in Spanish?

On page 11, paragraph 6, the clause in brackets on line 6 is not accurate. The reconstitution formula would not have to be fulfilled until a full 5-year period had run out. In that same paragraph the suggestion that reconstitution can be brought about by the purchase of special drawing rights from the Fund against convertible exchange has never to my knowledge been made. The only technique provided for reconstitution is the one you mention in the next sentence. Insofar as the Fund holds special drawing rights and participants can draw on the Fund, they might, however, be able to meet their reconstitution obligation by acquiring special drawing rights from the Fund against payment in their own currency. The penultimate sentence in the paragraph makes the admonition about balanced holdings of special drawing rights and other reserves rather more of an obligation than the Outline intends.

SUBJECT COPY

The brief paragraph at the top of page 12 does not really do justice to the precision of language that was adopted in drafting the Outline and suggests more freedom in the preparation of the amendment than the Outline leaves us.

With respect to Section IV, I find a certain difficulty in indicating which of the propositions put forward by the Six should still be considered as serious. For example, it is clear by now that the idea of including half the creditor vote has already been given up. On the other hand you don't mention the changes in the provisions on the uniform change in par values, an item which the Six have put in their agreed list at their recent meeting.

On a more technical point, (page 14, paragraph 4) the agreement at present does not so much permit a country to deduct increases in its reserves in currencies that cannot be used in repurchase, but abates any calculated repurchases that would have to be met in such currencies. Furthermore, the last suggestion on repurchase on the part of the Six is to include, rather than not to include, the currencies of nonmembers in the calculations of monetary reserves.

On page 18, paragraph 5(a) I would not suggest that this method is only used for unimportant matters. It has in fact almost always been used to obtain votes by Governors between sessions, including such important questions as general quota increases.

Towards the end of paragraph 7 on page 18, you refer to two-thirds instead of 60 per cent. To my mind, the expectation expressed in the last sentence of that paragraph is rather on the pessimistic side, assuming the vote by Governors is made by mail.

In paragraph 8 on page 19, you might have pointed out that the requirement of 75 per cent participation is not a legal provision of the Articles such as those quoted in the preceding paragraph but a proposal made in the draft amendment. I would personally not be surprised if the percentage proposed became higher, for example 80 per cent in the course of the discussions.

INTERNATIONAL MONETARY FUND

November 28, 1967

TO : The Managing Director

FROM: Joseph Gold

I attach for your approval the second legal memorandum which was promised at EBM/67/75.

cc: The Deputy Managing Director
Mr. Polak
Mr. Altman
Mr. Hebbard
Mr. Fleming

Legal Aspects of the Memorandum Entitled "Suggestions for Certain Reforms of the International Monetary Fund"-- Use of Gold Tranche for Capital Transfers

Prepared by the Legal Department

Approved by Joseph Gold

November 28, 1967

At EBM/67/75, Mr. van Campenhout stated that the Memorandum addressed by him to the Managing Director on June 22, 1967 and the attachment thereto (EBD/67/97) should not be understood as suggesting the total abolition of the distinction between difficulties resulting from capital transfers and other payments difficulties in connection with the use of the Fund's resources. The suggestion in the Memorandum should be understood to be that the distinction would not apply to purchases within the gold tranche. A supplementary legal paper on this subject was promised.

Under the present Articles, the use of the Fund's resources is not permitted to meet a large or sustained outflow of capital, except in the circumstances set out in Article VI, Section 2, which reads as follows:

> Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligibile to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired.

In order that a member may avail itself of the benefits of that provision, the Fund's holdings of the member's currency must have been below 75 per cent of quota for an immediately preceding period of six months. Moreover, under the second sentence, a purchase by a member may not increase the Fund's holdings of the member's currency above 75 per cent of its quota. Again, a member may purchase other members' currencies only if the Fund's holdings of them are above 75 per cent of quota and would not be reduced below that level. In short, the purchases for capital transfers permitted by Article VI, Section 2 are those that reduce the levels of the currencies purchased toward the 75 per cent level and increase the level of the purchasing member's currency toward 75 per cent.

Article VI, Section 2 contains certain ambiguities, not the least of which results from the words "any purpose, including capital transfers" at the end of the first sentence. As a result of these words, it is not clear whether the provision is confined to purchases for capital transfers or goes beyond this purpose. In addition, because these words are followed by a clause that speaks only of capital transfers in introducing the second sentence, the scope of the limitations set forth in the rest of that sentence is unclear.

If the suggestion mentioned in the first paragraph of this memorandum were adopted, Article VI, Section 2 would become inappropriate in so far as capital transfers were concerned. Even if the provision goes beyond capital transfers and embraces purchases made because of other payments difficulties, it would cease to have any obvious usefulness in the light

of other possible reforms associated with the gold tranche unless it were understood to allow purchases to be made without need on the part of the purchasing member. In order to sustain the interpretation that Article VI, Section 2 permits purchases without need, it would be necessary to conclude that purchases may be made under that provision without reference to and independently of Article V, Section 3(a). If it were concluded, however, that all purchases are governed by Article V, Section 3(a), as well as by such other provisions as are relevant, it would follow that the purchases permitted by Article VI, Section 2 must involve a need, although it could be one associated with capital transfers.

If it is assumed that the latter interpretation is correct, or that it would be undesirable to permit purchases without need under any amendments relating to the gold tranche that may be adopted, the question arises whether the best course for giving effect to the suggestion mentioned in the first paragraph of this memorandum would be the abrogation of Article VI, Section 2. It is recommended that this course should not be followed because it would create a gap in the Articles. This could be eliminated by re-numbering Section 3, but this might produce confusion in future references to what used to be Section 2. It would be possible to avoid disturbance to the structure of Article VI by a less radical revision of Section 1(a) than would have to be made if Section 2 were abrogated. Accordingly, the following amendments of Sections 1(a) and 2 of Article VI would be preferable. The amendment of Section 2 could also eliminate the obscurities that have been noted.

SECTION 1. Use of the Fund's resources for capital transfers.— (a) A member may not use the Fund's resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

[Present text:

"SECTION 1. Use of the Fund's resources for capital transfers.-- (a) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise to use the resources of the Fund."]

SEC. 2. Special provisions for capital transfers.-- A member that has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a) shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for capital transfers if the purchases do not have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above its quota.

[Present text:

"SEC. 2. Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remaind below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including

capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired."]

The proposed text of Section 2 could be further simplified by deleting the reference to ineligibility and the four provisions under which it may occur. The reference is not necessary because ineligibility would prevent the use of the Fund's resources without express mention. It is true that the ineligibility provisions are referred to in Article V, Section 3(a)(iv), but it might be argued that the reference is redundant there also. In any event, the reference to ineligibility in Article V, Section 3(a)(iv) is a good reason for eliminating the reference to it in an amended Article VI, Section 2. This formulation would be adopted on the basis of the understanding that requests to purchase in accordance with Article VI, Section 2 would also be governed by Article V, Section 3(a). On this basis, the amended text of Section 2 could be:

"SEC. 2. Special provisions for capital transfers.--A member shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for capital transfers if the purchases do not have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above its quota."

If the Articles were amended to include a definition of gold tranche purchases as discussed in paragraphs 13 *et seq*. of SM/67/99, the text could read:

"SEC. 2. Special provisions for capital transfers.--Notwithstanding the provisions of Section 1(a) of this Article, a member shall be entitled to make gold tranche purchases for capital transfers."*

A possible amendment which is not recommended is that Article VI, Section 1(a) should continue as at present but that Article VI, Section 2 should contain a definition of "net use" as a use beyond the gold tranche. This solution would not be desirable because "net use" has become entrenched in popular parlance as use beyond the super gold tranche. There would be no point in introducing a possible conflict between this usage and a new term of art.

None of the possible amendments discussed in this memorandum would call for the amendment of Article VI, Section 1(b).

*In this and the preceding draft language, the words "notwithstanding the provisions of Section 1(a) of this Article" could be deleted because the words "except as provided in Section 2 of this Article" appear in the draft language of an amended Section 1(a). It may be thought, however, that the cross-references in the two clauses would make the position clearer.

Reform

Mr. Oscar Altman

November 22, 1967

Joseph Gold

Sales of Gold for Replenishment

The following are my reactions to the draft memorandum which you sent to me on November 21.

I feel that we should observe great care in avoiding the impression that members have the right to designate the depository at which the Fund will deliver gold to them. It has been the policy of the Fund so far to avoid any such impression and to avoid the further impression that members can impose a charge or costs on the Fund, apart from minor labor costs, in connection with gold transactions. The legal problems connected with these issues have been raised from time to time in the Board and by the Managing Director and have been left unsettled in view of the policy of the Fund. Against this background, I would modify slightly your first two proposals on page 2 by suggesting to members that we will deliver gold in New York but would be prepared to deliver the gold (minus the amount you mention) that we have in London pro rata among those members that wish to receive it there.

It also follows from what I have said above that we should not rush into a program of shipping gold forthwith in order to meet the expected or invited preferences of members in connection with the impending transaction. Instead, we should take advantage of such opportunities as occur in the future for making swaps in order to arrangement for a better distribution of our gold holdings. For this purpose, however, it will be necessary to get authorization from the Board.

cc: Mr. Polak

Office Memorandum

Fund Reform

TO : Mr. J. J. Polak

DATE: November 16, 1967

FROM : Joseph Gold JG

SUBJECT : Remuneration on Super Gold Tranche Positions

Thank you for your note of November 8, 1967.

With respect to your first two paragraphs, I would say that the paper does not attempt to take a position for or against any of your three postulates. It would not be fair, however, to refrain from mentioning other possibilities, and not wise in view of the fact that they have already had their supporters in Board debates. In particular, I do not see how it is possible to suppress mention of the fact that the Board of Governors could continue to regard the power to distribute assets as one that should be reserved to itself. I will look at the draft again to see whether undue weight is given to any possible course and to make sure that all choices are kept open.

I find myself in more difficulty with your proposed redraft. Even Executive Directors well disposed to our version of the formula in Article XII, Section 6(b) were not convinced that only some and not all holdings are averaged in the calculation called for by the provision. You retain the word "holdings" and you imply averaging, so that we could have the same problem of interpretation as at present but complicated by the necessity to imply averaging. Although I would see some merit in your formula if we were starting afresh, I feel that we should be more direct now in dealing with the problems that have arisen.

In addition, your version could provoke a new legal difficulty. The normal rules of statutory interpretation would start from the proposition that deletion of the express mention of averaging meant that it was being eliminated from the operation. I would prefer to avoid this problem.

cc: Mr. Altman

Reform

Mr. Gold November 8, 1967

J.J. Polak

Payments on Super Gold Tranche Positions

I have some difficulty with the second paragraph on page 2. This paragraph raises the question of a minimum and maximum rate without disposing of it; it introduces the possibility of a fixed rate; and it starts out as if it were natural that any relevant decisions were to be taken by the Board of Governors.

I would argue, and I think there would be little dissent from this, that there should be no minimum or maximum rate, that the rate should not be fixed and that any decisions should be taken by the Executive Directors, for the reasons made clear on page 3. I wonder therefore whether the bottom paragraph of page 2 is necessary at all and whether the section could not be renamed "Periodic Determination of the Rate of Remuneration."

With respect to the proposed draft language, I would suggest eliminating the reference to a maximum, which could produce difficulty and useless discussion. I believe further that the following wording would take adequate care of the problem of definition discussed on page 4:

> "SEC. 9. Remuneration.--The Fund shall pay (annual) (quarterly) remuneration to a member, at a rate uniform for all members, on the amount by which seventy-five percent of its quota exceeded the Fund's holdings of the member's currency during the preceding (year) (quarter). Remuneration shall be paid in a member's own currency."

The intention is that only positive amounts produced by this calculation would bear interest. It is not necessary to introduce the concept of average amounts into the provision, nor is that concept helpful to the operation. The calculation can readily be made on the basis of the daily balances for such days as the Fund's holdings of the member's currency fell short of 75 per cent of quota. The rate applicable to such amounts would be 1/360 of the applicable annual rate.

cc: Mr. Altman

JJP:ms

MEMORANDUM

TO: Mr. Gold November 7, 1967

FROM: J. J. Polak

SUBJECT: Optional Use of Credit Tranches Before Gold Tranches
(The Late Floating Gold Tranche)

I would presume that the easiest solution to this problem would lie in arrangements under which the Fund in suitable cases could borrow the member's currency up to the point where the Fund's holdings of that currency attained 100 per cent of quota. We know that this would broadly achieve the objective listed as the subject of this memorandum. The first question to concentrate on would, therefore, seem to be whether this can be done in a manner which would not raise legal obstacles.

I am aware of legal difficulties; I recall for example that in connection with the GAB we refused to contemplate borrowing beyond the 75 per cent point.

Nevertheless, the following aspects of and suggestions for an operation of this kind are put forth for you to see whether they could be built into a justification for such operations.

(a) The Fund would only replace a gold tranche and super gold tranche position by a loan claim in immediate connection with a drawing or a stand-by arrangement in the credit tranches.

(b) The terms of the loan could be such as to involve no conceivable cost to the Fund. This might involve zero interest on the amount corresponding to the basic gold tranche and a commission on any encashment by the member of its claim.

(c) The transaction itself would meet the basic objective of enhancing Fund's liquidity: the Fund would hold a larger balance of the member's currency. Admittedly, the benefit of this to the Fund is at most marginal since by definition the currency is weak at the time. This might possibly lead one to consider the need for limiting the operation to countries whose currencies the Fund would be likely to need again in the future, which might mean in practice countries whose currencies had been used in drawings before. Alternatively, the facility could be made subject to some judgment in individual cases.

(d) In a more substantive way the operation could be shown to benefit the Fund's liquidity, in the sense that in some cases at least it might lead to a smaller drawing than would otherwise have been requested by the member.

cc: Mr. Fleming
Mr. Nicoletopoulos
Mr. Rhomberg
Mr. Ezekiel

Reform

MEMORANDUM

November 7, 1967

To: Mr. J. J. Polak
Mr. Oscar Altman

From: Joseph Gold JG

Subject: Payments on Super Gold Tranche Positions

I attach the draft of a paper on the legal aspects of the payment of remuneration on super gold tranche positions. I shall be grateful for any comments.

cc: Mr. Fleming

DRAFT
11/7/67

Legal Aspects Relating to the Payment of Remuneration on the Super Gold Tranche

Prepared by the Legal Department

Approved by Joseph Gold

Introduction

Staff Memorandum SM/67/99 (August 2, 1967), discussed certain legal aspects of the payment of "interest" on super gold tranche positions (pp. 11-12). At EBM/67/81, a further paper on this subject was promised which would take into account the discussion at that meeting and at the meetings in which the distribution of net income was considered (EBM/67/62, 67/63, 67/68, and 67/74).

Terminology

It is recommended that if any amendment were to be adopted which would provide for a fixed return on super gold tranche positions, the word "interest" should be avoided. According to normal legal usage, "interest" accrues on a debt and not on a subscription to capital. Currency and gold subscriptions to the Fund are owned by the Fund, and they do not constitute current debts of the Fund to members. Indeed, most of the Fund's currency holdings are in the form of non-negotiable, non-interest bearing notes or similar obligations under Article III, Section 5, and to that extent, therefore, members are indebted to the Fund in the sense that these notes or similar obligations do not eliminate the members' obligations to provide currency and members must encash the notes or obligations on demand.

Therefore, when the Fund receives currencies and uses them in transactions as a result of which super gold tranche positions emerge, the Fund is receiving or using its own assets and "interest" is not payable. A more adequate term would be "remuneration".

Remuneration

If it were decided to pay a remuneration on super gold tranche positions, it would seem advisable to do this by adding a provision entitled "Remuneration" as Section 9 to Article V. It would then follow a provision entitled "Charges" which deals with certain payments to the Fund. It is assumed that any new provision would deal with the payment of remuneration as an expense of the Fund. That is to say, it would be payable whether or not the income of the Fund covered all Fund expenses including the remuneration paid to holders of super gold tranche positions. For this reason, it would be preferable that the provision for this remuneration should not take the form of an amendment of Article XII, Section 6.

Discretionary rate

In SM/67/99, page 12, the possibility was envisaged of minimum and maximum annual rates of remuneration (or interest as it was there called), and a determination by the Fund each year of the rate that was to be paid. If this course were followed, it would be necessary to consider whether the Board of Governors should make a determination annually or at other intervals of the rate to be paid. If there were no discretion as to rate, the question whether determination of the rate should be a power that the Board of Governors should be unable to delegate would not arise. If there should be a discretion and the power to establish the rate was to be reserved to the Board of Governors, this could be done by adding a sub-paragraph (ix) to Article XII, Section 2(b).

It should be noted, however, that the exercise of the Fund's discretion to fix the various charges payable by members is not reserved to the Board of Governors. The determination of the rates for periodic charges on the Fund's holdings of currencies in excess of quota can be changed by the Executive Directors by a three-fourths majority of the total voting power (Article V, Section 8(e)). The service charge on exchange transactions (Article V, Section 8(a)) and handling charges on gold transactions (Article V, Section 8(b)) can be varied by a majority of votes cast by the Executive Directors. Presumably, the reason why the power to distribute net income under Article XII, Section 6 has been reserved to the Board of Governors whereas the power to vary charges may be delegated to the Executive Directors is that the former involves a distribution of part of the Fund's assets. Nevertheless, there would be no legal reason that would require a power to determine the rate of remuneration to be reserved to the Board of Governors.

At the moment, decisions with respect to net income have retrospective effect. They determine the way in which the net income of a financial year that has already ended shall be dealt with. If the analogy of charges under Article V, Section 8 is followed, the decisions could be given prospective effect. In short, determinations as to the rate of remuneration could apply to the last financial year or to the next year or until a decision was taken to make a new rate operative. Moreover, it is not essential that remuneration would have to be payable in yearly amounts. For example, remuneration could be paid quarterly.

Calculation

It is assumed that if remuneration were paid on the super gold tranche, it would be paid on the basis of an average position during a base period,

for example the preceding year or quarter. Article XII, Section 6 provides for a distribution of net income "on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year." This is not easy language to understand in the context of the Articles. In SM/66/130 (December 15, 1966) the view of this language which was recommended was that:

> "Average holdings are calculated by adding the holdings on each day during the year that they are at or below the 75 per cent level and dividing the total by the total number of days in the year. Holdings above the 75 per cent level on any day are assumed to be at that level." (P. 18)

It was pointed out that this technique was comparable to the one adopted in connection with the payment of periodic charges on the "average daily balances of its currency held by the Fund in excess of its quota" under Article V, Section 8(c). If a new provision were adopted for the purpose of paying a remuneration on super gold tranches, it would be useful to adopt clearer language to give effect to this technique of calculation.

The last conclusion in SM/66/130 (P. 19) could apply to the calculation under a new provision as a matter of administration without the necessity for express language:

> "The Fund's No. 2 Accounts up to 1/100 of one per cent of quota should be excluded from the calculation of average holdings, but this exclusion in itself should not qualify a member for a preferential distribution. A member should qualify, however, even if the reduction in average holdings is solely the result of the Fund's use of the member's currency for administrative expenditures."

Available Resources

If remuneration were payable under an amendment of the Articles, it would be payable whether or not the Fund's income were adequate to cover it. The General Reserve could be made available if the Fund's income was inadequate without any of the limitations with respect to the distribution of net income under Article XII, Section 6, which were explained in SM/66/130. Moreover, if the Fund's income were not sufficient in any year to cover all of the expenses of the Fund, including the expenses of paying the remuneration, administrative expenses would be charged first against the Special Reserve (Selected Decisions, p. 115).

Draft language

The following draft would give effect to some of the ideas mentioned above. Naturally, there would be modifications in this draft if other policy choices were made:

"SEC. 9. Remuneration.--The Fund shall pay (annual)(quarterly) remuneration to a member, at a rate uniform for all members, ~~of not more than ____ percent per annum~~ on the amount by which seventy-five percent of its quota exceeded ~~the average of~~ the Fund's holdings of the member's currency ~~not in excess of seventy-five percent of quota~~ during the preceding (year)(quarter). Remuneration shall be paid in a member's own currency."

Amendment of Article XII, Section 6

With an amendment such as the one indicated above, it would become necessary to amend Article XII, Section 6, somewhat along the following lines:

"SEC. 6. Distribution of net income.--The Board of Governors shall determine annually what part of the Fund's net income

shall be placed to reserve and what part, if any, shall be distributed. Any distribution shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

With this language, the same difficulties might arise in connection with the meaning of "net income" and the use of the General Reserve that were discussed in SM/66/30. Without any other change in the language of Article XII, Section 6, "net income" would continue to be the net income solely of the year for which a distribution was made. If, however, it were thought desirable to make the General Reserve available for distribution for any year, the language could read:

"The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, of net income and reserve shall be distributed."

If it were decided to make the Fund's Special Reserve available for distribution, that could be done by substituting "reserves" for "reserve" in the foregoing text.

The Acting Managing Director

November 7, 1967

Joseph Gold

<u>Proposals of ECE Countries on Reform of the Fund</u>

I do not want to comment in detail on your note of November 7, 1967, but I cannot refrain from one remark. It is on the following sentence:

> "But he concluded his remarks by pointing out that the Group of Ten had the controlling vote and this should settle the matter."

The proposals for reform involve amendments of the Articles. Three-fifths of the membership come to 65 members to the next whole member. The Ten, even though united, would have to recruit 55 supporters having more than 20 per cent of the total voting power.

How wise the Founding Fathers were.

cc: Managing Director
Mr. Polak
Mr. Sturc
Mr. Altman
Mr. Whittome
Mr. Fleming
Mr. Finch

Mr. Polak

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

November 7, 1967

MEMORANDUM

TO: Mr. Schweitzer

FROM: Frank A. Southard, Jr.

SUBJECT: Proposals of ECE Countries on Reform of the Fund

1. On November 6 René Larre, who was in Washington for a few hours, told me by phone that Plescoff was informed of the points on the reform of the Fund which had been agreed among the six countries in the ECE. Mr. Larre went on to say that he thought the points should be acceptable to the United States and that he therefore really did not believe that there would be much difficulty. I ventured the opinion that some of the points would be sharply debated by the non-Ten, but Mr. Larre did not seem to think this was very important.

2. On November 7 Mr. Plescoff listed the various agreed points as follows, trusting to memory, since he had not brought any notes with him.

(a) Various aspects of the gold tranche and super gold tranche.

(b) The calculation of net liabilities and other aspects of repurchase obligations. Here Plescoff mentioned the suggestion by the United States which seems to have interested the ECE countries, but he was rather vague and I am not sure what he meant.

(c) A third point contained in the original list, which Plescoff could not recall. I have checked the list in van Campenhout's memorandum (EBD/67/97) and it may be that it is his point II A "Conditions for Drawings within the Credit Tranches". But Plescoff will verify this.

(d) Uniform change in par values. The idea seems to be to change this provision so as to call for an 85 per cent vote and to eliminate the "veto" which any member with 10 per cent or more of the quotas has under Article IV, Section 7.

(e) General quota increases and any increase in automaticity in the tranches should call for an 85 per cent vote. Also, if there is a general quota increase there should be no mitigation of the gold payment.

(f) Gold investment. The ECE countries consider that the Fund's gold investment is no longer legal because the Fund no longer needs the income, and need was the only legal basis for the original decision. They realize that it would not be wise to call for an immediate reversal of the whole amount, but they will propose that the process of reversal should begin.

(g) Interpretation of the Articles. This has been postponed until the Ministerial Meeting in December because one of the six countries was not in agreement.

3. Plescoff, echoing Larre's view, expressed the opinion that these various points should not cause any great debate. I replied that I thought the more or less technical ones, while there might be debate, could be discussed dispassionately. But I was sure that item (e), calling for an 85 per cent vote on general quota increases and on any increase in automaticity, would cause very great debate, because the non-Ten did not like the proposal. I summarized their reasons as I understood them and Plescoff said he could understand why they might hold that view. But he concluded his remarks by pointing out that the Group of Ten had the controlling vote and this should settle the matter. I agreed that they had the controlling vote but I suggested that if the non-Ten countries as a group were united in their opposition and took a very strong line, they had ways of making their views felt. This impressed Plescoff enough so that he agreed that there could be effective pressures.

cc: Mr. Gold
✓Mr. Polak
Mr. Sturc
Mr. Altman
Mr. Whittome
Mr. Nicoletopoulos
Mr. Fleming
Mr. Finch

Mr. Polak

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

November 6, 1967

MEMORANDUM

TO: Mr. Schweitzer

FROM: Frank A. Southard, Jr.

SUBJECT: Floating Gold Tranche

1. While I was in Mexico Governor Gomez argued the case for working out an arrangement by which countries could leave their gold tranche and super gold tranche drawing rights intact (hence keeping them in their reserves) and make use of the credit tranches. In doing so, of course, the countries would meet whatever conditions the Fund wished to set in order to have access to the credit tranches. I attach a files memorandum reporting on this conversation. Since my visit Ortiz Mena talked about the matter with Alfredo Phillips and the Mexicans also spoke to the Canadians and Belgians in Rio and received some encouragement from them.

2. We have given some thought to this within the staff and I attach hereto, in case you wish to read them at this early stage, memoranda prepared by Gold, Polak, and Fleming. In brief, the lawyers feel that the tranche system is so built in to the Articles that very major amendments would be required in order to make it possible for countries to leave the gold tranche untouched and use the credit tranches. Polak recognizes these difficulties and therefore thinks that it might be possible to work out ways in which a country could convert its gold tranche into a loan claim on the Fund or into SDRs, thus keeping the equivalent of the gold tranche in its reserves. The country could then proceed to use the credit tranches in accordance with Fund policy.

3. I have told Phillips that we are studying this matter. He is aware that there are formidable legal problems and he is also aware that there might be other approaches such as those Polak has suggested. Therefore, he and Gonzalez del Valle will not hastily put forward a proposal in writing until further conversation with us. In the meantime, I have assured him we will be giving some further thought to the matter and will be glad to talk to Gonzalez del Valle and him on an informal basis whenever they wish.

Attachments

cc: Mr. Gold
✓Mr. Polak
Mr. Fleming
Mr. Nicoletopoulos

Office Memorandum

TO : Mr. Polak

DATE: November 6, 1967

FROM : J. Marcus Fleming

SUBJECT : Floating Gold Tranche

Your second suggestion for achieving an effective "floating" gold tranche by having countries draw their gold tranche in SDR's which they would then hold unused seems to me substantially much more drastic than the legal amendments in Mrs. Lachman's paper--some of which I believe to be unnecessary.

What it amounts to in effect is allowing (or encouraging) members to draw in excess of need, with corresponding effects on Fund liquidity.

Despite your genuflection to the Fund liquidity point at the foot of page 2 of your memorandum of November 3, you do not seem to be really persuaded that such a drain is indeed involved since you speak of a "drawing" of SDR's giving the "undesired impression of the country receiving Fund assistance to a greater extent than it actually does." I would maintain that even if the country is not getting Fund assistance to the extent it appears to be doing, the drain on Fund liquidity is even greater than appears to be; which, I would say, is the mark of a very poor arrangement.

The country is not getting the assistance it appears to be getting for the simple reason that it is drawing more than it needs and using its gold tranche to build up reserves in other forms. The same result would ensue if it drew currencies from the Fund in the ordinary way and held on to them.

The drain on Fund resources is even greater than in the case of an ordinary drawing without need since SDR's in the hands of the Fund, being usable to obtain the currency of any country that has not reached its holding limit, must be considered normally to have a higher liquidity value than that of any single currency that might otherwise have been drawn.

Moreover, if any substantial use were made of your facility, the Fund might have to accept SDR's more freely, and marginally such acceptance is likely to involve it in a loss of gold, which would represent an even greater loss of liquidity than would a loss of SDR's.

cc: Mr. Gold
Mr. Nicoletopoulos

MEMORANDUM

TO: Acting Managing Director

November 3, 1967

FROM: J. J. Polak

SUBJECT: Floating Gold Tranche

Mr. Gold's memorandum of November 1 shows that to introduce a "floating gold tranche" in the literal sense of the word would involve a fundamental change in the Articles in the sense of the creation of two separate systems of drawing rights. Once one went that far, I would suppose that one wanted to make a clean job of the separation, which would involve making substantially all the amendments in Mr. Gold's list, even though, as Mr. Fleming has pointed out, many of these would not be absolutely essential if one were satisfied with automatic drawing rights which did not carry with them the incidents at present attached to the gold tranche.

I would doubt that the Board would, on consideration, be prepared to recommend so drastic an operation on the Articles in order to create a facility which might in the end be used only rarely.

I feel this the more since we would be able to provide in substance what is wanted on the basis of the present Articles plus the special drawing right amendment. What is desired in substance is not, I take it, that the gold tranche be floating, but rather that a country that has a reserve position in the Fund in the form of a gold tranche or super gold tranche shall be able to maintain this position while using its conditional facilities in the Fund.

We are giving this characteristic to the special drawing rights. This characteristic is also attached to reserve positions in the Fund in the form of loan claims. The GAB decision nowhere says that a country must ask for the repayment of its loan claim before it draws on the Fund in any tranche. The lender can ask for earlier repayment if it has a need to do so and the Fund has, in effect, the power to make earlier repayment when the lender fills up the Fund's holdings of its currency by making drawings. But neither party has to exercise this right and it would, therefore, for example, be perfectly possible for Japan to draw its gold and first credit tranche while hanging on to its $25 million GAB claim. There would be a cost to Japan in doing so since the claim pays interest to Japan of 1 1/2 per cent per year while charges on use in the first credit tranche start at 2 per cent a year.

SUBJECT COPY

It should be noted in this connection that the Fund borrowed from Japan although the Fund's holdings of yen never fell below 52 per cent of quota. The Fund has borrowed from other members at a time when its holdings were close to 75 per cent of quota. In all these instances, the Fund gave to the country whose currency it sold a loan claim with a floating character where it could also have given the country a super gold tranche claim which did not float. This would seem to suggest the technical possibility of making any country's entire super gold tranche floating by transforming it into a loan claim. There would presumably be no occasion to do this except in the event that the country wanted to draw in the basic gold tranche or the credit tranches (probably only the latter) while maintaining a reserve position in the Fund at least to the extent of its super gold tranche position. Assuming that the Fund had the power to borrow from a member later in an area where it could have borrowed in the first place, and assuming further that it could reasonably expect to have again a large need for the currency in the future then it would be able under the present Articles to transform in suitable circumstances a country's super gold tranche into a floating asset, provided only that the country concerned was ready to lend its currency to the Fund for this amount on appropriate special terms.

It seems questionable whether this technique could be extended to the basic gold tranche; taken by itself, therefore, it may not meet the wishes expressed, for example, by Mexico which is no doubt seeking an arrangement that would apply to the basic gold tranche as well. Such an arrangement will, however, be available under the new amendment.

It is envisaged that under Article XXV, Section 7 (Transactions with Respect to the General Account) a country will be able to purchase from the Fund not only currencies but also, if the Fund has them in sufficient amount, special drawing rights. If a country drew its super gold tranche and gold tranche in the form of special drawing rights and at the same time its first credit tranche in the form of currencies, it would in effect have maintained its reserve position in the Fund while using its credit facility. The transaction by which it had turned its gold tranche and super gold tranche into special drawing rights (and the same would apply if it had used the technique previously mentioned to turn its super gold tranche into a loan claim) would have raised the Fund's holdings of currency to 100 per cent of quota. Consequently, the drawing in the credit tranches would take place on the normal basis as far as charges and arrangements for repurchase were concerned.

There are a few flaws attached to this solution, but they would not appear to be so serious as to justify looking for much more drastic other solutions.

(a) The technique is dependent on the Fund holding a sufficient amount of special drawing rights. One might assume that this condition could normally be fulfilled, the more so since it seems quite unlikely that the large industrial members would be interested in drawing in the credit tranches while maintaining their basic gold tranche. In this connection, the technique for converting super gold tranche positions into loan claims may be useful in limiting the demand on the Fund for special drawing rights. The Fund (General Account) might not want to give an open undertaking to sell special drawing rights even if it had them, depending on its own liquidity considerations.

(b) Under the technique as sketched, the replacement of the gold tranche by a special drawing right position would involve a "drawing" of that amount (which may give the undesired impression of the country receiving Fund assistance to a greater extent than it actually does), the payment of a transactions charge, and an understanding with respect to repurchase. All these aspects could be eliminated by a slight extension of Article XXV, Section 7(b) as now drafted. The present text gives the Fund the right to require a member to sell its currency for special drawing rights held in the General Account for purposes of replenishment. This provision might be extended to permit purchase by the Fund of a member's currency for special drawing rights otherwise than for replenishment, with the agreement of the latter, up to the point where the Fund's holdings attained 100 per cent of quota.

One final observation. A country that turns its gold tranche into a special drawing right claim for purposes of "floating" will earn the special drawing right rate of interest, while the basic gold tranche would, on current thinking, probably not receive any remuneration. The result of this is not, however, that the "floating gold tranche" gives the member a net financial benefit, but only that the technique here described would make the prior use of the credit tranches less costly to the member than it would otherwise be. The member could have drawn its basic gold tranche at zero continuous use charge; it now draws that much more in the credit tranches at a continuous use charge of at least 2 per cent, to which the 1 1/2 per cent (if that is the special drawing right rate of interest) it might make on the transformed gold tranche is only a partial offset.

cc: Mr. Gold
Mr. Nicoletopoulos
Mr. Fleming

Mr Polak

Acting Managing Director — November 2, 1967

J. Marcus Fleming

Floating Gold Tranche

Mr. Gold's memorandum of November 1 on this subject, and the accompanying memorandum of Mrs. Lachman, seem to me to paint an unnecessarily frightening picture of the implication of making the gold tranche into a floating facility. In saying this I am not pretending to be a lawyer, and I do not question that if it is considered necessary to give the floating gold tranche all or almost all of the qualities of the present gold tranche and super gold tranche the legal implications that have been sketched out in Mrs. Lachman's note follow. What I am questioning is whether the proponents of the floating gold tranche would in fact insist on all of these qualities being made to float together. What they are principally interested in, it seems to me, is the quasi-unconditionality of the right to draw, all other matters being secondary. The crucial part of Mrs. Lachman's memorandum is the following paragraph from page 2:

> "If the floating gold tranche were established by amending the Articles, the amendments would be guided by the propositions that members should have a choice between gold tranche or credit tranche drawings, that the former would be automatic while the latter would be conditional, that credit tranche drawings would be subject to the quantitative limits now laid down in Article V, Section 3(a)(iii), while gold tranche drawings would not be subject to such limits, that charges on Fund holdings would be payable in connection with credit tranche drawings only, that gold tranche drawings would either not be subject to repurchase obligations or subject to such obligations only in respect of that part of the gold tranche which is equal to 25 per cent of the member's quota, while all credit tranche drawings would be subject to repurchase obligations, and that the unused portion of the gold tranche above 25 per cent of the member's quota would earn interest."

My suggestion is that of the "propositions" listed in that paragraph only the first two are vital, and that sensible advocates of a floating gold tranche might be quite content to leave the questions of annual limits on drawings, charges, repurchase obligations and interest to depend, to the extent they are now dependent, on the level of Fund holdings. If this were done, the legal difficulties of the operation might well be considerably lightened.

cc: Mr. Gold
Mr. Polak ✓

Office Memorandum

TO : Mr. Polak

DATE: November 1, 1967

FROM : J. Marcus Fleming *JMF*

SUBJECT : Floating Gold Tranche

I quite agree with your approach that we should first decide what qualities a floating gold tranche should have before going into detail as to the amendments to the Articles that would be necessary to enable it to have these qualities. (On the other hand, a premonition as to what changes in the Articles would be necessary to give such and such qualities is useful in helping to decide which qualities we should insist on!)

I am still unconvinced about the necessity of attaching to the floating gold tranche the qualities you suggest with regard to charges, interest and repurchase. If interest and charges are reckoned separately on gold tranche holdings and credit tranche use, respectively, the effect of paying interest on the unused gold tranche would to some extent be offset by the fact that the country would have to pay greater charges on use of the credit tranche. Moreover the precise suggestions you make for interest (on the super gold tranche only) would not suffice to assimilate the position of gold tranches to those of S.D.R.'s. I doubt, therefore, that it is worth while disturbing the present system of charges to obtain this result.

As regards repurchase, if we adopt, as I would agree to be desirable, the convention of allocating all repurchases first to the reconstitution of credit tranche positions, the real effect of prescribing that there should be no repurchase on floating gold tranche positions in excess of 25 per cent might be to postpone the reconstitution of credit tranche positions. The association of unconditional use with no repayment obligation, and conditional use with a repayment obligation (which, incidentally, would not be strictly implemented either by your suggestion for the floating gold tranche, or by the system to be applied to S.D.R.'s) is simply a hang-over from an earlier epoch when people were convinced that an asset differed *toto callo* from a credit facility.

cc: Mr. Gold
Mr. Nicoletopoulos

The Acting Managing Director

November 1, 1967

Joseph Gold

Floating Gold Tranche

You have asked me what legal steps would have to be taken in order to make the gold tranche into a floating facility. The attached note by Mrs. Lachman shows that it would not be useful to have a floating gold tranche under a policy decision comparable to the one with respect to the compensatory financing decision. Instead, it would be necessary to set up two separate systems of drawing rights. There should be separate rules on such matters as use, repurchase and charges for the two systems. Most, and perhaps all, of the present provisions based on levels would become inappropriate. In my view, the amendments required to put a system of this type into effect would be of a sweeping nature.

cc: Mr. Polak
Mr. Fleming

Mr. Gold

November 1, 1967

Philine R. Lachman

Legal Aspects of Floating Gold Tranche

1. You have asked for a preliminary view of the legal aspects involved in the establishment of a "floating" gold tranche, which would make it possible for a member to use the credit tranches ahead of the gold tranche.

The Fund's tranche policies, including the gold tranche policy, are based on the general idea that "adequate safeguards" must be observed in making the Fund's resources available to members. Two actions that are relevant to the present inquiry have been taken consistently with this idea without the need for amending the Articles: (a) the Fund has decided that it can safely give the overwhelming benefit of any doubt to requests within certain limits (gold tranche policy), and (b) the Fund has decided that it can make certain drawing privileges "float" in the sense that the exercise of them does not affect the tranche policies applicable to other drawings (revised compensatory financing facility).

Clearly, the ideas on which these actions are based could be combined so that the gold tranche would become a "floating" facility. I am assuming, of course, that any additional strain on the Fund's liquidity resulting from making a quasi-automatic privilege exercisable after other privileges would cause no legal difficulties under Article I(v).

2. If the establishment of a "floating" gold tranche were effected by a policy decision without amendment of the Articles, the present provisions that deal with levels of Fund holdings would continue to apply. This would lead to unsatisfactory results both in respect of the gold tranche and in respect of the credit tranches. Under the Fund's present Articles, a member which is in a "creditor" position enjoys certain additional benefits, and "creditor" position is measured by the member's total net use of the Fund's resources. While gold tranche drawings would continue to enjoy virtual immunity from challenge, it would not be possible to preserve all characteristics of the present super gold tranche, for if a super gold tranche drawing were made after the Fund's holdings of the drawer's currency had been increased to 75 per cent of quota by a prior credit tranche drawing, the last clause of Article V, Section 3(a)(iii) would no longer apply to it. Under that provision members may make purchases in excess of 25 per cent of quota (as interpreted by Decision No. 451-(55/52)(Selected Decisions, Third Issue, page 20) in a 12-month period without the need for a waiver under Article V, Section 4, to the extent that the Fund's holdings of their currency would not be brought above the 75 per cent level. The Fund could, of course, adopt a policy to grant waivers in such cases. At the same time, certain benefits under the Articles would accrue to members which used the credit tranches ahead of the gold tranche, and this would be difficult to defend. For example:

(i) Under Article V, Section 3(a)(iii), such a member could make purchases in excess of 25 per cent of quota (as interpreted in Decision No. 451-(55/52)) in a period of 12 months to the extent that it had not made net use of the Fund's resources as measured by the level of 75 per cent of quota, without the need for a waiver under Article V, Section 4. Clearly, such privileges should be attached to a floating gold tranche and not to credit tranches if they are utilized first.

(ii) Under Article V, Section 8(c) and Rule I-4(f) no charges are levied on Fund holdings which are not in excess of the member's quota, and it is for this reason that for drawings in the basic gold tranche (represented by holdings between 75 and 100 per cent of quota) a member's obligation to agree with the Fund on repurchase when the charge of 4 per cent per annum becomes payable does not apply. If a member drew its credit tranches without increasing the Fund's holdings of its currency above quota level, no charge would be payable and the member could not be made to have a binding commitment to repurchase in respect of its credit tranche drawings.

(iii) A member may not be declared ineligible under Article V, Section 5 as a rule, since it is not using the Fund's resources as determined by the 75 per cent level (Decision No. 292-3, Selected Decisions, Third Issue, page 33). A member would be immune from this sanction even though it had drawn credit tranches and even though the Fund had laid down policy requirements on the proper use of its resources in connection with the drawing.

3. If the floating gold tranche were established by amending the Articles, the amendments would be guided by the propositions that members should have a choice between gold tranche or credit tranche drawings, that the former would be automatic while the latter would be conditional, that credit tranche drawings would be subject to the quantitative limits now laid down in Article V, Section 3(a)(iii), while gold tranche drawings would not be subject to such limits, that charges on Fund holdings would be payable in connection with credit tranche drawings only, that gold tranche drawings would either not be subject to repurchase obligations or subject to such obligations only in respect of that part of the gold tranche which is equal to 25 per cent of the member's quota, while all credit tranche drawings would be subject to repurchase obligations, and that the unused portion of the gold tranche above 25 per cent of the member's quota would earn interest.

In order to give effect to these propositions, it would be necessary to divide drawing rights into a gold tranche and a credit tranche category, and to establish for each member a gold tranche and a credit tranche drawing account, each of which could be drawn upon on the terms proper to it. It would be reasonable to provide that as long as a drawing on the credit account were outstanding, any reduction in Fund holdings would be credited against the use of the credit account, and a member's gold tranche account would be increased only after its use of the credit tranche account had ceased.

Under a system of this kind the gold tranche would not be a floating facility in the same sense as the revised compensatory financing facility; rather, two separate facilities would exist side by side and separate sets of rules would govern the use of each. To bring this about, amendments of a legally radical nature would have to be adopted. The provisions that would have to be considered for amendment would include:

(i) Article V, Section 3(a), which would be replaced by a provision setting forth the establishment of the two accounts, and the definition of each. In addition, it would provide for automaticity of the gold tranche and conditionality of the credit tranches and set forth quantitative limits for credit tranche drawings and allocation rules specifying against which account reductions in and additions to Fund holdings would be credited. These rules would determine increases and decreases in members' gold and credit tranche positions. According to the proposition mentioned above, the rules would specify that any reduction in Fund holdings would first be credited against use of the credit tranche account.

(ii) Article V, Section 5 (giving immunity from ineligibility to members not making use of the Fund's resources). While the provision could be left to apply on the basis of total use, as it does at present, it would probably be more logical to substitute a provision enabling the Fund to impose sanctions in connection with any use of the credit tranche account, while exempting all use of the gold tranche account. This would be tantamount to replacing the present level of 75 per cent with the quota level.

(iii) Article V, Section 7(a) (repurchase with gold down to the quota level) and Article V, Sections 7(b) and 7(c) (repurchase down to the 75 per cent level but not beyond; no use of any currency in repurchase above the 75 per cent level). In order to eliminate the anomaly that credit tranche drawings could not be repurchased to the extent that the Fund's holdings were below 75 per cent of the member's quota, it would be advisable to provide for repurchase of all credit tranche drawings irrespective of the level of Fund holdings. Gold tranche drawings would either not be subject to repurchase (which would in effect amount to substituting the quota level for the present 75 per cent level), or, alternatively, gold tranche drawings would be subject to repurchase up to 25 per cent of the member's quota.

(iv) Article V, Section 8(c) and (d) and Rule I-4(f) and (g) (charges on Fund holdings in excess of quota; requirement to agree on repurchase when rate of 4 per cent per annum becomes payable; possible sanctions for failure to repurchase), which would be replaced by a provision pursuant to which charges would be imposed in respect of all credit tranche drawings, without any reference to the level of the Fund's holdings resulting from such drawings, while the provision would prescribe that no charges would be due in respect of gold tranche drawings, again without reference to levels. The concept of average daily balances could be applied to Fund holdings derived from credit tranche drawings and the time progression and the progression by amount of use in the credit tranches could be retained. This would, of course, require an adaptation of all other rules and policies which are based on the present system of charges, including the Fund's three to five year policy on the use of its resources.

(v) Article XII, Section 3(c) (right to appoint additional Executive Directors because of reduction of Fund holdings below certain average level). It would be possible to continue determining a member's entitlement under this provision on the basis of its net use of the Fund in both the gold and the credit tranche account, but it would also be possible to base the right to appoint an additional Executive Director only on the average unused balance of the gold tranche account above 25 per cent of the member's quota.

(vi) Article XII, Section 6(b) (preferential distribution of net income in relation to 75 per cent level). A provision for the payment of interest on the average unused portion of the gold tranche, or on the portion in excess of 25 per cent of quota, would be substituted.

(vii) Article VI, Section 1 ("not use" to meet a large or sustained outflow of capital), and Article VI, Section 2 (special provisions for drawings for capital transfers if the Fund's holdings have remained below the 75 per cent level for at least six months) would also have to be amended in some appropriate way.

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

FD reform

CABLE ADDRESS
INTERFUND

MEMORANDUM

TO: Mr. Gold
Mr. Polak
Mr. Nicoletopoulos

October 31, 1967

FROM: J. Marcus Fleming

SUBJECT: Reform of the Gold Tranche

Here is a rather sketchy first draft of a possible Board paper on the Reform of the Gold Tranche. As you will see, I have trespassed quite a bit on to legal territory. This I think is inevitable in the nature of the case. If we can agree on the substance of what should be suggested to the Board and the line of argument to be employed, there should be no difficulty about getting the drafting right.

DRAFT: J.M. Fleming
October 31, 1967

Reform of the Gold Tranche

The present paper is concerned with certain of the suggestions contained in the Memorandum submitted by Mr. van Campenhout on behalf of a number of Executive Directors on June 22, 1967 (EBD/67/97), on which it offers observations supplementing those contained in SM/67/99 of August 2, 1967.

The suggestions in question are IA, IB, and IE, relating to the status of the gold tranche, and IIC, relating to Article VI. For convenience, these suggestions have in some instances been split up into parts and rearranged.

Criterion of Need to Draw

"Members eligible to use the Fund's resources would have the right to draw within the limits of their gold tranche position only in case of need and not for the sole purpose of changing the composition of their reserves." (from IA)

"If the *de jure* automaticity of the gold tranche is accepted, Article VI, Sec. 2 ceases to be applicable, and a simplification in the text of Article VI, Sec. 1, might be envisaged." (IIC)

As was indicated in SM/67/99, if the term "need" is construed in the sense of the Fund Articles, the concept of "presently needed" in Article V, Sec. 3(a)(i) would not require amendment in order to give effect to the suggestion contained in the first of the two passages set forth above. Thus drawings "for the sole purpose of changing the composition of their reserves" would be inconsistent with the present wording of Article V, Sec. 3(a)(ii), in the light of the other Articles as they stand.

From the second of the two extracts cited above, however, it is clear that the term "need" in Mr. van Campenhout's memorandum is intended to cover drawings that would not be fully legitimate under the Articles as they stand, including, for example, drawings to meet capital transfers of a type not now permissible to all members under Article VI, Sec. 1, but permissible, under certain restrictions, to members with super-gold tranche positions under Article VI, Sec. 2.

What would in fact appear to be the intention of the memorandum is to permit drawings within the gold tranche to make payments of all kinds on currency or capital account, including payments required to discharge short-term currency liabilities to private or official holders, but not to permit drawings the result of which would be to increase the gross reserves of the drawing member in forms other than reserve positions in the Fund.

This result could be attained not only for drawings in the gold tranche but for all Fund drawings, without amending Article V, Sec. 3(a)(i) by repealing Article VI, Sec. 1, in which case the retention of Article V, Sec. 2 would become pointless. While drawings needed to make payments on capital account would be permissible, drawings the effect of which was merely to raise the level of reserves other than Fund reserve positions (i.e., drawings for the sole purpose of changing the composition of reserves) would continue to be contrary to the Articles since they would not be "needed to make payments" at all.

If it were felt that to abrogate Article VI, Secs. 1 and 2 completely would go too far in permitting Fund resources to be used to meet over-all deficits as distinct from deficits on current account, two kinds of amendments of more limited scope might be considered. One possibility that has already been mentioned in SM/67/99 is to retain in a reworded form the second sentence

of Article VI, Sec. 1(a) under which the Fund may request a member to exercise controls to limit its use of Fund resources to meet an outflow of capital. If this were retained it might be held that Article VI, Sec. 2 had not altogether been deprived of its function and should also be retained.

Another possibility would be to retain the present provision of Article V, Sec. 1, but to confine its operation to the credit tranches by the insertion of a saving clause covering the gold tranche. If this were done the retention of Article V, Sec. 2 would seem to be unnecessary since if drawings in any part of the gold tranche can be used to meet capital movements, no special latitude in this respect would be given to drawings in the super-gold tranche.

A thir d possibility, a combination of the previous two, would be to retain of Article VI, Sec. 1 only the Fund's authority to request the imposition of controls limiting the use of Fund resources to cover capital outflows but to confine even this authority only to cases where Fund resources were being used in the credit tranches.

In this connection it seems relevant to point out that even if all legal obstacles to the use of Fund resources to meet capital outflows were removed, the Fund would still be able to make the use of the credit tranches contingent on the adoption of suitable policies including, if it sees fit, policies designed to limit the outflow of capital.

If any of the last three possibilities were selected, it would be useful to make it clear that the remaining restrictions on use of the Fund would be applicable only to private capital movements, and not to the conversion of officially held balances of a country's currency. The conversion of such balances is clearly envisaged in Article VIII, Sec. 4, and while subsection (b) of this section lists certain situations in which the member whose currency

is presented is not obliged to convert, it cannot be intended that the Fund would have the right to block conversion in any situation where the member was willing to convert.

If Article VI, Secs. 1 or 2, were abrogated, either entirely or subject to the retention of the power to request the imposition of capital controls limiting the use of Fund resources in the credit tranches only, such action would not only meet completely the proposal put forward in Mr. van Campenhout's memorandum, but would also make the need criterion applicable to drawings in the gold tranche quite consistent with that suggested for drawings of S.D.R.'s (other than those calculated to promote reconstitution) in V.1(c) of the "Outline of a Facility Based on Special Drawing Rights in the Fund," viz.,

> "(c) Except as indicated in V.3(c), a participant will be expected to use its special drawing rights only for balance of payments needs or in the light of developments in its total reserves and not for the sole purpose of changing the composition of its reserves."

Non-Challengeability

"In no case would the Fund have authority to prevent such a drawing. This applies to the Fund's right to challenge the representation envisaged in Article V, Sec. 3, whatever the legal basis of the right to challenge." (EBD/67/97, Section I.A.)

A draft of a possible amendment to implement this proposal, in the form of a new Section 3(c) of Article V, was suggested in paragraph (13) on page 7 of SM/67/99.

It should be noted that in V.1(d) of the Outline it is provided that "The use of special drawing rights will not be subject to prior challenge on the basis of this expectation, but the Fund may make representations to

any participant which, in the Fund's judgment, has failed to observe the expectation, and may direct drawings to such participant to the extent of such failure." There would appear to be no reason, if Executive Directors so desire, why the principle of guiding drawings in the General Account towards the currencies of countries that have abused the right to draw without challenge in the gold tranche by failing to observe the principle of need enunciated in Article V, Sec. 3(a)(i) should not be introduced into the "currencies to be drawn" policies of the Fund.

Elimination of the Representation

"In view of A above, the representation in respect of drawings within the gold tranche could be eliminated." (I.B of EBD/67/97)

For the reasons set forth at pp. 5-6 of SM/67/99, the elimination of the representation under Article V, Sec. 3(a)(i) would appear to be inadvisable.

Abolition of Charges

"The charges provided for in Article V, Sec. 8(a) would be abolished." (Part of I.E of EBD/67/97)

So long as transactions between the Fund and its members take place at par, some transactions charge may be necessary to obviate the arbitrage profits that could otherwise arise from drawing currencies that are at a premium in the market and repurchasing, sooner or later, with currencies that are at or below par or with gold. The transactions charge fulfils two other functions: that of discouraging drawings for which the need is trivial or slight, and that of providing income to the Fund and thus maintaining its liquidity position. Complete abolition of the transactions charge might make it difficult, for example, to pay a reasonable rate of interest on super gold

tranche positions or necessitate an increase in charges. For these reasons the possibility suggested at paragraph 21 on p. 11 of SM/67/99 deserves consideration; namely, an amendment increasing the discretionary authority of the Executive Directors and enabling, but not obliging, them to reduce or eliminate the transactions charge for all gold tranche purchases. This could be achieved by an amendment of Article V, Sec. 8(a), which would remove the lower but not the upper limit of the transactions charge as follows:

> "The Fund may levy a service charge, uniform for all members and not more than one per cent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

If this amendment were adopted, the charge could, if necessary, be reintroduced or increased after reduction, without any further amendment being required.

Interest on Super Gold Tranche Positions

"The super gold tranche positions would bear interest (within maximum and minimum limits that might be specified)." (part of I.E of EBD/67/97) The principal advantage of the payment of interest on super gold tranche positions, as compared to the distribution of net income on such positions under Article XII, Sec. 6, is that whereas the latter are restricted in amount to the net income of the year with respect to which the distribution is made and may therefore not be payable with respect to years of low net income, the former represents a deduction entering into the calculation of net income itself, and may be paid even if this results in a negative net income for the year. Interest payments can therefore be made steadier and

more reliable from year to year than can distributions. This does not mean, however, that interest can with impunity be set at a level which, taking one year with another, leads to net losses and forces the Fund to trench ever more deeply on its reserves. It would seem prudent, therefore, to make the payment of interest discretionary rather than mandatory, and consequently to refrain from laying down any minimum level for interest payments. An amendment to achieve this result might be worded as follows:

"(a) The Fund may pay annual interest [of not more than X per cent per annum] to a member on the amount by which seventy-five per cent of its quota exceeded the Fund's average holdings of its currency during the year. The Fund shall determine the rate of interest, if any, and such interest shall be uniform for all members.

(b) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. If any distribution is made, it shall be paid to all members in proportion to their quotas.

(c) Payments of interest and distributions of income to a member shall be made in its own currency."

Mr Polak [handwritten]

Mrs. Lachman October 31, 1967

J. Marcus Fleming

The Floating Gold Tranche

Your treatment of the floating gold tranche seems to me to make unduly heavy weather of the objections.

(Incidentally, your list in paragraph 3 of amendments that would have to be made "if a floating gold tranche were established by amending the Articles" is more extensive than your list in paragraph 2 of the anomalies that would arise if the floating gold tranche were established without amendment of the Articles. This seems odd. Should there not be a point by point correspondence?)

(1) I would not have called the right to make a drawing of more than 25 per cent without waiver an "important" privilege in view of the ease with which such waivers are given.

(2) I will grant you that there is a certain anomaly about the Fund being unable in certain circumstances to declare ineligible a country that has drawn subject to policy conditions.

(3) On the other hand, I do not feel that it matters much that gold tranche drawings might be subject to more stringent repurchase conditions than credit tranche drawings, or that they might pay higher charges, or that countries whose gold tranches remain intact might nevertheless lose their preferential claims on distributions from net income or their rights to appoint additional executive directors. Because oranges are juicier than apples it does not follow that they have to be sweeter too. A country drawing its credit tranche first would be aware that it was using up certain privileges which it would later have to forfeit when it used its gold tranche. Moreover, most of these privileges were intended to be given to countries in a net creditor position as such rather than to countries possessing unconditional drawing rights as such.

(4) As regards the point you make about Article VI, in addition to its being open to the comment made above, there is the possibility--I hope likelihood--that Article VI, Secs. 1 and 2 will be amended virtually out of existence as part of the reform of the gold tranche. In any event, they do not mean much in practice at the present time.

(5) I think you may be jumping to conclusions in (iii) and (iv) of your paragraph 3. The separation of the gold tranche and the credit tranches does not prejudge the question of how repurchases are allocated to particular drawings, which I imagine is something not envisaged in the Articles at all, but is a matter of pure policy convention. When we were considering the method of creating reserves by extending gold tranche rights into the credit tranche, we had in mind that the part of the credit tranche given those qualities (the "wedge") would

float, and at that time we proposed that repurchases should be allocated in the first instance to ordinary credit tranche drawings in preference to drawings in the "wedge." The same principle could be adopted with respect to the floating gold tranche. In this event, I imagine the difficulties you mention at (iii) and (iv) would not arise.

cc: Mr. Gold
Mr. Polak
Mr. Nicoletopoulos

MEMORANDUM

TO: Mr. Gold October 31, 1967

FROM: J. J. Polak

SUBJECT: Floating Gold Tranche

To obtain a reasonable judgment as to whether a floating gold tranche was possible by a modest amount of amendment, it would be necessary to do a little more work on the list given in paragraph 3 of Mrs. Lachman's memorandum. In the light of Mr. Fleming's comments I think one could essentially disregard items 6 and 7 of that list because we shall, in any event, have to deal with Article VI and also item 8 and any corresponding comments on voting. On the latter point, it is not by any means unreasonable to have these matters determined by the countries net use of the Fund taking into account both credit tranche use and gold tranche use. The same could even be said for ~~immunity~~ ineligibility (item 11 in the list).

On the other hand, I would disagree with Mr. Fleming that we could reasonably continue to use the present system of charges and distribution of income if we went to the trouble of amending the Articles to create a floating gold tranche.

In other words, an amendment to achieve this end would have to contain at least the following ingredients.

It would have to establish for each member a credit tranche account and a gold tranche account. The member would be free to use balances in either account at its option but nothing would be credited to its gold tranche account as long as there was still any debt outstanding in its credit tranche account. (This would mean that all payments by the member—gold payments on account of quota increases, repurchases—and all sales of the member's currency would in the first instance be credited to its credit tranche account, until any use of that account had been eliminated. This would be the same as what happens under the present Articles.) The provisions for use in the two accounts would be separate. Drawings in the credit tranches would be conditional, subject to the limit of 25 per cent per year and 100 per cent in total, to charges, and to repurchase. On the other hand

SUBJECT COPY

drawings in the gold tranche would be automatic, not subject to any limit, not subject to repurchase except perhaps for the first 25 per cent of quota. Moreover, any balance held in the gold tranche account in excess of 25 per cent of quota would earn interest.

This would, I believe, constitute a workable system of a floating gold tranche; the question to analyze in more detail is how much amendment would really be involved in order to give effect to it..

SUBJECT COPY

Mr. Blake

DRAFT

J. M. Fleming
October 31, 1967

Fund reform

Reform of the Gold Tranche

The present paper is concerned with certain of the suggestions contained in the Memorandum submitted by Mr. van Campenhout on behalf of a number of Executive Directors on June 22, 1967, on which it offers observations supplementing those contained in SM/67/99 of August 2, 1967.

The suggestions in question are IA, IB, and IE, relating to the status of the gold tranche, and II C, relating to Article VI. For convenience, these suggestions have in some instances been split up into parts and rearranged.

Criterion of Need to Draw

"Members eligible to use the Fund's resources would have the right to draw within the limits of their gold tranche position only in case of need and not for the sole purpose of changing the composition of their reserves." (from IA)

"If the de jure automaticity of the gold tranche is accepted, Article VI, Section 2 ceases to be applicable, and a simplification in the text of Article VI, Section 1, might be envisaged." (IIC)

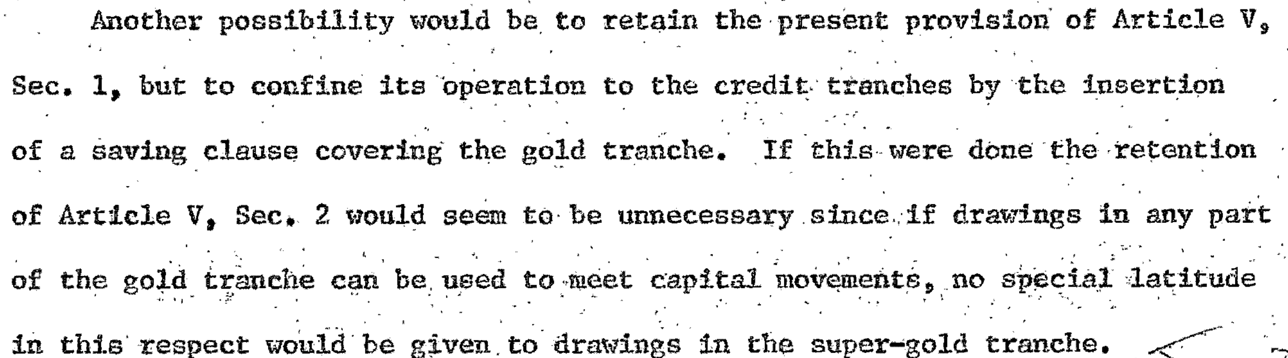
As was indicated in SM/67/99, if the term "need" is construed in the sense of the Fund articles, the concept of "presently needed" in Article V, Section 3(a)(i) would not require amendment in order to give effect to the suggestion contained in the first of the two passages set forth above. Thus drawings "for the sole purpose of changing the composition of their reserves" would be inconsistent with the present wording of Article V, Sec. 3(a)(ii), in the light of the other Articles as they stand.

From the second of the two extracts cited above, however, it is clear that the term "need" in Mr. van Campenhout's memorandum is intended to cover drawings that would not be fully legitimate under the Articles as they stand, including, for example, drawings to meet capital transfers of a type not now permissible to all members under Article VI, Sec. 1, but permissible, under certain restrictions, to members with super-gold tranche positions under Article VI., Sec. 2.

What would in fact appear to be the intention of the memorandum is to permit drawings within the gold tranche to make payments of all kinds on current or capital account, including payments required to discharge short-term currency liabilities to private or official holders, but not to permit drawings the result of which would be to increase the gross reserves of the drawing member in forms other than reserve positions in the Fund.

This result could be attained not only for drawings in the gold tranche but for all Fund drawings, without amending Article V, Sec. 3(a)(i) by repealing Article VI, Sec. 1, in which case the retention of Article V, Sec. 2 would become pointless. While drawings needed to make payments on capital account would be permissible, drawings, the effect of which was merely to raise the level of reserves other than Fund reserve positions (i.e., drawings for the sole purpose of changing the composition of reserves) would continue to be contrary to the Articles since they would not be "needed to make payments" at all.

If it were felt that to abrogate Article VI, Sections 1 and 2 completely would go too far in permitting Fund resources to be used to meet over-all deficits as distinct from deficits on current account, two kinds of amendments of more limited scope might be considered. One possibility that has already been mentioned in SM/67/99 is to retain in a reworded form the second sentence of Article VI, Sec. 1(a) under which the Fund may request a member to exercise controls to limit its use of Fund resources to meet an outflow of capital. If this were retained it might be held that Article VI, Sec. 2 had not altogether been deprived of its function and should also be retained.



Another possibility would be to retain the present provision of Article V, Sec. 1, but to confine its operation to the credit tranches by the insertion of a saving clause covering the gold tranche. If this were done the retention of Article V, Sec. 2 would seem to be unnecessary since if drawings in any part of the gold tranche can be used to meet capital movements, no special latitude in this respect would be given to drawings in the super-gold tranche.

A third possibility, a combination of the previous two, would be to retain of Article VI, Sec. 1 only the Fund's authority to request the imposition of controls limiting the use of Fund resources to cover capital outflows but to confine even this authority only to cases where Fund resources were being used in the credit tranches.

In this connection it seems relevant to point out that even if all legal obstacles to the use of Fund resources to meet capital outflows were removed, the Fund would still be able to make the use of the credit tranches contingent on the adoption of suitable policies including, if it sees fit, policies designed to limit the outflow of capital.

If Article VI, Sections 1 or 2, are abrogated entirely or subject to the retention of the power to request the imposition of capital controls limiting the use of Fund resources in the credit tranches only, such action would not only meet completely the proposal put forward in Mr. van Campenhout's memorandum, but would also make the need criterion applicable to drawings in the gold tranche quite consistent with that suggested for drawings of S.D.R.'s (other than those calculated to promote reconstitution) in V.1(c) of the "Outline of a Facility Based on Special Drawing Rights in the Fund," viz.,

"(c) Except as indicated in V.3(c), a participant will be expected to use its special drawing rights only for balance of payments needs or in the light of developments in its total reserves and not for the sole purpose of changing the composition of its reserves."

Non-Challengeability

"In no case would the Fund have authority to prevent such a drawing. This applies to the Fund's right to challenge the representation envisaged in Article V, Section 3, whatever the legal basis of the right to challenge." (EBD/67/97, Section I.A.)

A draft of a possible amendment to implement this proposal, in the form of a new Section 3(c) of Article V, was suggested in paragraph (13) on page 7 of SM/67/99.

It should be noted that in V.1(d) of the Outline it is provided that "The use of special drawing rights will not be subject to prior challenge on the basis of this expectation, but the Fund may make representations to any participant which, in the Fund's judgment, has failed to observe the expectation, and may direct drawings to such participant to the extent of such failure." There would appear to be no reason, if Executive Directors so desire, why the principle of guiding drawings in the General Account

towards the currencies of countries that have abused the right to draw without challenge in the gold tranche by failing to observe the principle of need enunciated in Article V, Sec. 3(a)(i) should not be introduced into the "currencies to be drawn" policies of the Fund.

Elimination of the Representation

"B. In view of A above, the representation in respect of drawings within the gold tranche could be eliminated."

For the reasons set forth at pp. 5-6 of SM/67/99, the elimination of the representation under Article V, Sec. 3(a)(i) would appear to be inadvisable.

Abolition of Charges

"The charges provided for in Article V, Sec. 8(a) would be abolished." (Part of E.)

So long as transactions between the Fund and its members take place at par, some transactions charge may be necessary to obviate the arbitrage profits that could otherwise arise from drawing currencies that are at a premium in the market and repurchasing, sooner or later, with currencies that are at or below par or with gold. The transactions charge fulfils two other functions: that of discouraging drawings for which the need is trivial or slight, and that providing income to the Fund and thus maintaining its liquidity position. Complete abolition of the transactions charge might make it difficult, for example, to pay a reasonable rate of interest on super gold tranche positions or necessitate an increase in charges. For these reasons the possibility suggested at paragraph 21 on p. 11 of SM/67/99 may be worthy of consideration; namely an amendment increasing the discretionary authority of the Executive Directors and enabling them to reduce or eliminate the transactions charge for all gold tranche purchases, but not obliging them to do so. This could be achieved by an amendment of Article V, Sec. 8(a), which would remove the lower but not the upper limit of the transactions charge as follows:

"The Fund may levy a service charge, uniform for all members and not more than one per cent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

If this amendment were adopted, the charge could, if necessary, be reintroduced or increased after reduction, without any further amendment being required.

Interest on Super Gold Tranche Positions

"The super gold tranche positions would bear interest (within maximum and minimum limits that might be specified)." (part of E)

The principal advantage of the payment of interest on super gold tranche positions, as compared to the distribution of net income on such positions under Article XII, Sec. 6, is that whereas the latter are restrcted in amount to the net income of the year with respect to which the distribution is made and may therefore not be payable in years of low net income, the former represents a deduction entering into the calculation of net income itself, and may be paid even if this results in a negative net use for the year. Internal payments can therefore be made steadier and more valuable from year to year than distributions. This does not mean, however, that interest can with impunity be set at a level which, taking one year with another, leads to net losses and forces the Fund to travel ever more cheaply on its reserves. It would seem prudent, therefore, to make the payment of interest discretionary rather than mandatory, and consequently to refrain from laying down any maximum level for interest payments. An amendment to achieve this result might be worded as follows:

"(a) The Fund may pay annual interest [of not more than X per cent per annum] to a member on the amount by which seventy-five per cent of its quota exceeded the Fund's average holdings of its currency during the year. The Fund shall determine the rate of interest, if any, and such interest shall be uniform for all members.

(b) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. If any distribution is made, it shall be paid to all members in proportion to their quotas.

(c) Payments of interest and distributions of income to a member shall be made in its own currency."

INTERNATIONAL MONETARY FUND

October 30, 1967

TO : Mr. J. J. Polak

FROM: Joseph Gold JG

Subject: Floating Gold Tranche

I shall be grateful if you can let me have any comments on the attached note. I am somewhat overdue in providing it to Mr. Southard, and I wonder, therefore, whether you could give me a fairly prompt reaction.

Office Memorandum

TO : Mr. Gold

DATE: October 30, 1967

FROM : Philine R. Lachman *PRL*

SUBJECT : Floating Gold Tranche

1. You have asked for a preliminary legal view of what would be involved in the establishment of a "floating" gold tranche, which would make it possible for a member to use the credit tranches ahead of the gold tranche.

The Fund's tranche policies, including the gold tranche policy, are based on the general idea that "adequate safeguards" must be observed in making the Fund's resources available to members. Two actions that are relevant to the present inquiry have been taken consistently with this idea without the need for amending the Articles: (a) the Fund has decided that it can safely give the overwhelming benefit of any doubt to requests within certain limits (gold tranche policy), and (b) the Fund has decided that it can make certain drawing privileges "float" in the sense that the exercise of them does not affect the tranche policies applicable to other drawings (revised compensatory financing facility).

Clearly, the ideas on which these actions are based could be combined so that the gold tranche would become a "floating" facility. I am assuming, of course, that any additional strain on the Fund's liquidity resulting from making a quasi-automatic privilege exercisable after other privileges would cause no legal difficulties under Article I(v).

2. If the establishment of a "floating" gold tranche were effected by a policy decision without amendment of the Articles, the present provisions that deal with levels of Fund holdings would continue to apply. This would lead to unsatisfactory results both in respect of the gold tranche and in respect of the credit tranches. Under the Fund's present Articles, a member which is in a "creditor" position enjoys certain additional benefits, and "creditor" position is measured by the member's total net use of the Fund's resources. While gold tranche drawings would continue to enjoy the virtual immunity from challenge, members with a super gold tranche position would lose an important benefit if they made a super gold tranche drawing after the Fund's holdings of their currency had been increased to 75 per cent of quota by a prior credit tranche drawing. What they would lose is the ability to make purchases in excess of 25 per cent of quota (as interpreted by Decision No. 451-(55/52)(Selected Decisions, Third Issue, page 20) in a 12-month period without the need for a waiver under Article V, Section 4, to the extent that the Fund's holdings of their currency would not be brought above the 75 per cent level. At the same time, certain benefits under the Articles would accrue to members which used the credit tranches ahead of the gold tranche, and this would be difficult to defend. For example:

(i) Under Article V, Section 3(a)(iii), such a member could make purchases in excess of 25 per cent of quota (as interpreted in Decision No. 451-(55/52)) in a period of 12 months to the extent that it had not made net use of the Fund's resources as measured by the level of 75 per cent of quota, without the need for a waiver under Article V, Section 4. Clearly, such privileges should be attached to a floating gold tranche and not to credit tranches if they are utilized first.

(ii) Under Article V, Section 8(c) and Rule I-4(f) no charges are levied on Fund holdings which are not in excess of the member's quota, and it is for this reason that for drawings in the basic gold tranche (represented by holdings between 75 and 100 per cent of quota) a member's obligation to agree with the Fund on repurchase when the charge of 4 per cent per annum becomes payable does not apply. If a member drew its credit tranches without increasing the Fund's holdings of its currency above quota level, no charge would be payable and the member could not be made to have a binding commitment to repurchase in respect of its credit tranche drawings.

(iii) A member may not be declared ineligible under Article V, Section 5 as a rule, since it is not using the Fund's resources as determined by the 75 per cent level (Decision No. 292-3, Selected Decisions, Third Issue, page 33). A member would be immune from this sanction even though it had drawn credit tranches and even though the Fund had laid down policy requirements on the proper use of its resources in connection with the drawing.

3. If the floating gold tranche were established by amending the Articles the amendments would have to be quite sweeping because it would not be possible to retain the concept of total net use which now determines the extent of members' gold tranche rights. The new concept would be a radically different one and would call for a considerable revision of the Articles. The provisions that would have to be considered for amendment would include:

(i) Article V, Section 3(a)(iii) (allowing a member to make purchases in excess of 25 per cent of quota in a period of 12 months to the extent that it is not making net use of the Fund's resources).

(ii) Article V, Section 5 (giving immunity from ineligibility to members not making use of the Fund's resources).

(iii) Article V, Section 7(a) (repurchase with gold down to the quota level).

(iv) Article V, Sections 7(b) and 7(c) (repurchase down to the 75 per cent level but not beyond; no use of any currency in repurchase above the 75 per cent level).

(v) Article V, Section 8(c) and (d) and Rule I-4(f) and (g) (charges on Fund holdings in excess of quota; requirement to agree on repurchase when rate of 4 per cent per annum becomes payable; possible sanctions for failure to repurchase).

(vi) Article VI, Section 1("net use" to meet a large or sustained outflow of capital).

(vii) Article VI, Section 2 (special provisions for drawings for capital transfers if the Fund's holdings have remained below the 75 per cent level for at least six months).

(viii) Article XII, Section 3(c) (right to appoint additional Executive Directors because of reduction of Fund holdings below certain average level).

(ix) Article XII, Section 6(b) (preferential distribution of net income in relation to 75 per cent level).

In addition, the question whether any changes would require amendment of the Articles or could be carried out by amending the Rules and Regulations would have to be considered.

Finally, many of the Fund's decisions would have to be reconsidered. For example, the present 3 to 5 year policy on use is based on the rule that consultation with the Fund under Article V, Section 8(d) is required no later than three years after a drawing. That in turn is based on a schedule of charges under which a certain rate is reached on total Fund holdings of a currency.

Office Memorandum

Reform of Fund

TO : Mr. Polak

DATE: September 12, 1967

FROM : Fred Hirsch FH

SUBJECT : Automatic Repurchase Provisions

1. It seemed evident from yesterday's Board Meeting that the EEC proposals on this subject, if pressed, will open a Pandora's box, above all by bringing the nonstatutory influences, through the scheduled commitments and through the currencies to be drawn policy, into the bargaining. Of the two possibilities raised in your memorandum of September 6, I imagine that the political obstacles to granting the Executive Directors power to suspend would be as formidable as the obstacles to the more radical elimination, for which on economic grounds a case might be made. The combination of voluntary repurchase, scheduled repurchase and drawing policy make a sufficient and rather well-balanced troika. I was impressed with the point made by Mr. Gold yesterday that the repurchase provisions as written into the Articles were a part of a system in which Fund transactions were essentially secondary and supplementary to countries' dealings in their first-line reserves. With the development of Fund positions as an integral part of countries' reserves, the policy of currencies to be drawn seems both a more refined instrument and a means of influencing in some degree countries' reserve composition as a whole.

2. This general consideration does not touch specifically on the question of equity between countries. But it seems important that in any examination of the workings of the present system or of the possible changes in it, one should show also the impact through the currencies to be drawn policy. This has a particular relevance since at least in the past, the reserve currency countries which have "gained" by reason of the exemptions on liabilities have probably been especially affected by this indirect repurchase. As a specific suggestion, might not the Tables 1-6 in the memorandum of the Treasurer's Department (SM/67/110) include a memorandum item something like Column 1(a) "Net Reduction in Fund Holdings of Currency Through Drawings, Net of Repurchase, by Other Members."

3. There does seem to me one fairly clear anomaly in the liability exemption in its present form. The significant economic distinction between currency liabilities and short-term contractual debts seems to me that currency liabilities can be called on demand, and can therefore be reasonably reckoned as a charge against available reserves. But this distinction breaks down in the case of nominal currency liabilities that are in effect specially contracted debts, viz., official swaps. The present distinction allows exemption for this support when they go through the rigamarole of the exchange of currencies but excludes exemption when official support is direct in the form of short-term loan of foreign currency. This may marginally affect the choice between different technical forms of support operations for large countries, which may not be too important; but it may also introduce a real degree of discrimination against small countries not large enough or strong enough to get into the swap network. Thus, it was Turkey's dollar loans from the EMA that helped push it into Article V,

Section 7(b) where swap credits would have saved it. Would one simple way of catching this anomaly be to add short-term loans to the category of exempted influences under Schedule B, Paragraph 3?

cc: Mr. Fleming
Mr..Schwartz
Mr. Hicks
Mr. Smith

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBD/67/139

Mr. J. J. Polak

Room 504 F

#1

September 12, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Modifications in Rules and Practices of the Fund - EEC Documents

In view of the discussions in the Executive Board on modification in the Fund's rules and practices, it has been suggested that the attached texts of the EEC Ministerial Communiqué, dated April 18, 1967 and the Report of the EEC Monetary Committee, dated April 11, 1967, together with unofficial English translations thereof, should be circulated.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

EBD/67/139

LES MINISTRES DES FINANCES DES SIX PAYS MEMBRES DE LA COMMUNAUTE ECONOMIQUE EUROPEENNE SE SONT REUNIS A MUNICH LE 17 ET LE 18 AVRIL 1967 SOUS LA PRESIDENCE DU DR. H.C. FRANZ JOSEF STRAUSS, MINISTRE DES FINANCES DE LA REPUBLIQUE FEDERALE D'ALLEMAGNE. PARTICIPAIENT A CETTE REUNION : M. ROBERT HENRION, MINISTRE DES FINANCES (BELGIQUE), M. MICHEL DEBRE, MINISTRE DE L'ECONOMIE ET DES FINANCES (FRANCE), LE DR. EMILIO COLOMBO, MINISTRE DU TRESOR, ET LE DR. ATHOS VALSECHI, SECRETAIRE D'ETAT (ITALIE), LE PROF. DR. H. J. WITTEVEEN, VICE-PREMIER MINISTRE ET MINISTRE DES FINANCES (PAYS-BAS), M. PIERRE WERNER, PRESIDENT DU GOUVERNEMENT ET MINISTRE DES FINANCES (LUXEMBOURG), LE PROF. DR. KARL SCHILLER, MINISTRE DE L'ECONOMIE, ET LE DR. J. SCHOELLHORN, SECRETAIRE D'ETAT (REPUBLIQUE FEDERALE D'ALLEMAGNE). LA COMMISSION DE LA CEE ETAIT REPRESENTEE PAR SON VICE-PRESIDENT, M. ROBERT MARJOLIN, ET PAR M. HANS VON DER GROEBEN. EN OUTRE ONT PRIS PART A LA REUNION M. MAURICE PEROUSE, PRESIDENT DU COMITE DE POLITIQUE CONJONCTURELLE, ET M. JONKHEER EMILE VAN LENNEP, PRESIDENT DU COMITE MONETAIRE DE LA CEE.

DANS LA PREMIERE PARTIE DE LA CONFERENCE, A LAQUELLE PARTICIPAIENT LES GOUVERNEURS DES BANQUES CENTRALES, ILS SE SONT ENTRETENUS DES PROBLEMES MONETAIRES INTERNATIONAUX, EN SE FONDANT SUR L'IDEE QUE LES PAYS MEMBRES DE LA CEE DOIVENT OCCUPER DANS LES INSTITUTIONS MONETAIRES INTERNATIONALES UNE PLACE PLUS EN RAPPORT AVEC LEURS RESPONSABILITES REELLES, LEUR SOLIDARITE ECONOMIQUE CROISSANTE, LE DEVELOPPEMENT DE LEURS ECHANGES, LEUR RAYONNEMENT ECONOMIQUE ET FINANCIER AUPRES DES PAYS TIERS. CES FAITS NE PEUVENT PAS NE PAS CONDUIRE CES PAYS A RECHERCHER UNE POSITION COMMUNE DANS LES DISCUSSIONS ACTUELLES SUR LA REFORME DU SYSTEME MONETAIRE

INTERNATIONAL ET A MAINTENIR A L'AVENIR UNE ETROITE COOPERATION AFIN D'ETRE EN MESURE DE SAUVEGARDER SOLIDAIREMENT LEURS INTERESTS LEGITIMES.

DANS L'ESPRIT DE CETTE COOPERATION LES MINISTRES DES FINANCES ET DE L'ECONOMIE PARTICIPANT A CETTE REUNION SE SONT MIS D'ACCORD SUR LES POINTS SUIVANTS :

1. LE FAIT QU'UNE INSUFFISANCE DE LIQUIDITES INTERNATIONALES N'EXISTE PAS ACTUELLEMENT N'EXCLUT PAS DE REFLEXIONS SUR LES MESURES A PRENDRE EN CAS DE BESOINS FUTURS EN RESERVES SUPPLEMENTAIRES.

2. DES MESURES EVENTUELLES POUR CREER DES RESERVES SUPPLEMENTAIRES, OU DES SOLUTIONS ALTERNATIVES CORRESPONDANTES DOIVENT ETRE SUBORDONNEES A LA CONSTATATION COMMUNE D'UNE PENURIE GENERALE, A UN MEILLEUR FONCTIONNEMENT DU PROCESSUS D'AJUSTEMENT, A UN MEILLEUR EQUILIBRE DANS LES TRANSACTIONS FINANCIERES INTERNATIONALES. ELLES NE DOIVENT PAS ETRE FONDEES SUR DES BESOINS EN MATIERE DE BALANCE DE PAIEMENT DE CERTAINS PAYS, CE QUI EXCLUT UN TRAITEMENT DE FAVEUR AU PROFIT D'UN PAYS OU D'UN GROUPE DE PAYS.

3. CES MESURES NE DOIVENT PAS S'ADAPTER AUX PHENOMENES CYCLIQUES A COURT TERME, MAIS AUX BESOINS A LONG TERME.

4. LE POIDS ACTUEL DES SIX ET LEUR UNION AU SEIN DE LA CEE DOIVENT, EN TOUT ETAT DE CAUSE, LEUR ASSURER UNE INFLUENCE SUFFISANTE AU SEIN DU FMI, NOTAMMENT DANS LES PROCEDURES DE VOTE. LE COMITE MONETAIRE A ELABORE A CETTE FIN DES PROPOSITIONS APPROPRIEES.

5. DANS CES CONDITIONS, EN CAS D'INSUFFISANCE RECONNUE DE LIQUIDITES INTERNATIONALES, IL SERAIT POSSIBLE D'ENVISAGER A L'AVENIR, AU SEIN DU FMI, LA CREATION DE DROITS DE TIRAGE CONDITIONNELS ET INCONDITIONNELS.

6. EN FONCTION DES OBJECTIFS MENTIONNES CI-DESSUS, LA QUESTION SE POSE DE SAVOIR S'IL Y A LIEU D'ENVISAGER, POUR LA CREATION DES DROITS DE TIRAGE AUTOMATIQUES SUPPLEMENTAIRES, DES COMPTES ET UN FINANCEMENT SEPARES DES TRANSACTIONS ACTUELLES DU FMI.

7. IL DEVRAIT Y AVOIR OBLIGATION DE REMBOURSEMENT DES DROITS DE TIRAGE AUTOMATIQUES POUR LES DEBITEURS AYANT UTILISE LA TOTALITE DE LEURS DROITS OU UNE PARTIE DE CEUX-CI DE FACON CONSTANTE ET PENDANT UNE LONGUE DUREE, AFIN DE LES CONTRAINDRE A RETABLIR, A L'EXPIRATION D'UN DELAI DETERMINE, AU REGARD DE LEURS DROITS DE TIRAGE AUTOMATIQUES, LEUR POSITION ANTERIEURE. UNE TELLE OBLIGATION AURAIT POUR EFFET UNE AMELIORATION DU PROCESSUS D'AJUSTEMENT. ELLE DOIT EGALEMENT EVITER QUE LES DROITS DE TIRAGE SOIENT UTILISES POUR MODIFIER LA COMPOSITION DES RESERVES.

8. LES DROITS DE TIRAGE DANS LE FONDS MONETAIRE INTERNATIONAL NE SONT PAS DIRECTEMENT TRANSFERABLES. TOUTEFOIS, LA QUESTION DE LA CESSIBILITE VOLONTAIRE BILATERALE DES NOUVEAUX DROITS DE TIRAGE QUI DEVRAIT AVOIR LIEU EN TOUT ETAT DE CAUSE SOUS LE CONTROLE DU FMI, ET QUI NE DEVRAIT PAS CHANGER L'OBLIGATION DE REMBOURSEMENT DU PAYS TIREUR ORIGINAIRE, DEMANDE ENCORE UNE ETUDE PLUS APPROFONDIE.

BEST REGARDS

O. EMMINGER

COMMUNAUTE ECONOMIQUE
EUROPEENNE

Comité monétaire

Bruxelles, le 11 avril 1967
5742/II/67 - F

TRES CONFIDENTIEL

RAPPORT DU COMITE MONETAIRE AUX
Ministres des Finances et aux Gouverneurs
des Banques centrales de la C.E.E.

1. Au cours de leur réunion des 16 et 17 janvier 1967, les ministres des Finances et les gouverneurs des Banques centrales des six pays de la Communauté économique européenne ont adopté un communiqué qui précise notamment : "les ministres et gouverneurs, soucieux d'affirmer leur solidarité sur une question aussi essentielle que celle du problème monétaire international, ont décidé, tout en poursuivant l'examen des projets précédemment discutés, de faire étudier sans tarder par leurs experts, réunis au sein du Comité monétaire de la C.E.E., le perfectionnement des méthodes de crédit international".

2. En exécution de ce mandat le Comité monétaire s'est efforcé d'élaborer les éléments d'une position commune des pays de la C.E.E. dans les discussions actuelles sur la réforme du système monétaire international. A cet égard il s'est laissé guider par les considérations suivantes :

i. Si, à l'avenir, une extension des liquidités internationales devait s'imposer, celle-ci pourrait être fondée sur un développement des mécanismes de crédit dans le cadre du Fonds Monétaire International.

ii. Afin de garantir que d'éventuelles décisions sur la création de liquidités ne soient prises d'une façon prématurée et ne dépassent le volume nécessaire, compatibles avec le maintien de la stabilité monétaire, les procédures de vote s'appliquant à ces décisions devraient être fixées de telle manière que les pays de la C.E.E. puissent exercer une influence correspondant à leurs responsabilités économique et financière.

iii. Enfin, il conviendrait de saisir l'occasion de l'adaptation de certaines dispositions des statuts du Fonds aux fins citées en (i) et (ii) pour procéder également à d'autres améliorations souhaitables des statuts, des principes de gestion du Fonds et des modalités de vote, notamment celles qui pourraient contribuer à améliorer le fonctionnement d'un mécanisme élargi de liquidités au sein du F.M.I.

3. Se basant sur ces principes fondamentaux, le Comité monétaire a fait un certain nombre de propositions pouvant se regrouper sur les trois rubriques suivantes :

A. Développement des activités du F.M.I.

B. Aménagement de certaines règles et pratiques du F.M.I.

C. Règles relatives à la procédure de décision concernant les questions importantes, en particulier celles relatives aux diverses formes de création de liquidités.

A. <u>DEVELOPPEMENT DES ACTIVITES DU F.M.I.</u>

4. Le Comité monétaire a examiné diverses techniques susceptibles de satisfaire les besoins de liquidités qui pourraient se manifester. Elles s'échelonnent depuis l'élargissement des facilités traditionnelles du F.M.I. jusqu'à l'ouverture de nouvelles facultés de tirage qui pourraient être partiellement ou totalement séparées des activités actuelles du F.M.I.

En premier lieu,il a été rappelé que des augmentations générales ou sélectives des quotes-parts, soit dans le cadre normal des révisions quinquennales, soit à d'autres occasions, permettraient d'accroître les moyens d'intervention du F.M.I.

Par ailleurs, on pourrait envisager d'élargir les droits de tirage des pays membres du F.M.I. dans les tranches de crédit jusqu'à présent limités à 125 % de leur quote-part, sous réserve d'un accord général relatif aux modifications proposées par ailleurs en ce qui concerne les engagements des pays tireurs et les règles de majorité pour la prise de telles décisions.

Toutefois, on a fait remarquer qu'après les majorations importantes tant générales que sélectives des quotes-parts qui en 1966 ont porté celles-ci de 15 à 21 milliards de dollars, il n'y a pas actuellement de nécessité d'augmenter le volume des liquidités conditionnelles.

5. Au-delà des possibilités exposées au paragraphe précédent figure l'augmentation du volume des droits de tirage automatiques dans le F.M.I. Cette possibilité a été également examinée; elle pourrait être envisagée sous diverses formes, par exemple octroi de tranches-or supplémentaires contre paiement partiel en or ou sans versement d'or, automaticité progressive des tranches de crédit.

Les membres du Comité monétaire ont été unanimes à rappeler que la création de nouveaux droits de tirage automatiques dans le F.M.I. ne devrait pas intervenir avant que ne soit reconnue collectivement une pénurie générale de réserves et que n'ait été constaté un meilleur fonctionnement du processus d'ajustement ainsi qu'un meilleur équilibre des paiements internationaux, l'augmentation des avoirs en monnaies de réserve des Banques centrales ne contribuant plus d'autre part au financement des déficits extérieurs des pays à monnaie de réserve.

L'augmentation éventuelle du volume des droits de tirage automatiques pourrait être réalisée selon différentes modalités du point de vue institutionnel, comptable et financier :

a) On pourrait réaliser cette augmentation soit par une intégration des nouveaux droits de tirage automatiques dans le système des quotes-parts du Fonds, soit moyennant un système de comptes séparés; dans ce dernier cas les nouveaux droits de tirage pourraient avoir un caractère dit "flottant" (utilisables avant ou après épuisement des autres droits de tirage).

b) Les moyens additionnels nécessaires pour le financement des droits de tirage supplémentaires pourraient être incorporés dans l'ensemble des ressources du Fonds, ou pourraient demeurer séparés; dans le premier cas les nouvelles ressources feraient partie de la liquidité générale du Fonds.

c) La séparation des comptes visée sous (a) et celle des ressources visée sous (b) pourraient être effectuées soit dans le cadre du Fonds même, soit par la création d'un organisme associé au Fonds (Fund affiliate).

6. Une formule dont les lignes générales ont reçu l'appui d'un certain nombre des membres du Comité monétaire consisterait à ouvrir des droits de tirage automatiques avec une comptabilité et un financement séparés de ceux des autres droits de tirage sur le Fonds. Les nouvelles facilités automatiques seraient (a) utilisables suivant des règles bien définies à établir, parmi lesquelles figurerait la condition qu'elles ne devraient pas être utilisées dans le seul but de modifier la composition des réserves des pays tireurs, et (b) directement transférables entre les autorités monétaires des pays membres.

7. Le chois éventuel d'une solution dans ce domaine permettra de satisfaire dans les meilleures conditions les besoins légitimes de l'ensemble de la communauté internationale. Toutefois, la mise en place de techniques de cette nature requerra des aménagements à la structure et au fonctionnement du F.M.I., et notamment un accord sur les procédures de décisions, tels qu'exposés ci-après.

B. AMENAGEMENT DE CERTAINES REGLES ET PRATIQUES DU F.M.I.

8. Le Comité est d'avis qu'eu égard aux changements multiples et profonds intervenus depuis la création du F.M.I. dans la situation économique générale, dans les situations respectives des pays membres et dans le fonctionnement du système monétaire international, diverses adaptations au fonctionnement de cette institution paraissent opportunes en vue de la mettre mieux en mesure de répondre aux nécessités actuelles.

a) Adaptation de certaines dispositions

i. Statut de la tranche-or et de la super tranche-or

Les droits de tirage acquis par les pays membres en tranches-or et en super tranches-or sont devenus pour plusieurs d'entre eux un actif important, qui a d'ailleurs pris la place d'autres réserves. Ces droits pourraient être appelés à augmenter encore. Il est nécessaire de leur assurer toutes les qualités d'une véritable réserve. Il y aurait lieu d'améliorer leur statut en ce qui concerne la pleine automaticité de leur utilisation, leur expression en une unité de compte or et la suppression de la commission perçue par le F.M.I.

La possibilité d'unifier les propriétés des droits de tirage correspondant aux tranches-or et aux super tranches-or, d'assortir leur détention d'une certaine rémunération et d'assurer la transférabilité directe de ces droits devrait être envisagée. Il est souhaitable que les études techniques en cours au F.M.I. aboutissent dans les meilleurs délais à des propositions concrètes.

ii. Conditions de tirage dans les tranches de crédit

Les principes régissant actuellement la politique de tirage dans les tranches de crédit devraient faire l'objet d'un réexamen afin de contribuer plus efficacement au processus d'ajustement, en renforçant le caractère conditionnel de ces tirages. Dans ce but, il y aurait lieu de chercher à rendre plus précis les engagements à prendre par les pays tireurs, en prévoyant par exemple certaines normes quantitatives auxquelles ils seraient appelés à se conformer, notamment en ce qui concerne leurs politiques budgétaire, monétaire et des revenus. La révision du barème des redevances pourrait par ailleurs être envisagée.

Si un renforcement dans le sens indiqué était opéré, on pourrait envisager la suppression de la clause du statut du F.M.I. qui limite à 25 % de la quote-part le montant des tirages opérés dans le délai d'un an, celle-ci n'étant guère observée dans la pratique.

iii. Règles concernant les conditions de remboursement des tirages sur le F.M.I.

Les statuts du F.M.I. prévoient que les pays membres ayant opéré un tirage sur le Fonds peuvent, dans certaines conditions, être dispensés des obligations de remboursement. Il y aurait lieu d'étudier la révision des dispositions correspondantes (art. V, sec. 7 b et c et art. XIXe).

iv. Autres adaptations

Lors d'une révision éventuelle des statuts du F.M.I., on pourrait envisager :

- d'une part, de compléter la liste des objectifs énumérés à l'art. I en faisant spécifiquement mention de la stabilité des prix;
- d'autre part, de supprimer la distinction qui n'est plus opérée dans la pratique entre mouvements de capitaux et transactions courantes (art. VI, sec. 1 et 2; art. VIII, sec. 4 a des statuts du F.M.I.).

b) Maintien de la valeur or des avoirs du F.M.I. et expression du pair des monnaies

Il a été suggéré de remplacer la disposition qui requiert l'approbation de tout pays ayant 10 % du total des quotes-parts du F.M.I. en cas d'une proposition de modification uniforme de la parité des monnaies par l'approbation d'une majorité d'au moins 85 %.

L'article IV sec. 8 des statuts du F.M.I. prévoit qu'il peut être dérogé à la clause qui assure le maintien de la valeur or des avoirs du Fonds. Afin de sauvegarder au mieux cette valeur, il est proposé qu'une décision de dérogation ne puisse être adoptée que par une majorité de 80 % au moins du total des droits de vote.

Enfin, le Comité monétaire propose de simplifier la définition actuelle des parités et de l'unité de compte du F.M.I. (art. IV sec. 1 a) en retenant seulement la référence à un poids d'or.

C. REGLES RELATIVES A LA PROCEDURE DE DECISION CONCERNANT LES QUESTIONS IMPORTANTES, EN PARTICULIER CELLES RELATIVES AUX DIVERSES FORMES DE CREATION DE LIQUIDITES

9. A l'exception d'un nombre très limité de décisions qui doivent être prises à la majorité qualifiée ou à l'unanimité, les décisions du F.M.I. sont prises à la majorité simple des votes exprimés (1).

Ainsi, dans les domaines importants pour les finances de l'organisation et des pays membres, des décisions pourraient être prises sans avoir recueilli nécessairement l'accord des pays appelés à en assumer la charge. Il conviendrait donc que de telles décisions soient prises à une importante majorité qualifiée. Il devrait en être ainsi particulièrement en ce qui concerne les modifications générales des quotes-parts et la création de facilités additionnelles. Pour ces décisions, une majorité de 85 % du total des votes devrait être réunie; cette majorité devrait comprendre au moins la moitié des importants pays créditeurs (2).

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(1) Il s'agit de votes pondérés principalement suivant l'importance des quotes-parts.

(2) On pourrait considérer comme "importants pays créditeurs" les pays dont les avoirs en monnaie nationale dans le Fonds étaient, en moyenne, au cours des 5 ou 10 dernières années, inférieurs à 75 % de leurs quotes-parts, la contribution minimum nette pour le financement des tirages sur le Fonds étant, en moyenne annuelle, de x % (par exemple au moins 3 %) du montant total du financement.

Dans un tel système, les pays de la C.E.E., qui disposent actuellement de 17 % des quotes-parts, exerceraient - tant qu'ils ne sont pas débiteurs - pour les décisions de cette nature, une influence comparable à celle des Etats-Unis. Dans l'hypothèse où cette majorité qualifiée n'était que de 80 % les pays de la C.E.E. pourraient bénéficier des mêmes garanties, à condition que le total de leurs quotes-parts soit supérieur à 20 % du total des quotes-parts. Ceci postulerait des augmentations sélectives des quotes-parts des pays de la C.E.E.; certains d'entre eux, dont la quote-part est inférieure à ce que justifierait l'application des règles habituelles de calcul, seraient disposés à procéder à un tel ajustement. Ce n'est évidemment pas le cas pour un pays de la C.E.E. qui, en juin 1966, a majoré sa quote-part de plus de 50 %.

10. Les statuts du F.M.I. prévoient (art. XII, sec 5 b) que, pour deux types de décisions ("waiver" et "inéligibilité"), les droits de vote à la disposition des pays soient ajustés en fonction de leur position créditrice et débitrice. Il est proposé de mettre à l'étude le renforcement des mécanismes d'ajustement des droits de vote. Il est également suggéré que soit étendu le champ des décisions devant être prises selon ces modalités à toutes celles comportant un caractère financier.

En liaison avec l'octroi éventuel de votes supplémentaires aux pays créanciers, il serait nécessaire de modifier les pratiques existantes en ce qui concerne la faculté de vote des pays tireurs. La formule prévue dans les Accords Généraux d'Emprunts (abstention du pays tireur) pourrait être envisagée.

11. Le Comité monétaire est d'avis qu'il y aurait lieu de prévoir que les décisions soient également prises à une majorité qualifiée dans d'autres domaines, notamment dans ceux mentionnés ci-après :

- politique du crédit du F.M.I. (changement dans les lignes directrices de cette politique)

- politique du F.M.I. envers l'or (versements d'or par les membres et investissements par le Fonds)

- politique du F.M.I. à l'égard des emprunts (art. VII)

- interprétation des statuts.

Il y aurait lieu d'examiner si parmi les décisions devant être prises à la majorité qualifiée, celles qui comportent un accroissement des charges des pays débiteurs du F.M.I. pourraient être assorties d'une condition supplémentaire analogue à celle mentionnée précédemment en ce qui concerne les pays créditeurs et prévoyant que la moitié au moins des pays débiteurs importants devrait faire partie de la majorité requise.

12. Enfin, étant donné qu'il est envisagé d'accroître les tâches du F.M.I. et qu'il est souhaitable de faciliter la prise de décisions importantes au sein de cette institution, on pourrait envisager d'associer plus étroitement les gouverneurs du F.M.I. à la vie de cette institution. A cet effet, on pourrait prévoir la constitution d'un groupe restreint de gouverneurs, ou de leurs délégués, qui se réunirait périodiquement. Il serait chargé de suivre la politique générale du F.M.I. et en particulier pourrait être appelé à préparer les décisions relatives aux tâches nouvelles qui seraient confiées au Fonds Monétaire. En outre, il pourrait être saisi des questions relatives à l'interprétation des statuts du F.M.I.

TRANSLATION

Munich, April 18, 1967

The Finance Ministers of the six member countries of the European Economic Community held a meeting at Munich on April 17 and April 18, 1967, under the Chairmanship of Dr. h. c. Franz Josef Strauss, Minister of Finance of the German Federal Republic. Taking part in the meeting were: Mr. Robert Henrion, Minister of Finance (Belgium); Mr. Michel Debré, Minister of Economic Affairs and Finance (France); Dr. Emilio Colombo, Minister of the Treasury, and Dr. Athos Valsechi, Secretary of State (Italy); Prof. Dr. H. J. Witteveen, Deputy Prime Minister and Minister of Finance (Netherlands); Mr. Pierre Werner, President of the Government and Minister of Finance (Luxembourg); Prof. Dr. Karl Schiller, Minister of Economic Affairs, and Dr. J. Schoellhorn, Secretary of State (German Federal Republic). The EEC Commission was represented by Mr. Robert Marjolin, Vice President, and Mr. Hans von der Groeben. Also present were: Mr. Maurice Pérouse, Chairman of the Short-Term Economic Policy Committee, and Mr. Emile Van Lennep, Chairman of the EEC Monetary Committee.

During the first part of the meeting, in which the Central Bank Governors took part, they discussed international monetary problems, starting from the idea that the EEC member countries ought to occupy a place in the international monetary institutions more in keeping with their actual responsibilities, their growing economic solidarity, the expansion of their trade, and their economic and financial influence ("rayonnement") on outside countries. This state of affairs cannot fail to lead the countries in question to seek a common position in the present discussions on the reform of the international monetary system and to continue a close cooperation in the future, so that they will be in a position, acting together, to safeguard their legitimate interests.

In the spirit of this cooperation, the Ministers of Finance and Economic Affairs taking part in this meeting agreed on the following points:

1. The fact that there is no present shortage of international liquidity does not prevent consideration of the measures to be taken in case there should be a need for additional reserves in the future.

2. Any measures which may be taken to create additional reserves, or any alternative solutions adopted for the same purpose, should be dependent upon a common judgment that a shortage exists, upon a better functioning of the adjustment process, and upon the achievement of a better equilibrium in international financial transactions. They should not be based on the balance of payments requirements of certain countries, thus excluding any special treatment benefiting a single country or group of countries.

3. These measures should not be related to short-term cyclical phenomena but to long-term requirements.

4. The present strength of the Six and their union in the EEC must, in any event, ensure that they have a proper influence in the IMF, particularly in the voting procedures. The Monetary Committee has made suitable propositions for this purpose.

5. On these conditions it would be possible, in the event of an agreed shortage of international liquidity, to envisage in the future the creation of both conditional and unconditional drawing rights within the IMF.

6. In connection with the goals mentioned above, the question arises as to whether it is opportune to establish, for the creation of additional automatic drawing rights, accounts and a method of financing separate from the current IMF operations.

7. Automatic drawing rights, should carry an obligation to repurchase for debtors who had used all their drawing rights, or part of them persistently and over a long period, in order to compel them to re-establish their previous position with regard to their automatic drawing rights at the end of a given period. The effect of such an obligation would be to improve the adjustment process. It should also prevent drawing rights being used to alter the composition of reserves.

8. International Monetary Fund drawing rights are not directly transferable. Nevertheless, the question of voluntary bilateral transferability of the new drawing rights, which would have to take place in any event under the control of the IMF and which should not be allowed to affect the repurchase obligation of the original drawing country, requires still further examination.

Translation

EUROPEAN ECONOMIC
COMMUNITY

Brussels, April 11, 1967
5742/II/67 - F

Monetary Committee

VERY CONFIDENTIAL

REPORT BY THE MONETARY COMMITTEE*

to the Finance Ministers and the

Central Bank Governors of the EEC

1. During their meeting of January 16 and 17, 1967, the Finance Ministers and the Central Bank Governors of the six countries forming the European Economic Community agreed on a communiqué which contained the following: "the Ministers and Governors, anxious to confirm their solidarity on a question as important as the international monetary problem, have decided, while pursuing the examination of the plans discussed hitherto, to instruct their experts in the Monetary Committee of the EEC to study without delay the improvement of the methods of international credit".

2. In carrying out these instructions, the Monetary Committee has tried to work out the main points for a common position by the EEC countries in the current discussions on the reform of the international monetary system. In this connection, it has been guided by the following considerations:

i. If, some time in the future, an increase in international liquidity became necessary, this increase could be based on an extension of the credit mechanisms within the International Monetary Fund.

ii. In order to ensure that any decisions on the creation of liquidity are not taken prematurely and do not exceed the necessary volume compatible with the maintenance of monetary stability, the voting procedures used for these decisions should be arranged in such a way that the EEC countries can exercise an influence corresponding to their economic and financial responsibilities.

iii. Finally, it would be desirable to take the opportunity afforded by the alteration of certain Fund Articles for the purposes mentioned in (i) and (ii) above, in order to make other desirable changes in the Articles, the principles underlying the Fund's operations and in its voting procedures, in particular such changes as could help to improve the functioning of an expanded liquidity mechanism within the Fund.

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* A provisional English translation by the Fund staff.

3. Basing itself on these fundamental principles, the Monetary Committee has made a number of proposals which may be grouped under the following three headings:

A. Expansion of the activities of the International Monetary Fund

B. Changes in certain rules and practices of the International Monetary Fund

C. Rules relating to the procedure for reaching decisions on important questions, and in particular those relating to the various forms of liquidity creation.

A. EXPANSION OF THE ACTIVITIES OF THE INTERNATIONAL MONETARY FUND

4. The Monetary Committee has examined a number of techniques which might meet the needs for liquidity that could arise. These techniques run from the enlargement of the Fund's existing facilities to the opening of new drawing rights which might be partly or wholly separate from the Fund's present activities.

In the first place it was pointed out that general or special increases in quotas, whether as part of the normal quinquennial review, or on other occasions, would make it possible to increase the Fund's resources.

Secondly, it would be possible to extend the drawing rights of Fund members in the credit tranches, hitherto restricted to 125 per cent of quota, provided that there were a general agreement relating to the changes proposed elsewhere regarding the commitments of the drawing countries and the rules regarding the majority required for taking such decisions.

However, it was pointed out that after the large increases, both general and special, in quotas, which raised quotas from 15 billion to 21 billion dollars in 1966, there is no need at the present time to increase the volume of conditional liquidity.

5. In addition to the possibilities set forth in the preceding paragraph, there is the possibility of increasing the volume of automatic drawing rights in the Fund. This possibility was also examined; there are various ways in which it could be implemented--for example, by granting additional gold tranches either against partial payment in gold or without gold payment, or by giving the credit tranches a progressively automatic character.

The members of the Monetary Committee unanimously recalled that the creation of new automatic drawing rights in the Fund should not be undertaken in advance of a collective judgment that there was an over-all shortage of reserves, that the adjustment process was functioning better, and that there was better balance in international payments, with increases in holdings of reserve currencies by the Central Banks no longer contributing toward the financing of the foreign deficits of the reserve currency countries.

The possible increase in the volume of automatic drawing rights could be brought about through the adoption of various institutional, accounting, and financial techniques.

a. It would be possible to bring about this increase either by incorporating new automatic drawing rights in the Fund's quota system, or by means of a system of separate accounts. In this latter case, the new drawing rights could be "floating" (i.e., they could be used either before or after other drawing rights were used up).

b. The additional resources required to finance the supplementary drawing rights could be incorporated in the Fund's general resources, or they could be kept separate. In the former case, the new resources would be part of the Fund's general liquidity.

c. The separation of accounts as at (a) above and the separation of funds as at (b) above could be carried out either within the Fund itself or by establishing a Fund affiliate.

6. One proposal, whose general principles received the support of a number of members of the Monetary Committee, would consist of opening automatic drawing rights, with both their accounting and their financing separate from those of the other drawing rights in the Fund. The new automatic facilities would be (a) usable in accordance with well-defined rules which would have to be drawn up in advance, including a condition that the drawing rights could not be used for the sole purpose of altering the composition of the reserves of the drawing countries, and (b) directly transferable between the monetary authorities of the member countries.

7. The eventual choice of a solution in this field will enable legitimate requirements of the international community as a whole to be satisfied under the most favorable conditions. However, the introduction of techniques of this sort would require changes in the structure and operations of the International Monetary Fund, and in particular an agreement on decision-taking procedures, such as those set out below.

B. CHANGES IN CERTAIN RULES AND PRACTICES OF THE INTERNATIONAL MONETARY FUND

8. The Committee feels that in view of the many far-reaching changes that have taken place, since the establishment of the International Monetary Fund, in the general economic situation, in the relative positions of the member countries and in the functioning of the international monetary system, a number of modifications in the working of this institution appear desirable in order to make it more capable of meeting the needs of the present day.

a. Changes in certain provisions

(i) Status of the gold tranche and the super gold tranche

For many member countries, the drawing rights that they have acquired in the gold tranche and the super gold tranche have become major

assets that have, moreover, taken the place of other reserves. These drawing rights may well become still larger. It is necessary to ensure that they have all the qualities of a true reserve. It would be desirable to improve their status with respect to full automaticity in their use, their expression in terms of a gold accounting unit, and abolition of the commission levied by the International Monetary Fund.

The possibility should be considered of harmonizing the characteristics of the drawing rights in the gold tranche and those in the super gold tranche, of attaching a certain remuneration to the holding of these drawing rights, and of ensuring their direct transferability. It is desirable that the technical studies now being undertaken by the IMF should lead to concrete proposals as rapidly as possible.

(ii) Conditions attaching to drawing rights in the credit tranches

The principles now governing the policy for drawings in the credit tranches should be re-examined in order to make them play a more effective part in the adjustment process, by strengthening the conditional character of these drawings. For this purpose, it is desirable to seek a means of rendering more precise the commitments undertaken by drawing countries, for example, by setting down certain quantitative standards to which they would have to conform, especially with respect to their budgetary, monetary and income policies. A change in the scale of charges could also be envisaged.

If the rules were strengthened in the direction mentioned above, it would be possible to consider abolishing the clause in the IMF Articles of Agreement which limits the amount of drawings in a given year to 25 per cent of quota, since this limit is hardly ever respected in practice.

(iii) Rules governing the conditions for repurchase from the Fund

The Fund Articles of Agreement provide that member countries which have made a drawing on the Fund may in certain circumstances be exempt from repurchase obligations. A revision of the Articles in question (Article V, Section 7 (b) and (c) and Article XIX, (e)) should be considered.

(iv) Other changes

If the Fund Articles of Agreement are reviewed, it might be worthwhile considering:

first, adding to the list of Purposes set out in Article I by making specific mention of price stability;

secondly, abolishing the distinction, which is no longer made in practice, between capital transfers and current transactions (Article VI, Section 1 and Section 2; Article VIII, Section 4 (a) of the Fund Articles of Agreement).

b. Maintenance of the gold value of the Fund's assets and expression of par values

It has been suggested that the provision requiring the approval of every member holding 10 per cent or more of the total of the quotas in the Fund for a proposal to make a uniform change in the par values of currencies should be replaced by a clause requiring the approval of at least an 85 per cent majority.

Article IV, Section 8 of the Fund Articles of Agreement lays down that a waiver may be granted from the clause which insures the maintenance of the gold value of the Fund's assets. In order to protect this value as far as possible, it is proposed that a decision in favor of a waiver shall only be taken by a majority of at least 80 per cent of the total voting power.

Finally, the Monetary Committee proposes that the present definition of par values and of the IMF unit of account (Article IV, Section 1 (a)) should be simplified by retaining only the reference to a weight of gold.

C. RULES RELATING TO THE PROCEDURE FOR REACHING DECISIONS ON IMPORTANT QUESTIONS, AND IN PARTICULAR THOSE RELATING TO THE VARIOUS FORMS OF LIQUIDITY CREATION

9. Except for a very small number of decisions which have to be taken by a qualified majority or unanimously, IMF decisions are taken by simple majority of votes cast.1/

Thus, in areas that are significant for the finances both of the organization and of the member countries, decisions might be taken without necessarily having the agreement of the countries which would have to assume the consequent burden. It is therefore desirable that such decisions should be taken with a large qualified majority. In particular, this should be the case for general changes in quotas and for the creation of additional facilities. For these decisions, an 85 per cent majority of all votes should be required; this majority ought to include at least half the major creditor countries.2/

In such a system, the EEC countries, which now hold 17 per cent of the quotas, would exercise an influence comparable to that of the United States in decisions of this sort, provided that they did not become debtors. Assuming that this qualified majority were only 80 per cent, the EEC countries

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1/ These votes are weighted mainly in accordance with the size of the quotas.

2/ Major creditor countries may be defined as those countries whose national currency holdings by the Fund have been on the average during the last five or ten years less than 75 per cent of their quotas, the minimum net contribution for financing drawings on the Fund being x per cent (e.g. at least 3 per cent) of the total volume of financing, on the average over the years.

could have the same protection, provided that taken together their quotas came to more than 20 per cent of total quotas. This would involve special increases in the quotas of the EEC countries. Some of them, whose quota is lower than would be justified by the application of the usual methods of computation, would be prepared to accept such an adjustment. This is clearly not the case for one EEC country, which raised its subscription by more than 50 per cent in June 1966.

10. The Fund Articles of Agreement provide (Article XII, Section 5(b)) that for two types of decision (waiver and ineligibility), the voting rights to which a country is entitled shall be adjusted to take account of its creditor or debtor position. It is proposed that a strengthening of the machinery for adjusting voting rights should be studied. It is also suggested that the range of decisions to be taken in this way should be extended to cover all those of a financial nature.

In connection with the possible granting of additional votes to creditor countries, it would be necessary to alter the existing practices regarding the voting rights of drawing countries. The system envisaged in the General Arrangements to Borrow (where drawing countries do not vote) could be considered.

11. The Monetary Committee feels that it would also be desirable to lay down that decisions should be taken by a qualified majority in other fields, and particularly in those listed below:

Fund credit policy (changes in the guidelines for this policy);

Fund gold policy (gold payments by members and Fund investments);

Fund policy on borrowing (Article VII);

Interpretation of the Articles of Agreement.

Consideration could be given to the question whether, among the decisions which ought to be taken by qualified majority, a supplementary clause could be introduced in those involving an increase in the burden falling on debtor countries in the Fund which, in analogy to the clause mentioned above regarding creditor countries, would provide that at least half the major debtor countries should be included in the required majority.

12. Finally, as consideration is being given to increasing the work of the Fund, and as it is desirable to facilitate the taking of important decisions within that institution, it might be worth considering associating the Governors of the Fund more closely with its activities. For this purpose, the establishment of a small group of Governors or of their representatives, which would meet periodically, might be considered. This group would be made responsible for keeping an eye on the general policy of the Fund; in particular, it could carry out the preparatory work for decisions connected with the new tasks that might be entrusted to the Fund. Finally, it could handle questions relating to the interpretation of the Fund Articles of Agreement.

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FOR AGENDA

SM/67/110
Reform of IMF

Mr. J. J. Polak

Room 504 F

#1

SM/67/110

September 7, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Observations on the Memorandum entitled "Suggestions for Certain Reforms in the International Monetary Fund"

The attached paper is issued in connection with the discussion of the memorandum "Suggestions for Certain Reforms in the International Monetary Fund", which is to begin at the Executive Board Meeting scheduled for Monday, September 11.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

Some Observations on the Memorandum Entitled
"Suggestions for Certain Reforms in the International Monetary Fund"

Prepared by the Treasurer's Department

Approved by Oscar L. Altman

September 7, 1967

I. Introduction

In this memorandum the proposals under Section II B of EBD/67/97 entitled "Rules governing the conditions for repurchase and drawings on the IMF" have been applied to the calculations of repurchase obligations under Article V, Section 7(b) for a number of recent fiscal years.

In EBD/67/97 three proposals have been made:

"(a) abolishing the deduction of currency liabilities provided for in Article XIX (e) in calculating the amount of the monetary reserves that form the basis for determining the repurchase obligations.

(b) abolishing the abatements in cases of repurchases calculated in currencies which the Fund may not accept.

(c) including the currencies of non-member countries that are recognized as convertible by the IMF in the calculation of reserves."

To establish the hypothetical repercussions of these proposals in past fiscal years the staff has extracted the repurchase obligations of members incurred under Article V, Section 7(b) as of April 30, 1958, and 1962 through 1966. Repurchase obligations have been recalculated for members in the light of proposals (a) and (b) above (which are referred to in this paper as "the new proposals") and compared with repurchases by members. In these comparisons no account has been taken of sales, by the Fund, of members' currencies, such sales reduce the Fund's holdings of a member's currency and have the same effect as a repurchase in cases where the holdings are above 75 per cent of quota. These results are set out in Tables 1 - 6.

It should be noted that the adoption of the new proposals would have had a considerable impact on the total repurchase obligations, the creditor and debtor positions of members, payment to the Fund of substantial amounts of gold and convertible currencies, and the composition and levels of the Fund's holdings of Article VIII currencies. Consequently, it is virtually certain that the Fund's policies on drawings and repurchases, sales of gold

to reconstitute holdings, and drawings under the General Arrangements to Borrow would also have been influenced, in addition to members' assessments of their positions in the Fund. These changes would also have affected members' reserves policies and their holdings of gold and currency, which would have had a bearing on the composition of subsequent repurchases under Article V, Section 7(b).

It has been considered impractical to show the cumulative progression of the effects of the new proposals through a series of years. For example, the amounts no longer abated would need to be reallocated in one of several different ways; and this reallocation will affect not only the repurchasing members' reserves but also the Fund's holdings of gold and other currencies, as the method of reallocation has not been determined and the basis for the subsequent year's repurchase calculations is not known. Therefore, the effect of the proposals in each of the six years has been presented separately, and in isolation from the possible impact of changes in holdings, quota increases and sales of currency by the Fund. The data in the tables are not cumulative, cannot be aggregated, and should be looked upon as nonconsecutive.

II. The Financial Effects of a Change from a "Net" to a "Gross" Concept of Monetary Reserves

Past and Present Practice

Prior to 1952, the repurchase policy in the Fund was confined to the application of Article V, Section 7(b) and Article V, Section 7(a). The first section is a mandatory provision which is applicable if the member's net reserves are above the level of its quota and if the currencies in which any repurchase obligation is calculated are acceptable to the Fund. Under the second section a member could repurchase its currency from the Fund for gold down to a level of 100 per cent of quota. Executive Board Decision No. 7-(648) adopted March 8, 1951 provided for voluntary repurchases by members down to 75 per cent of quota in gold or convertible currencies acceptable to the Fund. The limitation on the length of time a drawing could remain outstanding was provided by Article V, Section 8(d) which required consultation between the member and the Fund on ways and means to reduce the Fund's holdings of the member's currency at a time when the rate of charge on the Fund's holdings of the member reached a prescribed level. The 1952 Decision introduced a new operational basis for the Fund, including repurchases.

In reporting this Decision the Annual Report for 1952 mentioned that in some circumstances members' reserves are unlikely to increase sufficiently to create a repurchase obligation, even if the general economic position of the member had improved substantially. The Decision, therefore, aims to ensure that in no case would a repurchase be too long delayed.

It should be noted that currencies used in repurchase under the 1952 Decision are now governed by the 1962 Decision. Under this Decision the Fund does not select gold to be used in repurchase.

At present, if a member repurchases under the 1952 Decision, between April 30 and the date of incurring an Article V, Section 7(b) repurchase, the Article V, Section 7(b) repurchase is regarded as having been discharged <u>pro tanto</u> by the earlier repurchase, subject only to a substitution of the

appropriate gold and currency as calculated under Article V, Section 7(b). If a member incurred an Article V, Section 7(b) repurchase obligation prior to a repurchase under the 1952 Decision, the discharge of the Article V, Section 7(b) repurchase obligation cancels pro tanto the undischarged outstanding commitments in accordance with the principles for allocating repurchases set out in SM/63/21 dated February 20, 1963 "Allocation of Reductions in Fund Holdings of a Currency".

Change from "Net" Reserves Concept to "Gross" Concept

Article V, Section 7(b)(i) provides that a member shall use its monetary reserves in repurchase in an amount equal to half of any increase during the fiscal year in the Fund's holdings of the member's currency, plus half of any increase (or less half of any decrease) in the level of the member's monetary reserves. This calculation provides the basis on which the repurchase obligation of the member is determined. Article XIX stipulates that the monetary reserves shall be calculated by deducting currency liabilities from gross reserves. These currency liabilities represent holdings of the reporting member's currency by specified holders in other member countries. The reserve currency countries have very considerable currency liabilities; but many other countries whose currency is held by another member as counterpart to financial aid received also have currency liabilities. In 1966, out of 103 Fund members, 14 did not report any currency liabilities which qualified for inclusion in the calculation of monetary reserves; i.e., Bolivia, Central African Republic, China, Congo (Brazzaville), Ethiopia, Kenya, Kuwait, Liberia, Panama, Paraguay, Saudi Arabia, Sierra Leone, Somalia and Venezuela. Currency liabilities reduce the absolute amount of monetary reserves or prevent their increase, and may permit members, whose monetary reserves are brought below their quotas, (Article V, Section 7(c)(i)), to avoid repurchase obligations. In addition they also affect the payment of charges under Article V, Section 8(f).

The position of members with respect to inter-central bank swap arrangements may also be affected. Under the present procedure of the Fund, when a swap arrangement is utilized, the increase in one member's holdings of convertible currency is offset by a similar increase in its currency liabilities to the member with whom the swap is transacted. Thus, under present Fund procedures, swaps which run over April 30 increase both monetary reserves and currency liabilities but, leaving aside the question of its composition, do not affect repurchase obligations. If the new proposals were adopted and currency liabilities were no longer deducted, swaps would inflate monetary reserves positions, thus increasing the likelihood and magnitude of repurchase obligations under Article V, Section 7(b). Swaps entered into by Fund members with the Bank for International Settlements may inflate monetary reserves for the purposes of Article V, Section 7(b) since the currency liabilities, representing the members' currency held by the B.I.S., do not qualify for deduction from the gross monetary reserves since the B.I.S. is not an institution in the "territories of members, or non-members specified under [Article XIX] (d) above" (Article XIX (e)).

Results of Hypothetical Recalculations

In Tables 1 through 6 the actual repurchase obligations under Article V, Section 7(b) have been shown as they were incurred, and no allowance has been made for those members which requested Executive Board approval to postpone settlement of their obligations. In column (1) of these tables repurchases effected by the member do not include any postponed Article V, Section 7(b) repurchases, nor have they been mitigated in cases where the member made a drawing in close proximity to the date of repurchase. In other words, the tables refer only to the repurchase obligations which were incurred; it does not necessarily follow that these were discharged fully in that year nor should the inference be drawn that the figures disclose an accurate picture of the turnover of the Fund assets.

Tables 1 through 6 for 1958 and the years 1962 through 1966 list all Fund members whose currency was held by the Fund in excess of 75 per cent of quota as of April 30. They give the total repurchases incurred during the year following April 30 and the amounts actually calculated under Article V, Section 7(b). In addition, the amounts of repurchases under Article V, Section 7(b) are set out for members as if the new proposals had been in effect for that particular fiscal year. In order to describe in more detail the impact on members of the adoption of the new proposals, the three years following April 30, 1958, 1962 and 1966 have been selected. The year 1958 is of particular interest since at that time several of the major European countries had drawings outstanding with the Fund, and since the Fund was still able to accept U.S. dollars only a very small abatement under Article V, Section 7(c)(iii) in El Salvadoran colones was necessary.

Table 1, giving members' repurchase obligations as of April 30, 1958, covers a period of the Fund's operations when the number of Article VIII currencies was extremely limited and the creditor positions of members were adequate to absorb nearly all repurchases.

As of April 30, 1958, there were 29 members whose currency was held by the Fund in excess of 75 per cent of quota. Of this number 7 incurred repurchase obligations under Article V, Section 7(b) totalling the equivalent of $239 million, and in addition, other repurchases during the year amounted to $298.3 million. The two make a total for the whole year of $537.3 million.

Monetary reserves calculated on a "gross" basis would have caused 9 members to incur repurchase obligations totalling $525.6 million. The 2 additional members who would have incurred repurchase obligations on this basis would have been Turkey and the United Kingdom. Iran and Japan would have had smaller repurchase obligations since currency liabilities had decreased by more than the Fund's holdings of these members' currencies had increased. Repurchases for Denmark, Iran, Israel and Japan caused the Fund's holdings of the currencies of these members to fall into the gold tranche. Under the new proposals the holdings of Japan would not have done so. Since the Fund was able to accept U.S. dollars calculated in repurchase obligations as of April 30, 1958 there would have been no difference between those calculated on a "gross" reserves basis before or after abatement (the very small abatement in El Salvadoran colones has been ignored).

Table 2 sets out the same information for April 30, 1962 and the subsequent year. There were 34 members in a debtor position of which 10 incurred repurchase obligations amounting to $81.6 million under Article V, Section 7(b). In addition, other repurchases by these members amounted to $725.7 million. The two make a total of $807.3 million. On a "gross" monetary reserves basis 16 members would have incurred repurchases amounting, after abatement, to $738.9 million, an amount nearly $70 million less than the total repurchases incurred in the year. The 6 additional members who would have incurred repurchase obligations if gross reserves had been used were: Brazil, Colombia, the Philippines, Turkey, the United Arab Republic and the United Kingdom. Only Costa Rica, Iran, Mexico and Nicaragua repurchased sufficient of their currency to reduce the Fund's holdings into the gold tranche, but under the new proposals these countries would have been joined by the United Kingdom.

Table 5 shows that 47 members were in a debtor position in the Fund as of April 30, 1966. Of this number, 12 incurred Article V, Section 7(b) repurchase obligations amounting to $18.6 million, out of total repurchases amounting to $340.1 million. On a "gross" reserves basis the repurchase obligations before abatement would have totalled $1179.1 million, while after abatement they would have totalled $443.7 million, the large increase in both cases being almost entirely due to the repurchase obligation of the United Kingdom. This hypothetical repurchase obligation of the United Kingdom would have been due to the decision by the U.K. authorities to add to their monetary reserves by liquidating part of their U.S. dollar investment portfolio, and to inter-central bank swaps.

Five members who did not incur repurchase obligations under the present practice would have done so on a "gross" reserves basis; they are Ecuador, Morocco, Nigeria, Syrian Arab Republic and the United Kingdom. Under present practice no member had the Fund's holdings of its currency reduced by its repurchase obligation into the gold tranche, but Ireland and Uruguay would have been in this position, before abatement, on a "gross" reserves basis.

Table 6 shows that 35 members whose currency was held by the Fund at levels in excess of 75 per cent of quota did not incur repurchase obligations under the existing practice and that 30 did not under the "gross" reserves concept. Of the 35 members who did not incur a repurchase obligation as of April 30, 1966, the net reserves of 30 were below the level of their quotas (Article V, Section 7(c)(i)). On a "gross" basis the reserves of 25 members would still have remained below the level of their quotas. Four members would not have incurred a repurchase obligation under the present procedure because their reserves declined by the same amount, or by more, than the Fund's holdings of their currency increased (Article V, Section 7(b)(i)), and one member because the whole repurchase obligation was abated under Article V, Section 7(c)(iii).

The following table gives a breakdown of Fund members as of April 30, 1966 into those members eligible and those ineligible to incur repurchase obligations on the basis of the comparable levels of their quotas with the levels of their monetary reserves on a "net" and "gross" basis (Article V, Section 7(c)(i)). The questions of whether the member had drawn from

the Fund and whether the Fund's holdings of the member's currency were above the level of 75 per cent of quota have been ignored. A member has been considered eligible to incur a repurchase obligation if its monetary reserves, either on a "net" or "gross" basis were above the level of its quota although clearly a member could not have actually incurred a repurchase obligation unless the Fund's holdings of its currency were above the level of 75 per cent of quota. A member has been considered ineligible if the level of its reserves was below the level of its quota. There were a number of members (24) who, irrespective of the levels of their reserves or quotas could not incur a repurchase obligation since the payment of their subscriptions was incomplete.

	As at April 30, 1966		Under new proposals for "gross" reserves	
	No. of Members	% of Total Quotas	No. of Members	% of Total Quotas
Total Fund membership	103	100	103	100
Less members who could not incur a repurchase obligation	24	5	24	5
	79	95	79	95
Members eligible to incur a repurchase obligation	47	43	53	83
Members ineligible to incur a repurchase obligation	32	52	26	12

III. The Abolition of Abatement of Currencies which the Fund Cannot Accept

Article V, Section 7(c)(iii) provides that the calculation of a repurchase obligation will not be carried to a point at which the Fund's holdings of any currency required to be used is above 75 per cent of the quota of the member concerned. The Executive Board decided that:

> "If part of a member's gross repurchase obligation for any financial year is allocated to a currency which the Fund cannot accept because of Article V, Section 7(c)(iii), that part of the gross obligation is abated for that year under Schedule B, Paragraph 1(c), and is not required to be discharged in gold or some other currency."
> Executive Board Decision No. 521-3 adopted January 16, 1950.

This has substantially limited the amounts of repurchases under Article V, Section 7(b) since the Fund's holdings of U.S. dollars and U.K. pounds have, at times, been above the level of 75 per cent of the quotas of the United States and the United Kingdom. The Fund has, in consequence, not been able to accept either of these major reserve currencies in repurchase.

The effect of the new proposals is most evident in recent years if abatement is abolished. Tables 2, 5 and 6 show that repurchase obligations calculated on a "gross" basis without abatement would have exceeded the total repurchases actually incurred in 1962 by a margin of nearly $70 million, in 1965 by about $130 million, and in 1966 by some $840 million. Tables 3 and 4 for 1963 and 1964, show that total repurchases actually incurred are larger than the repurchase obligations calculated under the new proposals, including those unabated. In 1958 abolishing abatement would have had little additional effect on the total repurchase obligations resulting from the new proposals since the Fund was able to accept all currencies, except a small amount of El Salvadoran colones, in which repurchase obligations had been calculated.

The question will then arise as to how the balance of any repurchase obligation under Article V, Section 7(b) presently abated under Article V, Section 7(c)(iii) should be reallocated. These amounts could be settled entirely in gold or in currencies acceptable to the Fund or in some combination of the two, but this paper does not discuss this question of policy.

Table 7 compares the media in which repurchase obligations under Article V, Section 7(b) were calculated in 1958, 1962 and 1966 with the media contained in the repurchase obligations recalculated in accordance with the new proposals, using "gross" monetary reserves before and after the abatement of currencies. The following table summarizes the payments in gold under the proposed "gross" monetary reserves concept over those paid under the present "net" reserves concept (in millions of U.S. dollars):

	Gold payments under the present "net" concept	Gold payments under the proposed "gross" concept
1958	91.0	380.2
1962	18.9	387.5
1966	14.5	434.8

In addition substantial amounts of currency not acceptable to the Fund because of Article V, Section 7(c)(iii) would have had to be reallocated either to acceptable currencies or gold. In 1958 only a very small reallocation would have been called for. Table 8 sets out the amounts of currency abated in the years 1962 through 1966. The "Other" amounts represent a number of very small items including such currencies as Canadian dollars, Italian lire, El Salvadoran colones and Honduran lempiras.

Charges (Article V, Section 8(f))

The Fund now determines the proportions to be paid to the Fund in gold and currency under Article V, Section 8(f) by calculating monetary reserves in the same way as for repurchase obligations under Article V, Section 7(b). On page 18 of SM/67/99 "Legal Aspects of the Memorandum Entitled 'Suggestions for Certain Reforms in the International Monetary Fund'" it is stated that "There would be no legal reason, however, why a change could not be made for one purpose but not for the other". It would seem, therefore, that if the new proposals were to be adopted for the purposes of Article V, Section 7(b), charges might continue to be based

on the present method of calculation which allows for the deduction of currency liabilities. If this were so a member wishing to avail itself of the provisions of Article V, Section 8(f) would have to continue to maintain a reporting system for the collection of the appropriate data, some of which would come from the commercial banks, or be prepared to institute such a system, at some future time, to provide the data to the Fund to justify the payment of charges, in part or whole in its own currency.

The actual breakdown of charges on the Fund's holdings of members' currencies in excess of quota and for service on drawings, received by the Fund in the years 1958, 1962 and 1966 into gold and currency is compared in the following table with the amounts which would have been received had the Fund calculated monetary reserves for this purpose in accordance with the new proposals. Increased payments in gold would have fallen to be made chiefly by the U.K., the U.S., India and Ceylon.

	1958		1962		1966	
	Actual	Under new Proposals	Actual	Under new Proposals	Actual	Under new Proposals
	(In millions of U.S. dollars)					
Gold	4.5	11.0	20.6	32.5	27.7	78.9
Currency	6.5	-	12.0	0.1	52.2	1.0

IV. The Inclusion of Nonmember Currencies in the Calculation of Monetary Reserves

It is not possible to evaluate the proposal to include nonmember currencies in the calculation of monetary reserves because the Fund does not know the amounts of these currencies held by members. The Fund would need to establish a list of the currencies which it felt to be of significance and specify such currencies (Article XIX (d)). The Fund has not, at this time, specified any currencies of nonmembers in accordance with this provision although the Fund has requested members to report holdings of Swiss francs in the same way that other currencies are reported for purposes of Article V, Section 7(b).

Apart from the Swiss franc the only important currencies would be those of the U.S.S.R., Mainland China and the currencies of Eastern Europe.

The data received concerning Swiss francs show that until relatively recently the official holdings of this currency by Fund members have been modest and would not have made a significant difference in their repurchase obligations. With the growth of the inter-central bank swap arrangements, however, the size of these holdings has increased. The holdings of Swiss francs by commercial banks, which are also reported to the Fund, have always been fairly large, but these holdings would not have been included in the calculations of monetary reserves unless the Fund were to deem, after consultation with the member, that they were substantially in excess of working balances (Article XIX (c)).

Table 1. A comparison of total repurchases incurred as of April 30, 1958 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

Fund's holdings above 75 per cent of quota as at April 30, 1958	(1) Actual Total Repurchases 5/1/58-4/30/59	(2) of which: under Art.V Sect. 7(b) 4/30/58	(3) Column (1) as % of quota	(4) Calculated Repurchases as Suggested in EBD/67/97: Before Abatement, Amount	(5) Before Abatement, as % of quota	(6) After Abatement, Amount	(7) After Abatement, as % of quota
Argentina							
Australia							
Belgium	50.0	50.0	22	50.0	22	50.0	22
Bolivia							
Brazil	17.3		12				
Burma	3.0		20				
Chile							
Colombia	5.0		10				
Cuba	25.0		50				
Denmark	32.5	32.5	48	32.5	48	32.5	48
France							
Haiti							
Honduras	3.7	0.6	49	0.6	8	0.6	8
India							
Indonesia							
Iran		11.7		10.3	29	10.3	29
Israel	3.7	3.7	49	3.7	49	3.7	49
Japan	125.0	76.7	50	60.7	24	60.7	24
Jordan							
Luxembourg							
Netherlands	63.7	63.7	23	63.7	23	63.7	23
Nicaragua 1/	1.9						
Pakistan							
Paraguay							
Philippines	2.5		17				
South Africa							
Turkey	4.0		9	4.9	11	4.9	11
United Arab Rep.							
United Kingdom	200.0		15	299.2	23	299.2	23
Yugoslavia							
Totals 2/	537.3	239.0		525.6		525.6	

1/ Holdings at 75 per cent of quota on April 30, 1958; repurchase in respect of purchase during year ended April 30, 1959.
2/ Totals may not equal sum of items because of rounding.

Table 2. A comparison of total repurchases incurred as of April 30, 1962 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

Fund's holdings above 75 per cent of quota as at April 30, 1962	(1) Actual Total Repurchases 5/1/62-4/30/63	(2) of which: under Art. V Sect. 7(b) 4/30/62	(3) Column (1) as % of quota	(4) Calculated Repurchases as Suggested in EBD/67/97: Before Abatement Amount	(5) Before Abatement as % of quota	(6) After Abatement Amount	(7) After Abatement as % of quota
Argentina	36.0		13				
Australia	27.4	1.6	7	27.4	7	1.6	
Bolivia	2.5		11				
Brazil	17.5		6	47.8	17	38.8	14
Burma				1/			
Ceylon							
Chile	12.7		13				
Colombia	1/			24.7	25	23.4	23
Costa Rica	6.6	6.3	44	6.7	45	5.3	35
Cuba							
Dominican Rep.							
Ecuador	6.2	6.2	41	6.3	42	5.5	37
Ghana							
Guatemala	1.1	1.1	7	1.1	7	0.9	6
Haiti	2.5		22				
Honduras	1.8	1.2	16	1.8	16	1.4	12
Iceland	6.8		60				
India							
Indonesia							
Iran	20.4	14.2	29	20.4	29	12.7	18
Ireland	1/	1/		3.0	7	1/	
Jordan				0.6	10		
Luxembourg	1.3	1.3	11	2.0	17	1.7	14
Mexico	45.0	45.0	25	45.0	25	36.7	20
Nicaragua	4.5	4.5	40	4.5	40	3.5	31
Pakistan							
Paraguay	1.5		13				
Philippines				2.7	4	2.4	3
Sudan	2.9		19				
Syria							
Turkey	18.0		21	11.6	13	11.5	13
United Arab Rep.	2.5		3	21.1	23	20.0	22
United Kingdom	582.0		30	647.7	33	573.5	29
Yugoslavia	7.9		7				
Totals 2/	807.3	81.6		874.4		738.9	

1/ Less than $50,000.
2/ Totals may not equal sum of items because of rounding.

Table 3. A comparison of total repurchases incurred as of April 30, 1963 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

Fund's holdings above 75 per cent of quota as at April 30, 1963	(1) Actual Total Repurchases 5/1/63-4/30/64	(2) of which: under Art.V Sect.7(b) 4/30/63	(3) Column (1) as % of quota	(4) Calculated Repurchases as Suggested in EBD/67/97 — Before Abatement: Amount	(5) Before Abatement: as % of quota	(6) After Abatement: Amount	(7) After Abatement: as % of quota
Afghanistan		2.8		5.1	23	2.7	12
Argentina	36.0		13				
Bolivia	3.5		16				
Brazil	55.5		20				
Burma	1/			1/		1/	
Canada	138.5	78.5	25	275.7	50	76.9	14
Ceylon							
Chile	10.0		10				
Colombia	6.0		6				
Costa Rica	1.3	1.3	9	4.2	28	1.2	8
Cuba							
Cyprus							
Dominican Rep.	9.0	1.3	60	6.1	41	1.3	9
Ecuador	3.3	3.2	22	7.1	47	3.4	23
Ghana							
Guatemala	3.9	1.0	26	3.9	26	0.9	6
Haiti	2.5		22				
Honduras	2.5	0.4	22	2.8	25	0.5	4
Iceland	1/			1/		1/	
India	50.0		8				
Indonesia							
Ireland	2.3	2.3	5	3.0	7	1.4	3
Jamaica	1.2	1.2	6	1.6	8	0.7	4
Jordan		0.3		0.6	8	0.2	3
Luxembourg							
Malaysia	3.4	3.4	10	5.4	15	2.2	6
Mexico							
Nicaragua	12.3	1.0	109	4.5	40	1.0	9
Pakistan	12.5		8				
Paraguay	0.4		4				
Philippines	2.0		3	2.6	4	2.6	4
Sudan	0.3	0.3	2	1.9	13	0.9	6
Syrian Arab Rep.	5.1		34	7.7	51	4.8	32
Turkey	9.0		10	22.0	26	18.1	21
United Arab Rep.				16.6	18	15.6	17
Uruguay							
Yugoslavia	10.0		8				
Totals 2/	380.4	97.1		370.8		134.4	

1/ Less than $50,000.
2/ Totals may not equal sum of items because of rounding.

Table 4. A comparison of total repurchases incurred as of April 30, 1964 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

Fund's holdings above 75 per cent of quota as at April 30, 1964	(1) Actual Total Repurchases 5/1/64-4/30/65	(2) of which: under Art. V Sect.7(b) 4/30/64	(3) Column (1) as % of quota	(4) Calculated Repurchases as Suggested in EBD/67/97: Before Abatement — Amount	(5) Before Abatement — as % of quota	(6) After Abatement — Amount	(7) After Abatement — as % of quota
Afghanistan							
Argentina	50.0		18	13.9	5	3.6	1
Bolivia	2.8		12				
Brazil	44.0		16				
Canada	107.2		20				
Ceylon	3.8		8				
Chile	13.0		13				
Colombia	22.0		22	20.6	21	7.3	7
Costa Rica	2.1	0.4	14	5.2	35	0.4	3
Cyprus							
Ecuador	6.6	0.5	33	7.8	39	0.5	3
El Salvador							
Ghana							
Haiti							
Honduras	2.5		17	4.0	27		
Iceland							
India	100.0		17				
Indonesia							
Ireland	0.4	0.4	1	0.7	2	0.1	
Israel 2/	12.5		25				
Italy	65.3		24				
Jamaica	0.2	0.2	1	0.4	2	0.1	1
Jordan	0.3		3				
Liberia							
Luxembourg				0.4	3	0.4	3
Malaysia	1.1	1.1	3	2.0	5	0.4	1
Mexico							
Nicaragua	1/			4.8	43		
Nigeria							
Pakistan							
Paraguay	0.5		4				
Philippines	11.3		15	2.5	3		
Somalia	1/			0.9	8		
Sudan							
Syrian Arab Rep.	2.5		10				
Turkey	16.0	1.6	19	1.6	2	1.4	2
United Arab Rep.	18.0		15	17.7	15	9.8	8
United States				39.6	1	39.2	1
Uruguay							
Yugoslavia	35.0	—	29	—		—	
Totals 3/	517.0	4.2		122.1		63.2	

1/ Less than $50,000.
2/ Holdings at 75 per cent of quota on April 30, 1964; repurchase in respect of purchase during year ended April 30, 1965.
3/ Totals may not equal sum of items because of rounding.

Table 5. A comparison of total repurchases incurred as of April 30, 1965 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Actual Total Repurchases			Calculated Repurchases as Suggested in EBD/67/97			
		of which:		Before Abatement		After Abatement	
Fund's holdings above 75 per cent of quota as at April 30, 1965	5/1/65 4/30/66	under Art.V Sect. 7(b) 4/30/65	Column (1) as % of quota	Amount	as % of quota	Amount	as % of quota
Afghanistan	1.1	2.6	5	3.3	15	2.4	11
Argentina	52.0		19				
Bolivia	2.5	0.4	11	1.8	8	0.4	2
Brazil	59.0		21	140.7	50	24.7	9
Burundi	2.0		18				
Ceylon	11.3		18				
Chile	41.5		42				
Colombia	28.0		28				
Costa Rica	2.5		13				
Cyprus							
Dominican Rep.							
Ecuador	2.0		10				
El Salvador							
Ghana	5.6		10				
Haiti	2.8		25				
Honduras	2.5		17	1.6	11		
Iceland							
India	75.0		13				
Indonesia							
Iran	3.5	3.5	5	17.5	25	3.5	5
Ireland				0.3	1	0.1	
Jamaica							
Jordan	1/			0.3	3		
Liberia							
Luxembourg				0.4	3	0.4	3
Malaysia	1/			0.8	1		
Mali							
Morocco	5.9		11	8.2	16	4.9	9
Nicaragua	1/			11.2	100		
Nigeria							
Pakistan							
Panama							
Paraguay	0.4		4				
Philippines	10.5		14	21.3	28	4.5	6
Somalia	1/			0.1	1		
Sudan	2.5		6				
Syrian Arab Rep.	7.3		29	7.1	28	2.6	10
Trinidad & Tobago							
Tunisia	0.2	0.2	1	1.0	4	0.4	2
Turkey	21.5	31.2	25	1.5	2	1.5	2
U.A.R.	34.5		29	2.3	2	1.8	2
United Kingdom				313.5	16	285.5	15
United States							
Uruguay	2.0	0.1	7	3.6	12	0.1	
Yugoslavia	30.0		25				
Totals[2/]	406.0	38.1		536.5		332.8	

1/ Less than $50,000.
2/ Total may not equal sum of items because of rounding.

Table 6. A comparison of total repurchases incurred as of April 30, 1966 under Article V, Section 7(b), or incurred during the subsequent twelve months with those Article V, Section 7(b) repurchases calculated in accordance with the proposals in Section II B (a) and (b) of EBD/67/97

(Amounts in millions of U.S. dollars)

Fund's holdings above 75 per cent of quota as at April 30, 1966	(1) Actual Total Repurchases 5/1/66-4/30/67	(2) of which: under Art.V Sect.7(b) 4/30/66	(3) Column (1) as % of quota	(4) Calculated Repurchases as Suggested in EBD/67/97 — Before Abatement: Amount	(5) Before Abatement: as % of quota	(6) After Abatement: Amount	(7) After Abatement: as % of quota
Afghanistan	4.4	2.1	15	6.4	22	2.1	7
Argentina	64.0		23				
Bolivia	2.5		9				
Brazil	27.0	0.5	8	17.6	5	0.1	
Burundi	3.2		21				
Ceylon	7.5		10				
Chile	38.5		39				
Colombia	34.0		27				
Costa Rica	2.5		13				
Cyprus	1.2		8				
Dominican Rep.							
Ecuador	0.3		1	0.6	2	0.2	1
Ghana	4.0		6				
Guatemala	0.4	0.4	2	5.0	20	0.4	2
Haiti	3.1		21				
Honduras	5.3	0.7	28	1.9	10	0.9	5
Iceland		1/		1/		1/	
India	57.5		8				
Iran							
Ireland	1.3	1.3	2	22.8	29	1.3	2
Jamaica	1/	1/		0.2	1	1/	
Jordan	1/	1/		0.3	2	1/	
Liberia	5.0		25				
Luxembourg							
Malaysia		1/		0.8	1	1/	
Mali							
Morocco				2.7	4	1/	
New Zealand							
Nicaragua	5.6		29				
Nigeria				1.6	3		
Pakistan	1.9		1				
Panama							
Philippines	10.8	2.5	14	10.8	14	2.5	3
Rwanda							
Sierra Leone							
Somalia							
Sudan	3.1		5				
Syrian Arab Rep.	3.2		8	3.6	9	1/	
Trinidad & Tobago							
Tunisia	0.5		2				
Turkey	18.0	10.4	21	12.1	14	10.2	12
United Arab Rep.	16.0		11				
United Kingdom				1082.7	44	425.4	17
United States							
Uruguay	8.0	0.7	27	10.0	33	0.6	2
Yugoslavia	11.5		8				
Zambia							
Totals 2/	340.1	18.6		1179.1		443.7	

1/ Less than $50,000.
2/ Totals may not equal sum of items because of rounding.

Note: Of the 35 members, in column (2), who did not incur repurchase obligations, the monetary reserves of 30 were below quota (Article V, Section 7(c)(i)); 1 had its repurchase abated since the currency could not be accepted by the Fund (Article V, Section 7(c)(iii)) and the monetary reserves of 4 decreased by more than the Fund's holdings of the members' currency increased (Article V, Section 7(b)(i)). Of the 30 members in Column (4) which would not have incurred repurchase obligations, 25 members had "gross" reserves below the level of their quota and the monetary reserves of 5 members decreased by more than the Fund's holdings of the members' currency increased (Article V, Section 7(b)(i)).

Table 7. Total Gold and Currencies Used for Article V, Section 7(b) Repurchase Obligations as of April 30, 1958, 1962, 1966

(In millions of U.S. dollars)

	1958			1962			1966		
		As calculated in accordance with EBD/67/97			As calculated in accordance with EBD/67/97			As calculated in accordance with EBD/67/97	
	As presently calculated After abatement	Before Abatement	After Abatement	As presently calculated After abatement	Before Abatement	After Abatement	As presently calculated After abatement	Before Abatement	After Abatement
Gold	91.0	380.2	380.2	18.9	387.5	387.5	14.5	434.8	434.8
Currencies									
Austrian schillings							0.5	0.5	0.5
Belgian francs				1/	0.3	0.3	0.5	0.6	0.6
Canadian dollars	0.1	0.1	0.1	1/	0.3	0.3	0.7	4.1	4.1
El Salvadoran colones				1/	1/	1/	1/	1/	1/
Deutsche mark				1.3	4.4	4.4	0.7	1.8	1.8
French francs				1/	2.4	2.4	0.2	0.5	0.5
Guatemalan quetzales	1/	1/	1/						
Honduran lempiras								0.1	-
Italian lire				1/	1.0	1.0	0.7	0.7	0.7
Japanese yen							0.4	0.1	0.1
Mexican pesos							1/	1/	1/
Netherlands guilders				0.1	0.9	0.9	0.3	0.5	0.5
Peruvian soles				1/	1/	1/			
Saudi Arabian riyals					0.2	-			
Swedish kronor				1/	1.8	1.8		0.1	0.1
U.K. pounds					40.2	-		39.9	-
U.S. dollars	147.8	145.2	145.2	61.3	433.9	339.1		694.9	-
Total Currencies 2/	148.0	145.4	145.4	62.7	483.9	351.4	4.0	744.3	8.9
Total Repurchases 3/	239.0	525.6	525.6	81.6	874.4	738.9	18.6	1,179.1	443.7
Gold as percentage of Total Repurchases	38.1	72.3	72.3	23.2	44.5	52.4	78.3	36.9	98.0

1/ Less than $50,000.
2/ Totals may not add due to rounding.
3/ From columns 2, 4 and 6, Tables 1, 2 and 6.

Table 8. The amounts of currency actually abated in accordance with the provisions of Article V, Section 7(c)(iii) are compared with the amounts of abatements which would have taken place under Section II B (a) of EBD/67/97

(In millions of U.S. dollars)

April 30	Actually Abated Under Present Procedures		Abatement Under the New Proposal	
1962	£ stg.	37.7	£ stg.	37.7
			US$	94.8
				132.5
1963	£ stg.	2.1	£ stg.	8.1
	US$	219.2	US$	227.1
	Other	0.4	Other	0.6
		221.7		235.8
1964	£ stg.	1.1	£ stg.	12.8
	US$	18.3	US$	42.3
	Other	2.1	Other	3.4
		21.3		58.5
1965	£ stg.	4.4	£ stg.	17.5
	US$	30.5	US$	184.8
	Other	0.6	Other	1.2
		35.5		203.5
1966	£ stg.	62.7	£ stg.	39.9
	US$	68.0	US$	694.9
	Other	0.1	Other	0.1
		130.8		734.9

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/67/99

August 2, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Legal Aspects of the Memorandum Entitled "Suggestions for Certain Reforms in the International Monetary Fund" (EBD/67/97)

The attached memorandum will be brought to the agenda of the Executive Board for discussion in September.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

SM/67/99

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Legal Aspects of the Memorandum Entitled "Suggestions for Certain Reforms in the International Monetary Fund"

Prepared by the Legal Department

Approved by Joseph Gold

August 1, 1967

Introduction

1. On June 26, 1967, a memorandum addressed to the Managing Director by Mr. van Campenhout on behalf of himself and Messrs. Lieftinck, Larre, Siglienti, and vom Hofe was circulated as EBD/67/97. This memorandum makes more explicit certain suggestions for the reform of the Fund that were included in the Report of April 11, 1967 of the Monetary Committee of the European Economic Community, which report was referred to in the Communiqué of April 18, 1967 of the Finance Ministers of the Community. The preambular comments in the memorandum circulated as EBD/67/97, referred to for convenience in this paper as the Memorandum, conclude as follows:

> "In view of these discussions, the staff of the Fund might usefully undertake now a study of certain subjects corresponding to those of the suggestions of the Monetary Committee which, because of their operational character, raise technical questions.
>
> We would be grateful if you would see that a study of these subjects, which are indicated below, is undertaken. We may in due time submit additional information with regard to the other suggestions of the Monetary Committee."

The present paper has been written in response to that request. It is confined to the legal aspects under the present Articles and decisions of the Fund of the suggestions in the Memorandum, and as such it is intended to be a framework for discussion and for any later studies that may be necessary. It does not deal with the policy issues involved in the various suggestions. In this respect, the paper employs the same approach as the one followed in "Legal Aspects of Reform of the Gold Tranche" (SM/67/41, April 12, 1967). That paper should be read in conjunction with the present paper in so far as this one deals with the status of the gold tranche. The present paper has been divided into four Parts, entitled Status of the Gold Tranche, Use of the Fund's Resources, Repurchase, and Capital Transfers.

2. Greater precision has been attempted in the drafting of amendments to give effect to the suggestions on the gold tranche than to certain other suggestions in the Memorandum. This is in part because the Memorandum contains more specific suggestions on the gold tranche. Equal precision might be attempted for the other suggestions in the Memorandum after a first discussion of them by the Executive Directors.

Part I

Status of the Gold Tranche

3. On the basis of the earlier legal paper (SM/67/41), the Memorandum advances certain ideas for amendment of the Articles with respect to the gold tranche. Under paragraphs I.C, D, and F of the Memorandum, it is thought that no changes need be made in certain provisions that have a bearing on the gold tranche. No changes are contemplated with respect to the ineligibility provisions of Article IV, Section 6, Article V, Section 5, and Article XV, but this is made subject to what is said under I.A, an aspect which will be discussed below. It will be observed that Article VI, Section 1 is not included among the ineligibility provisions for which the prospect of amendment is not raised. The possibility of the amendment of Sections 1 and 2 of Article VI is mentioned in the Memorandum in connection with another topic, and the issues involved in this are discussed elsewhere in this study. Other provisions in which amendment is not foreseen are the repurchase provisions of Article V, Section 7 and the scarce currency provisions of Article VII.

4. The first suggestion for study is expressed as follows:

> "A. Members eligible to use the Fund's resources would have the right to draw within the limits of their gold tranche position only in the case of need and not for the sole purpose of changing the composition of their reserves. In no case would the Fund have authority to prevent such a drawing. This applies to the Fund's right to challenge the representation envisaged in Article V, Section 3, whatever the legal basis of the right to challenge."

In a footnote "gold tranche position" is said to include "super gold tranche position."

5. Need. The suggestion quoted above makes the point that an eligible member would be entitled to exercise its amended gold tranche privileges only in the case of need and not for the sole purpose of changing the composition of its reserves. This is the present legal position under the words "presently needed" in Article V, Section 3(a)(i). These words must be understood in the light of the Article XVIII interpretation of September 26, 1946 (pursuant to Decision No. 71 - 2) and the clarifying decision of July 28, 1961 (Decision No. 1238-(61/43), Selected Decisions, 3rd issue, p. 54). That is to say, use of the Fund's resources is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations, but this does not preclude use for coping with difficulties resulting from capital transfers in accordance with the provisions of the Articles, including Article VI. It must also be recalled that the Executive Directors have decided that the phrase "'presently needed' cannot be defined in terms of a formula uniformly

applicable to all cases" but must be applied "in each case in the light of all the circumstances." (Decision No. 284-4, March 10, 1948; Selected Decisions, p. 19) The conclusion, therefore, is that the concept of "presently needed" would not require amendment in order to give effect to that part of the suggestion in I.A of the Memorandum which has been discussed in this paragraph.

6. Challenge. The heart of the suggestion for amendment is, of course, to immunize the request of a member for a purchase in the gold tranche from challenge by the Fund. At the moment, the Fund has the legal power under Article V, Section 3(a) and in accordance with Decision No. 284-4 to challenge a representation made in connection with a request, even for a purchase in the gold tranche, for any one of the reasons mentioned in that decision, although in the practice of the Fund the overwhelming benefit of any doubt that a request for a gold tranche purchase receives makes challenge most unlikely. As was pointed out in SM/67/41 (p. 7), the Fund has also decided that it has the power to challenge a request under Article V, Section 5 in order to consider whether to apply that provision. The Fund may do this if it receives the request when it is already considering whether to send the member a report under Article V, Section 5, but the Fund may also defer compliance with the request even when the Fund is not already considering whether to send a report if the Fund finds that it should consider that action. If, having postponed the transfer of exchange under the request, the Fund decides that it should send the member a report and limit the member's use of the Fund's resources, the limitation will apply to the pending request (Decision No. 286-1, March 15, 1948; Selected Decisions, pp. 32-33). It was pointed out in SM/67/41 (p. 7) that the Executive Directors have not adopted any comparable decisions under Article VI, Section 1 or Article XV, Section 2, but that it was not apparent why powers of challenge such as those exercisable under Article V, Section 5 should not be exercisable under the other provisions as well.

7. There is, of course, no legal reason why abrogation of the power to challenge could not be confined to challenge under Article V, Section 3(a) without making the same change under the other provisions. The rationale for a distinction of this kind could be that a challenge under these other provisions, but not under Article V, Section 3(a), is a prelude to ineligibility or limitation of use or at least to the consideration of these actions. A distinction of this kind would leave requests to make purchases in the gold tranche open, in law at least, to a number of possibilities of challenge, and sometimes even to challenge for reasons that would have justified challenge under Article V, Section 3(a). Therefore, the suggestion in the Memorandum refers to challenge under any provision: "In no case would the Fund have authority to prevent such a drawing."

8. Definition of gold tranche. The original definition of the gold tranche is to be found in paragraph 3 of Decision No. 102-(52/11) of February 13, 1952 (Selected Decisions, pp. 21-24):

> "Each member can count on receiving the overwhelming benefit of any doubt respecting drawings which would raise the Fund's holdings of its currency to not more than its quota."

This definition cannot be translated now into statutory form if the Fund continues to give effect to the third sentence of paragraph 10 of Decision No. 2192-(66/81) of September 20, 1966 amending Decision No. 1477-(63/8) of February 27, 1963 (Selected Decisions, pp. 40-43) on the compensatory financing facility:

> "Moreover, the Fund will apply its tranche policies to drawing requests by a member as if the Fund's holdings of the member's currency were less than its actual holdings of that currency by the amount of any drawings outstanding under paragraph (5)."

The privileges under the revised compensatory financing facility are sometimes said to "float". This is not a satisfactory word because it is not always understood and it is certainly not a term of art. What is intended by the word is that the privileges in question are treated for certain purposes as being outside the whole range of tranches and tranche policies, i.e., even alongside and without prejudice to the gold tranche. There are two consequences of this character of the Fund's compensatory financing facility. One is that a member may be able to make a gold tranche purchase even though the Fund's holdings of the member's currency exceed an amount equal to the member's quota. The other is that a member may be able to make a purchase under the compensatory financing facility which will not be regarded as a gold tranche purchase even though the Fund's holdings of the member's currency are less than the member's quota. Some of the effects of these complications are discussed below.

9. The second suggestion on the gold tranche is that:

> "B. In view of A above, the representation in respect of drawings within the gold tranche could be eliminated."

There is an attractive directness about this suggestion as a technique for eliminating challenges under Article V, Section 3(a) in respect of purchases within the gold tranche. Decision No. 284-4 states that in appropriate circumstances certain aspects of the representation under Article V, Section 3(a)(i) are subject to challenge, and it would seem, therefore, that if there were no representation, it could not be challenged under that provision. Nevertheless, a member would still have to make a request to purchase within the gold tranche, and if requests must still comply with all the conditions of Article V, Section 3(a), it would be possible legally to hold that a request could be challenged on the ground of some inconsistency with Article V, Section 3(a) even though the member had made no representation under that provision. In short, requests might still be challenged even if representations were not required. It is relevant in this connection that although Decision No. 284-4 speaks of

challenging a member's declaration (which is equated with representation), Decision No. 286-1 is drafted in terms of postponing action on a request.

10. On the basis of the foregoing paragraph, it would be a more effective abrogation of the power to challenge if this were done expressly and not by relying on the implication derived from eliminating the representation. The issue is a technical one of legal drafting because I.A of the Memorandum does not intend that requests for purchases in the gold tranche shall be made unless there is need to make the purchase. If a member remains subject to the criterion of need, and indeed to all of the provisions of the Articles on the use of the Fund's resources, a representation in which the member declares that it has satisfied itself that the purchase is in accordance with the Articles would not subject it to any legal burden of consistency with the Articles that does not already rest on it.

11. Moreover, elimination of the representation could give rise to some misunderstanding. If the representation were made unnecessary, the implication might be drawn that members were being released from all of the constraints of consistency with the Articles in making gold tranche purchases. If that were taken to be the intention behind the amendment, a question would arise whether the amendment was consistent with Article I(v) of the Articles:

> "(v) To give confidence to members by making the Fund's resources available to them under adequate safeguards..."

It might be objected that if a member could make a request which could not be challenged and which was not accompanied by any representation of consistency with the Articles, "adequate safeguards" no longer existed. It might not be a convincing reply that adequate safeguards still existed because the member remained subject to the ineligibility provisions. The sanction of ineligibility might not be available in some circumstances (e.g., under Article V, Section 5 when a member's purchase was in the super gold tranche). Under the present provisions, the representation must be made in connection with all purchases, whether in the super gold tranche, basic gold tranche, or credit tranches.

12. If a member continued to be obliged to make the representation, that would eliminate any ambiguity on the question whether requests to make purchases in the gold tranche must be consistent with the Articles. The representation could also be regarded as an adequate safeguard for the limited purchases, in terms of quota, that a member could make in the gold tranche. There would be no way in which the Fund could prevent a gold tranche purchase when it doubted the correctness of the representation, but, as indicated above, the member might be subject to ineligibility after the event in the circumstances discussed in SM/67/41. It is not so much the possibility of ineligibility in some cases as the very fact of the representation that could be regarded as an adequate safeguard because of the legal principle that such a representation must be made in good faith whether or not there is an effective sanction for bad faith.

13. Amendment. On the basis of the foregoing discussion of I.A and B, the following is the draft of a possible amendment. It could be Section 3(c) of Article V:

> "A request to buy currency under Section 3(a) of this Article shall not be subject to challenge by the Fund under any provision of this Agreement if the proposed purchase is a gold tranche purchase."

A definition of the gold tranche would be added to the Article on Explanation of Terms as Article XIX(j). This definition would have to take account of the two consequences of the floating character of the compensatory financing facility that are mentioned in paragraph 8. One definition could be drafted as follows:

> "Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that the Fund may decide that purchases under specified policies on the use of the Fund's resources and amounts of the Fund's holdings of currency equal to outstanding purchases under these policies shall be excluded for the purposes of this definition."

The following would be a briefer formulation of the proviso:

> "provided that for the purposes of this definition the Fund may decide to exclude purchases and holdings under specified policies on the use of its resources."

14. The following are some notes on this draft:

(i) The phrase "request to buy" does not appear in the present Articles. The phrase "a proposal to buy" would be closer to language already in use in the Articles and might be substituted if the phrase was not thought to imply a discretion to refuse the proposal.

(ii) The phrase "under Section 3(a) of this Article" would make it clear that all of the "conditions" of that provision applied to the request for a gold tranche purchase and would avoid any danger that the language could be read to mean that a request had to be met even if the member was already ineligible.

(iii) The text refers to "a request" and not, for example, "the representation under Section 3(a)(i) of this Article" because of the point that has been made that elimination of the power to challenge "representations" under Article V, Section 3(a)(i) might be understood to leave untouched the power to challenge "requests" under Article V, Section 5 and other provisions.

(iv) The exclusion of holdings is referred to in the draft definitions of the gold tranche in order to prevent the challenge of requests to make gold tranche purchases even when the Fund's holdings of a member's currency are in excess of quota as a result of purchases under the compensatory financing facility. The exclusion of purchases is referred to in order to permit the challenge of requests to make purchases under the compensatory financing facility when the Fund's holdings of a member's currency are less than its quota.

(v) It may be considered a disadvantage of the incorporation of a definition of the "gold tranche" in the Articles that it converts the words into a term of art. That term has certain obvious shortcomings, but it has become so well established that it might be difficult to substitute other terminology. It might be useful nevertheless to consider the possibility of some other terminology, such as "automatic purchase", even though it would be less familiar and less colorful.

15. If representations were to be eliminated for gold tranche purchases, the text as drafted in paragraph 13 would have to be modified. The following draft could be considered for this purpose:

> "(c) If a member's request to buy currency under Section 3(a) of this Article is a request for a gold tranche purchase, the member shall not be required to make a representation under Section 3(a)(i) of this Article, and the request shall not be subject to challenge by the Fund under any provision of this Agreement."

16. The drafts set forth in paragraphs 13 and 15 do not limit the purchases and holdings that could be excluded to the compensatory financing facility or in any other way. If it were decided to limit the exclusion to purchases and holdings under that facility, the draft Article XIX(j) could be formulated as follows:

> "Gold tranche purchase means a purchase by a member of the currency of another member in exchange for its own currency which does not cause the Fund's holdings of the purchasing member's currency to exceed one hundred percent of its quota; provided that the Fund may decide that purchases under policies on the use of its resources for the compensatory financing of fluctuations in the exports of members and amounts of the Fund's holdings of currency equal to outstanding purchases under these policies shall be excluded for the purposes of this definition."

The briefer formulation of the proviso could be:

> "provided that for the purposes of this definition the Fund may decide to exclude purchases and holdings under policies on the use of its resources for the compensatory financing of fluctuations in the exports of members."

There are two comments on this text. First, it refers to "members" and not "primary exporting members" because the decision on compensatory financing uses such language as "members, particularly primary exporters" in speaking of the beneficiaries of that decision. Secondly, it may be considered undesirable to give the rigidity of law to a policy, but at least the language advanced above would give the Fund a continuing discretion to decide whether or not to retain the "floating" feature of the compensatory financing facility. If there were objection to the exclusion of any purchases or holdings, the compensatory financing facility would have to be revised so as to float alongside the credit tranches only. In that event, all of the words in the draft definition of gold tranche purchases after "its quota" would be deleted.

17. In connection with the discussion of the reform of the gold tranche, two related issues must be mentioned:

(a) SM/67/41, pp. 16-17, dealt with pre-par value transactions under Article XX, Section 4(d) and under Membership Resolutions. The present memorandum assumes that the Fund would continue to have the authority to prescribe conditions even for gold tranche transactions by members that had not yet established an initial par value. If, however, it were decided that members in these circumstances should have the same right to engage in gold tranche transactions as other members, it would be necessary to amend Article XX, Section 4(d) and Article II, Section 2 and to change the language of Membership Resolutions. Even if pre-par value gold tranche transactions were not treated in this way, the text of the last sentence of paragraph (b) of Decision No. 1678-(64/22), April 22, 1964, (Selected Decisions, p. 48) would have to be reconsidered.

(b) The reform of the gold tranche in accordance with the foregoing paragraphs might call for some corresponding amendment in those provisions of the Fund's borrowing arrangements that are intended to give gold tranche treatment to requests for early repayment. This subject is discussed in SM/67/41, p. 18.

18. A further suggestion in the Memorandum associated with the gold tranche is the following:

> "E. The charges provided for in Article V, Section 8(a) would be abolished. The super gold tranche positions would bear interest (within maximum and minimum limits that might be specified)."

Charges. Article V, Section 8(a) provides for the levy of a charge in connection with all purchases from the Fund without reference to the length of time during which the purchase for which the charge is paid remains outstanding.

> "Any member buying the currency of another member from the Fund in exchange for its own currency shall pay a service charge uniform for all members of three-fourths percent in addition to the parity price. The Fund in its discretion may increase this service charge to not more than one percent or reduce it to not less than one-half percent."

The charge may be varied, but when fixed must apply to all members. The present charge is fixed by Rule I-2:

> "The service charge payable by a member buying the currency of another member in exchange for its own currency shall be paid at the time the transaction is consummated. The service charge payable for such transactions taking place after November 30, 1951, shall be 1/2 of 1 per cent."

The purpose of the charge was to limit the financial advantage that could accrue to members if they were able to purchase currencies at par from the Fund and dispose of them at more favorable exchange rates in the market.

19. If it were decided to adopt the suggestion on charges in the Memorandum, the practice of the Fund would be changed in an obvious respect, but it would be changed in another and perhaps less obvious way. Hitherto, the concept of the gold tranche in its present form, i.e., the difference between quota and Fund holdings of currency after excluding currency which results from purchases outstanding under the compensatory financing facility, has been relevant only in connection with the Fund's policies on the use of its resources. It has not affected any calculations under the provisions of the Articles involving levels of Fund holdings. This would be changed under the suggestion in paragraph 18 above, because no charge would be levied on a gold tranche purchase whatever might be the level of the Fund's holdings of the purchasing member's currency. For example, it is possible for the Fund to hold a member's currency at the level of, say, 140 percent of quota in circumstances in which the member still has gold tranche privileges. These would be circumstances in which the member's currency subscription was equal to 90 percent of its quota and in which the member had made purchases equal to 50 percent of its quota under the compensatory financing facility. In such a case, the suggestion, if adopted, would mean that the member would pay a service charge on the compensatory financing purchases but not on a subsequent gold tranche purchase equal to 10 percent of quota. Similarly, a member might elect to make a purchase under the compensatory financing facility when it came within that provision even though the Fund's holdings of the member's currency were below an amount equal to its quota. In those circumstances the member would pay a service charge on the purchase.

20. The suggestion on charges could be made effective by an amendment which added the following words to the end of the second sentence of Article V, Section 8(a):

> ", but no service charge shall be paid on any gold tranche purchase."

21. Another course which could be considered would be the creation of discretionary authority. For this purpose, Article V, Section 8(a) could be rewritten as follows:

> " The Fund may levy a service charge, uniform for all members and not more than one percent in addition to the parity price, on any member buying the currency of another member from the Fund in exchange for its own currency."

The Executive Directors could then decide to eliminate the service charge for all gold tranche purchases or for super gold tranche purchases. This would be compatible with the words "uniform for all members" which permits the interpretation that the change shall be uniform for all members in the same circumstances. There is legal authority for the proposition that uniformity in such a context is intended to avoid discrimination but that it permits reasonable categories that are not capriciously devised. On this view, the legal position would be the same under Article V, Section 8(a) as amended as it is now under Article V, Sections 8(c) and (e). In addition, the Fund would be able to resume the practice of levying a charge on gold tranche purchases if, having terminated the practice, the Fund were to conclude that it was desirable to reinstate the charge. However, the amendment as drafted above would give the Fund authority to levy a charge lower than the present minimum. Finally, a wider discretion to vary service charges could be exercised by the Fund more closely in conjunction with its present discretion to distribute net income or any new discretion to pay interest (see paragraph 22). It will be recalled that in the past the Fund reduced the service charge from 3/4 to 1/2 percent in conjunction with a variation in the periodic charges on the Fund's currency holdings.

22. Interest. It is suggested in the Memorandum that super gold tranche positions should bear interest within specified maximum and minimum limits. This would call for the amendment of Article XII, Section 6:

> "Distribution of net income.--(a) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed.

(b) If any distribution is made, there shall first be distributed a two percent non-cumulative payment to each member on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year. The balance shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

The provision could be amended along the following lines to give effect to the suggestion:

"(a) The Fund shall pay annual interest of not more than X percent per annum and not less than Y percent per annum to a member on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during the year. The Fund shall determine the rate of interest, which shall be uniform for all members.

(b) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed. If any distribution is made, it shall be paid to all members in proportion to their quotas.

(c) Payments of interest and distributions of income to a member shall be made in its own currency."

23. The following are some notes on paragraph 22:

(i) Sub-paragraph (a) could be taken out of Article XII, Section 6 and perhaps added to Article V, Section 8, with consequential modifications of text. It would be appropriate to do this because, as indicated in (iii) below, the payment of interest would not depend on the avilability of income.

(ii) "Net income" under (b) would be calculated after deducting interest paid under (a).

(iii) Under (a), interest would be payable whether or not net income was earned. Moreover, the obligation to pay interest would continue to apply even after the Fund's reserves were exhausted. The legal position would be different, therefore, from the present position with respect to the distribution of net income.

(iv) Although it is suggested in the Memorandum that a minimum rate of interest should be paid, no change is suggested in the present provisions on periodic charges. Under these provisions, it is not prescribed that minimum charges must be levied.

Part II

Use of the Fund's Resources

24. Section A under this heading of the Memorandum is entitled "Conditions for drawings within the credit tranches (Paragraph 8a(ii) of the Monetary Committee Report)". It reads as follows:

> "The suggestions contained in that paragraph should, at a convenient time, be examined by the Executive Board, both with respect to the schedule of charges, and the Fund's policy regarding the conditions applicable to drawings within the credit tranches. On the other hand, it would be advisable to state explicitly in the Articles of Agreement that the Fund has authority to determine the principles which are necessary to ensure that the use of the Fund's resources is in conformity with the Articles of Agreement and that such use is of a temporary nature."

The suggestion for immediate study is that the Articles should be amended so as to state explicitly that the Fund has authority to determine the principles that are necessary to ensure that the use of the Fund's resources is consistent with the Articles and that one element of consistency is the temporary character of any use.

25. Policies. Article V, Section 3(a) already requires a member which purchases exchange from the Fund to represent that the exchange is presently needed for making in that currency payments "which are consistent with the provisions of this Agreement." In this connection, the Executive Directors have decided that:

> "The phrase 'consistent with the provisions of this Agreement' in Article V, Section 3, means consistent both with the provisions of the Fund Agreement other than Article I and with the purposes of the Fund contained in Article I." (Decision No. 287-3, March 17, 1948; Selected Decisions, pp. 19-20)

There are a number of legal procedures and powers, including the power to adopt such rules and regulations as may be necessary or appropriate to conduct the business of the Fund (Article XII, Section 2(g)), which enable the Fund to make sure that any particular use of the Fund's resources will be consistent with the purposes and provisions of the Fund. For example, the Fund can challenge requests, limit the use of the Fund's resources, declare a member ineligible, impose terms safeguarding the Fund's interests under Article V, Section 4, and impose terms and conditions under other provisions. The suggestion in the Memorandum does not propose any addition to these procedures and powers. The suggestion has a different objective. In applying the legal procedures and powers available to the Fund, e.g., in deciding whether to permit or deny the use of the Fund's resources, or

more properly in deciding on what conditions a member may use the resources instead of being denied access to them where that would be possible, the Fund acts according to certain principles of policy. It establishes tranche policies, a compensatory financing facility, a policy on pre-par value transactions, and so on. The power to adopt such principles of policy is reflected in the concept of "adequate safeguards" in Article I(v), in the last sentence of Article I, and elsewhere in the Articles. But there is no statement in the Articles which declares in so many words that the Fund can adopt general policies on the use of its resources, and it is this absence that the suggested amendment would remedy. The suggestion would seek to go beyond the necessary implication of the language which does appear in the Articles and would state expressly that the Fund can establish general policies in administering its resources.

26. Temporary use. What has been said above with respect to policies on use applies equally to the concept of the temporary use of the Fund's resources. There is no express mention of this in the Articles, but there are many indications that only a temporary use is legitimate, and these were relied on as the basis for the interpretation of September 26, 1946 (pursuant to Decision No. 71-2, Selected Decisions, p. 54). Later in this paper, there is a discussion of the possibility of amending Article VI, Section 1 (paragraph 62), and that amendment could include a reference to the temporary character of the use of the Fund's resources. If that course was not adopted, and if it was thought advisable to make express mention of the two topics of policies on use and the temporary character of use, one way in which this could be done would be by amendment of Article I(v) as follows:

> "To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, and in accordance with such policies as the Fund may adopt, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." (Words underlined are added.)

With this language, the Fund would continue to be able to determine what it understood by temporary use.

Part III

Repurchase

27. In order to "ensure the effectiveness and equal application of members' repurchase obligations", three suggestions are made for examining the provisions of the Articles that govern repurchase obligations and the calculation of monetary reserves on which they are based. These relate to currency liabilities, the abatement of obligations, and non-member currencies.

Currency liabilities

28. Introduction. The first suggestion under the heading of repurchase involves "abolishing the deduction of currency liabilities provided for in Article XIX (e) in calculating the amount of the monetary reserves that form the basis for determining the repurchase obligations." Something must be said, therefore, of the rôle of currency liabilities in the calculation of monetary reserves for the purpose of repurchase obligations under Article V, Section 7(b). Although a great body of refinements has grown up inevitably in connection with the calculation, monetary reserves may be said to consist of the central holdings of a member (i.e., gold and convertible currencies owned by its Treasury, central bank, stabilization fund, or similar fiscal agency), but subject to:

(i) the exclusion (for calculations connected with Article V, Section 7(b)) of the three categories of holdings mentioned in Schedule B, Paragraph 3, and

(ii) the deduction (for all calculations of monetary reserves) of only one type of obligation, "currency liabilities."

29. The deduction of currency liabilities is provided for by Article XIX(e):

> "A member's monetary reserves shall be calculated by deducting from its central holdings the currency liabilities to the Treasuries, central banks, stabilization funds, or similar fiscal agencies of other members or non-members specified under (d) above, together with similar liabilities to other official institutions and other banks in the territories of members, or non-members specified under (d) above. To these net holdings shall be added the sums deemed to be official holdings of other official institutions and other banks under (c) above."

The basic decision of the Executive Directors on currency liabilities is Decision No. 493-3, adopted on November 4, 1949:

> "The Executive Board has considered questions relating to the concept of currency liabilities in Article XIX(e), as set forth in Executive Board Special No. 107 (10/18/49), and agrees that the following principles apply:
>
> 1. The currency liabilities of a member are the liabilities represented by the holdings of its currency by the Treasuries, central banks, stabilization funds, similar fiscal agencies, other official institutions or other banks of other members, or of such nonmembers as have been specified by the Fund.
>
> 2. Currency liabilities are not confined to convertible currencies.
>
> 3. The deductibility of currency liabilities does not depend on whether the holder's currency is convertible.
>
> 4. "Currency" in the concept "currency liabilities" means "without limitation coins, paper money, bank balances, bank acceptances, and government obligations issued with a maturity not exceeding twelve months.
>
> 5. A blocked balance is not a currency liability." (<u>Selected Decisions</u>, pp. 104-105)

30. <u>Legislative history</u>. Executive Board Special No. 107 (October 18, 1949), which led to Decision No. 493-3, discussed currency liabilities and set forth the legislative history of Article XIX(e). It is useful for the present purpose to recall the history of the provision because it sheds light on the intentions that led to its adoption. One of the original ideas advanced in the negotiation of the Articles was that monetary reserves should be an uncompromisingly gross concept, that is to say, one that would admit no exclusions and no deductions. This was the view of the United States delegation at Atlantic City, which proposed a text defining holdings as being "without reduction for any liabilities, whether such liabilities are actual or potential, general or specific, external or internal." However, another proposal envisaged deductions from the gross holdings of a member that had a convertible currency in respect of the holdings of its currency by others. The theory on which this proposal rested was made clear in a text proposed by the United Kingdom delegation:

> "'Net' official holdings shall be calculated by deducting the liabilities of other official holders in gold or convertible currencies from the gross official holdings of gold and convertible currency, so as to provide that gold and convertible currencies do not count twice, first in respect of a country holding convertible currency and second in respect of gold held against it by the country having this liability. Accordingly, convertible exchange reckoned as part of the official holdings of one country shall be deductible in reckoning the net official holdings of the country whose exchange is involved."

The underlying theory on which this proposal was based was that, subject to such modifications as might be introduced under other provisions, the total monetary reserves of all members would be equal to the total of their holdings of gold after the currencies of all members had become convertible.

31. At Bretton Woods, a joint proposal was introduced by the United States and the United Kingdom which accepted the theory of the United Kingdom proposal at Atlantic City. Under this proposal, there would have been deducted from the gross holdings of a member the holdings by others of its currency provided that its currency was convertible. However, in the next and final chapter in the evolution of the provision, the limitation of the deduction to the holdings of a convertible currency was eliminated, and the concept of currency liabilities was broadened so as to enable a member to deduct the holdings of its currency by specified holders whether that currency was convertible or inconvertible. It was pointed out in Staff Memorandum No. 349, Sup. 1 (4/28/49) that the justification for this broadening of the concept was that there were great gradations in the _de facto_ convertibility of currencies, and that the use of holdings of even an inconvertible currency to pay for imports from the currency issuer diminished its current receipts. It required the issuer to develop an equivalent surplus in its balance of payments or absorb a reduction in its reserves.

32. _Operation of currency liabilities_. It will be seen, therefore, that the concept of currency liabilities covers only one type of liability, the liability inherent in the holding of the issuer's currency by another. The concept does not include debts payable in the issuer's currency or in some other currency, whether already due or contingent, if these liabilities are not accompanied by the holding of the issuer's currency. The application of the concept has led to fine distinctions on occasion, although this would undoubtedly be true of any other definition of monetary reserves that must be applied with legal precision. For example, it has been held that if there is a bilateral payments agreement under which there is a debit bank balance for one party expressed in its currency, it can claim the deduction of a currency liability, whereas this will not be the result if the bank balance is expressed in the currency of the creditor member.

33. One consequence of the decution of currency liabilities has been that repurchase obligations have not accrued under Article V, Section 7(b) for the United States or the United Kingdom because their monetary reserves have been less than their quotas; and indeed in recent years their monetary reserves have been negative because the deductible holdings of dollars and sterling have exceeded the gross holdings of those members. Repurchase obligations cannot accrue for a member unless its monetary reserves as calculated under the Articles exceed an amount equal to its quota (Article V, Section 7(c)(i)). It must not be thought, however, that only reserve currency members have had currency liabilities to deduct. In particular, many members have been able to make these deductions because of the holding of their currencies by the United States under U.S. Public Law 480. Although these balances are not usable for unlimited purposes, they are nevertheless usable, and it has been held, as a result, that they have the quality of currency and can therefore be deducted as "currency" liabilities.

34. Charges. If it were decided to abrogate the deduction of currency liabilities for repurchase purposes, it would be necessary to decide whether this should be done under other provisions. The first of these is Article V, Section 8(f):

> "All charges shall be paid in gold. If, however, the member's monetary reserves are less than one-half of its quota, it shall pay in gold only that proportion of the charges due which such reserves bear to one-half of its quota, and shall pay the balance in its own currency."

Under this provision, the charges to which it relates[1/] may be paid in the currency of the member paying the charge if its monetary reserves are below the specified level. If it were decided to abrogate the deduction of currency liabilities in the calculation of monetary reserves for the purpose of Article V, Section 8(f) as well, the tendency would be to reduce the amount of charges that could be paid in the currencies of members paying charges. There would be no legal reason, however, why a change could not be made for one purpose but not for the other.

1/ Charges for stand-by arrangements do not fall under Article V, Section 8(f) by operation of law, but the provision has been applied to them by decision of the Executive Directors:

> "Charges for stand-by arrangements will be payable in gold, or U.S. dollars in lieu of gold, or in the member's currency as specified for other charges by Article V, Section 8(f)." (Selected Decisions, p. 27).

35. Quota increases. The other provision under which calculations of monetary reserves are made is Article III, Section 4:

> "Payments when quotas are changed.--(a) Each member which consents to an increase in its quota shall, within thirty days after the date of its consent, pay to the Fund twenty-five percent of the increase in gold and the balance in its own currency. If, however, on the date when the member consents to an increase, its monetary reserves are less than its new quota, the Fund may reduce the proportion of the increase to be paid in gold."

Although the Fund has never reduced the proportion of a quota increase payable in gold, it would be necessary nevertheless to decide whether the calculation of monetary reserves should be changed for the purpose of this provision if it were changed for some other provision. The abrogation of the deduction of currency liabilities under Article III, Section 4 would tend to reduce the scope of the Fund's discretion to reduce gold payments under that provision.

36. Article XIX(c). A second consequential legal problem would arise in connection with Article XIX(c):

> "The holdings of other official institutions or other banks within its territories may, in any particular case, be deemed by the Fund, after consultation with the member, to be official holdings to the extent that they are substantially in excess of working balances; provided that for the purpose of determining whether, in a particular case, holdings are in excess of working balances, there shall be deducted from such holdings amounts of currency due to official institutions and banks in the territories of members or non-members specified under (d) below."

The origin of this provision was the fact that in certain countries represented at Bretton Woods, what would be central holdings held by monetary authorities in other countries were owned by non-central institutions. The problem raised by this institutional difference was solved by giving the Fund a discretion to deem a certain amount of the holdings of these non-central institutions to be central holdings. The Fund has exercised this discretion on one occasion.

37. Article XIX(c) was clarified as follows in Decision No. 298-3 adopted by the Executive Directors on April 14, 1948:

"The holdings of other official institutions or other banks within its territories may, in any particular case, be deemed by the Fund, after consultation with the member, to be official holdings to the extent that they are substantially in excess of working balances; provided that for the purpose of determining whether, in a particular case, holdings are in excess of working balances, there shall be deducted from such holdings amounts of currency due to official institutions and banks in the territories of members or nonmembers specified under (d) below."

"(1) 'Other official institutions' and 'other banks' are official institutions and banks not embraced by Article XIX(b). 'Other official institutions' are those representing a member anywhere. 'Other banks' are banks within its territories.

"(2) 'Working balances' must be determined in the light of all the facts of the individual case, and no rigid rule can be formulated for their measurement. The general idea is that a working balance is one which is necessary to meet the requirements of its owner, taking into account normal receipts and payments, for a period not unreasonably protracted.

"(3) No deduction may be made from central holdings on the ground that they are said to represent, in whole or in part, 'working balance,' for example, because there are no commercial banks or because the holdings of commercial banks are alleged by the member to be inadequate for working purposes.

"(4) Gold or dollars owned by 'other official institutions' and 'other banks' may be included in a member's official holdings, after consultation with the member, to the extent that they are substantially in excess of 'working balances.'

"(5) The proviso in Article XIX(c) declares that in determining whether the holdings of other official institutions and other banks are substantially in excess of working balances, certain deductions shall be made. These deductions are in respect of liabilities arising from the holdings of the currency of the member whose official holdings are being calculated. Such liabilities must be owed by that member's official institutions and banks to the official institutions of and banks in the territories of countries which were members of the Fund on September 12, 1946." (Selected Decisions, pp. 101-102).

What is of particular interest in connection with the current inquiry is paragraph 5 of the decision. This says, in effect, that before deciding whether the holdings of a member's other official institutions or other banks within its territories are substantially in excess of working balances, there must first be deducted what are in effect the currency liabilities of those institutions and banks owed to official institutions and banks in the territories of other members or specified non-members. The question, therefore, is whether the abrogation of the currency liabilities of Article XIX(e) should be accompanied by the abrogation of the currency liabilities in the proviso of Article XIX(c). There is no legal reason why Article XIX(c) could not be left in its present form whatever might be done under Article XIX(e).

38. Sudden increase. If currency liabilities ceased to be deductible, there could be a sudden increase in the monetary reserves of certain members as calculated under the Articles resulting solely from the difference in calculation. If, as a result of this calculation, a member's monetary reserves at the end of a financial year of the Fund increased considerably as compared with the beginning of that year, there could be a large and sudden repurchase obligation. The drafters were aware of this problem in connection with other phenomena. For example, in the year in which a currency becomes convertible under the Articles, any member holding that currency might find that its monetary reserves as calculated increased steeply at the end of the year as compared with the beginning. A similar result might follow from the receipt during a year of the proceeds of a medium-term or long-term loan contracted during the year. The drafters protected members against the consequences of such sudden increases by adopting Paragraph 3 of Schedule B:

> "In calculating monetary reserves and the increase in monetary reserves during any year for the purpose of Article V, Section 7(b) and (c), no account shall be taken, unless deductions have otherwise been made by the member for such holdings, of any increase in those monetary reserves which is due to currency previously inconvertible having become convertible during the year; or to holdings which are the proceeds of a long-term or medium-term loan contracted during the year; or to holdings which have been transferred or set aside for repayment of a loan during the subsequent year."

39. The Executive Directors have given effect to the intention of this provision in Decision No. 510-2 of December 16, 1949:

"In applying the provisions of Schedule B, paragraph 3 to the calculation of members' repurchase obligations, the following principles shall govern (Staff Memorandum No. 413, 12/8/49 and Supplement 1, 12/13/49):

"1. Where exclusions have been made at the end of one year for holdings which are the proceeds of long-term or medium-term loans contracted during the year or for holdings which have been transferred or set aside for the repayment of a loan during the subsequent year, the exclusion continues to be made in the monetary reserve figures for the beginning of the succeeding year.

"2. Where an exclusion has been made in respect of currency which became convertible during the year, this currency is included in the monetary reserve figures for the beginning of the subsequent year . . ." (Selected Decisions, pp. 108-109).

A similar solution could be adopted if currency liabilities were no longer deductible. That is to say, any amendment that did this could be made to operate only from the beginning of a financial year of the Fund for repurchase purposes.

40. Effect on distribution of repurchases. If currency liabilities ceased to be deductible, at least one problem in applying Schedule B, Paragraph 1 would disappear. That provision lays down the rules for the distribution of repurchase obligations among the components in a member's monetary reserves. Sub-paragraph (b) deals with distribution when monetary reserves and the Fund's holdings of a member's currency have both increased:

"If the member's monetary reserves have increased during the year, a part of the amount payable to the Fund equal to one-half of the increase shall be distributed among those types of reserves which have increased in proportion to the amount by which each of them has increased. The remainder of the sum payable to the Fund shall be distributed among all types of reserves in proportion to the member's remaining holdings thereof."

The first sentence applies to the obligation based on an increase in the member's monetary reserves and the second to the obligation based on an increase in the Fund's holdings of the member's currency. Difficulties have arisen in a few cases in which there has been an increase in monetary reserves attributable to an increase in a member's holdings and a larger increase resulting from a decline in currency liabilities.

The application of the first sentence quoted above has meant that the obligation based on the total increase in monetary reserves has been discharged in those media that have increased but in amounts that exceeded the increase in the media. For example, suppose that at the beginning of a year a member holds 1,000 of gold and 500 of dollars and has 1,000 of currency liabilities. At the end of the year the corresponding figures are gold 1,010, dollars 500, and currency liabilities 800. Total monetary reserves have increased by 210. Assume that the member's repurchase obligation is the full half of this total increase. The whole of the 105 would have to be paid in gold, the only reserve medium that had increased, even though the member's holdings of gold had increased by no more than 10. If currency liabilities were not deductible, decreases in them would not produce increases in monetary reserves, and results such as the one illustrated here would no longer occur.

Abatement

41. Present law. A second suggestion in the field of repurchase relates to "abolishing the abatements in cases of repurchases calculated in currencies which the Fund may not accept." The provisions directly involved in this suggestion are Article V, Section 7(c) and Schedule B, Paragraph 1.

Article V, Section 7(c)

"None of the adjustments described in (b) above shall be carried to a point at which

(i) the member's monetary reserves are below its quota, or

(ii) the Fund's holdings of its currency are below seventy-five percent of its quota, or

(iii) the Fund's holdings of any currency required to be used are above seventy-five percent of the quota of the member concerned."

Schedule B, Paragraph 1

"In determining the extent to which repurchase of a member's currency from the Fund under Article V, Section 7(b), shall be made with each type of monetary reserve, that is, with gold and with each convertible currency, the following rule, subject to 2 below, shall apply:

(a) If the member's monetary reserves have not increased during the year, the amount payable to the Fund shall be distributed among all types of reserves in proportion to the member's holdings thereof at the end of the year.

(b) If the member's monetary reserves have increased during the year, a part of the amount payable to the Fund equal to one-half of the increase shall be distributed among those types of reserves which have increased in proportion to the amount by which each of them has increased. The remainder of the sum payable to the Fund shall be distributed among all types of reserves in proportion to the member's remaining holdings thereof.

(c) If after all the repurchases required under Article V, Section 7(b), had been made, the result would exceed any of the limits specified in Article V, Section 7(c), the Fund shall require such repurchases to be made by the members proportionately in such manner that the limits will not be exceeded."

The relevant decision of the Executive Directors is Decision No. 521-3 of January 16, 1950:

"If part of a member's gross repurchase obligation for any financial year is allocated to a currency which the Fund cannot accept because of Article V, Section 7(c)(iii), that part of the gross obligation is abated for that year under Schedule B, Paragraph 1(c), and is not required to be discharged in gold or some other currency." (Selected Decisions, p. 109).

42. The effect of the foregoing provisions and decision is that if a repurchase obligation is calculated for a member in a convertible currency which the Fund cannot accept, or accept in full, that part which the Fund cannot accept is abated and is not re-allocated. The member is not required to pay in some other reserve medium which the Fund can legally accept. The situation in which the Fund cannot accept the currency in which the obligation is calculated may arise because the Fund's holdings of the currency of the member in which the obligation is calculated are already at or above 75 percent of that member's quota, or would be at that level on the payment of a smaller amount than the obligation as calculated, or because the total of all obligations calculated in that currency for members exceeds the amount that the Fund can accept.

43. Decision No. 521-3 was based on Staff Memorandum No. 424 of December 29, 1949. Three reasons were given in that memorandum in support of the conclusion that abatement was the correct legal result. They were as follows:

(i) The same language of proportionate reduction in Schedule B, Paragraph 1 governs the three cases in which reduction may occur under Article V, Section 7(c). In cases covered by Section 7(c)(i), re-allocation of the repurchase obligation instead of abatement would defeat the purpose of the provision; and in cases covered by Section 7(c)(ii) there is no repurchase obligation to the extent that the Fund's holdings of the repurchasing member's currency would fall below 75 percent of its quota. That is to say, re-allocation would still reduce the repurchasing member's monetary reserves below an amount equal to its quota or the Fund's holdings of the member's currency below 75 percent of its quota. Textually, therefore, it was difficult to see how the same words could provide for abatement in two cases and re-allocation in the third.

(ii) There was no formula in the Articles for carrying out a re-allocation, and this suggested a conclusion in view of the care with which the drafters had provided formulas for the calculation of monetary reserves and the distribution of repurchase obligations among them.

(iii) The third reason was of a more substantive character. It was concluded that the text, supported by the legislative history, reflected an intention to reject re-allocation of an automatic character for repurchase obligations under Article V, Section 7(b). This reason was stated more briefly in a memorandum dated March 29, 1962 ("Legal Aspects of Fund Policies on Repurchases", SM/62/22), in which the problem was re-examined in relation to the new conditions of convertibility, and in which it was concluded that abatement continued to be the correct legal result under the provisions in question:

> "The rationale of Schedule B, paragraph 1, as supported by the legislative history, would be offended by re-allocation instead of abatement. The object of the drafters was to ensure that only fixed portions of each medium of monetary reserves would be payable by way of the basic and automatic obligations of Article V, Section 7(b). The reason for this was the realization that all currencies may not have the same qualities even though they are all technically 'convertible' under the Articles. For example, a currency is still convertible in this sense, and included in the monetary reserves of other members under the Articles, even though the Fund has approved sweeping restrictions or other practices under Article VIII, Section 2 or 3. Thus, a currency would be included in a member's monetary reserves as 'convertible' even though the member might not be able,

> in fact, to convert it into another currency which the Fund could accept. Again, some convertible currencies may be convertible into gold because the currency issuer freely buys and sells gold, but other convertible currencies may not be convertible in this way. If there were re-allocation, the context of Schedule B suggests that this would have to be in accordance with some fixed and automatic formula. The result, therefore, might be to thrust an undue burden on a member's holdings of gold or gold-convertible exchange because the Fund could not accept more of the member's holdings of currencies that are not gold-convertible. Therefore, the drafters adopted a rule for the automatic repurchases of Article V, Section 7(b) according to which each category of monetary reserves was to bear only a precisely allotted share of a total obligation." (p. 3)

44. Possible new policy. If the view were taken that a member should make a repurchase if its monetary reserves had increased, and that it should not be released from this duty for a reason not related to its own economic position, it is possible that this could be reflected in a new policy without amendment of the Articles, although it will be shown in paragraph 45 that members could not be required to observe the policy in certain instances. When the Fund grants a waiver under Article V, Section 4, or in any case in which the Fund can apply conditions, or when the Fund agrees with a member on the reduction of the Fund's holdings of the member's currency under Article V, Section 8(d), the terms of the waiver, the conditions, or the agreement could prescribe that any repurchase obligation subject to proportionate reduction under Article V, Section 7(c)(iii) should be discharged in some other reserve medium acceptable to the Fund. The discharge of that part of a repurchase obligation which is at present abated would be a repurchase outside Article V, Section 7(b). With respect to repurchases of this character, the Executive Directors have adopted the following decision:

> "It has been concluded that the Fund has the legal authority to specify the convertible currencies to be used in making repurchases in discharge of obligations to repurchase that do not arise under Article V, Section 7(b), and that, accordingly members are required to obtain the prior agreement of the Fund on the convertible currencies to be used in making such repurchases. Such repurchases must not increase the Fund's holdings of a member's currency beyond 75 per cent of that member's quota or decrease the Fund's holdings of the repurchasing member's currency below 75 per cent of that member's quota." (Decision No. 1371-(62/36), July 20, 1962; Selected Decisions, p. 35)

45. A policy of the kind described above would be within the powers of the Fund. It would merely add a more specific requirement of repurchase to the various undertakings that members now assume. The undertaking on repurchase would be binding on members only in those cases in which repurchase undertakings are binding now. Therefore, there would be instances in which the member's statement on repurchase would be a representation of intention and would not constitute a legal obligation. This would be the position in any case in which a member made a purchase which did not require a waiver under Article V, Section 4 and there was no other legal basis for a condition. Moreover, the policy could not be made effective in those cases in which a repurchase obligation arose as a result of the payment of a currency subscription in excess of 75 percent of quota. For these or other reasons, there might be a preference for amendment instead of a development in repurchase policy as the way in which to abolish the abatement rule.

46. Amendment. In order to abolish the abatement rule, language could be added to the present text of Paragraph 1(c) of Schedule B. This could say that the amounts by which the limits specified in Article V, Section 7(c)(i) and (ii) were exceeded shall be abated, although there would be no need to make this explicit. It would have to be said, in any event, that the amounts by which the limit specified in Article V, Section 7(c)(iii) was exceeded shall be distributed among all types of reserves in proportion to the member's remaining holdings thereof (i.e., after allowing for all repurchases that were not re-allocated). Alternatively, it could be provided that the amount by which the limit in Section 7(c)(iii) was exceeded would be re-allocated, not according to some formula, but by agreement between the Fund and the repurchasing member, with authority for the one or the other to determine the re-allocation in default of agreement, or in all cases by the Fund in consultation with the repurchasing member. This alternative would be more consistent with one aspect of the intention behind the present provisions, namely, that under the rules for distributing repurchase obligations no more than a due proportion should be distributed mechanically to each component in a member's monetary reserves.

Non-Member Currencies

47. Present provisions. A third suggestion for study in the Memorandum is "including the currencies of non-member countries that are recognized as convertible by the I.M.F. in the calculation of reserves." There is already authority in the Articles to include non-member currencies in the calculation of the monetary reserves of members, so that amendment would not be necessary for this purpose, although it might be necessary in order to attain certain results as indicated below. Article XIX(a) provides that:

> "A member's monetary reserves means its net official holdings of gold, of convertible currencies of other members, and of the currencies of such non-members as the Fund may specify."

The first sentence of Article XIX(d) provides that:

> "A member's holdings of convertible currencies means its holdings of the currencies of other members which are not availing themselves of the transitional arrangements under Article XIV, Section 2, together with its holdings of the currencies of such non-members as the Fund may from time to time specify."

It will be noted that nothing explicit is said about the characteristics of the non-member currency that may be specified, but it is obvious from the context that the drafters must have had in mind non-member currencies held by members in substantial amounts and with characteristics comparable to those of member currencies that are convertible both *de jure* and *de facto*. Once a member currency becomes convertible under Article VIII, it remains convertible in the legal sense for all time, and therefore members holding it must include those holdings in their monetary reserves whatever the restrictions that may be applied by the issuer on the use of its currency. This result would not follow if a non-member currency were specified, and the Fund could terminate a specification if the currency were to lose certain characteristics of *de facto* convertibility. This would be a sensible result and the words "from time to time" in Article XIX(d) give it textual support.

48. If a non-member currency is specified under Article XIX(a), it is then specified for Article XIX(c), (d), and (e) as well. That is to say, a member's holdings of the non-member currency will be included in its monetary reserves under Article XIX(a). Under Article XIX(c), the holdings of the member's other official institutions and banks within its territories that may be deemed to be substantially in excess of working balances may include their holdings of the non-member currency, but due allowance would have to be made for the currency liabilities of the member's other official institutions and banks to the official institutions of and banks in the territories of the non-member. Finally, under Article XIX(e), there would have to be deducted from a member's holdings under Article XIX(a) and (b), the member's currency liabilities to the Treasury, central bank, stabilization fund, similar fiscal agencies, other official institutions, and other banks in the territories of the non-member.

49. Effects of specification under present law. The Fund has not specified any non-member currency and has not taken any decisions explicating the relevant provisions. The possible legal consequences of specification under these provisions will now be outlined, and it will be assumed, therefore, that the present provisions with respect to currency liabilities and abatement are not amended. In a later section, an attempt will be made to show how amendment in respect of these two topics could affect the specification of a non-member currency.

50. Before examining the effects of specification, something must be said of the meaning of Paragraph 2 of Schedule B:

> "The Fund shall not acquire the currency of any non-member under Article V, Section 7(b) and (c)."

This provision is referred to in Paragraph 1 of Schedule B, which sets out the directions for the distribution of repurchase obligations among the various elements in a member's monetary reserves. Before setting out those directions, Paragraph 1 says that they are "subject to 2 below." It is clear enough that under these provisions the Fund cannot accept any of the specified non-member currency from any member. Beyond this, it is less clear whether the provisions require the calculations to be made in any one of the following ways:

(i) the non-member currency is included in the monetary reserves for determining the gross amount of the repurchase obligation, but that obligation is distributed only among member currencies and gold;

(ii) the gross repurchase obligation as calculated in (i) is distributed among all elements of monetary reserves, but that part of the obligation allocated to the non-member currency is re-allocated to member currencies and gold;

(iii) the procedure is as in (ii) above except that that part of the obligation allocated to the non-member currency is abated and not re-allocated.

51. The words "subject to 2 below" can conceivably be read to support any one of these three constructions. The strongest argument for abatement, as already indicated, is that the drafters intended that, under the provisions dealing with the calculation of repurchases, no more than a due proportion of a repurchase obligation should be borne mechanically by any one element in a member's monetary reserves. In the case of a comparable problem, the inclusion in the monetary reserves of member A of its holdings of the convertible currency of a subordinate territory of member B, the staff has followed the abatement principle.

52. The strongest argument for the reading which favors distribution to acceptable reserve media only (i.e., gold and member currencies) under solution (i) or (ii) in paragraph 50 is that in default of such a reading the specification of non-member currencies may lead to no change or even to a decrease in the repurchase obligations that would be calculated in the absence of specification. The forcefulness of this argument is reduced by the fact that it is possible to show that in some cases there would be an increase as the result of specification. It is indeed possible to pile example on example without drawing from them any unassailable conclusion. If it were thought useful, examples could be given in another paper of what would follow from specification if the provisions of Paragraphs 1 and 2 of Schedule B were read to mean that obligations are allocated to non-member currency and then abated. As already indicated, there may be an increase, a decrease, or no change in obligation.

53. Amendment. If it were felt that the Fund should specify certain non-member currencies, and that abatement (solution (iii)) was the correct interpretation of the present provisions, but that the probable results would be unsatisfactory without amendment, a number of legal solutions would be available in theory. Among them would be these:

(i) Paragraph 2 of Schedule B and the words in Paragraph 1 could be repealed with the intention that repurchase obligations could be allocated to the specified non-member currencies and that the Fund could accept these currencies. This would be a simple solution of the issues relating to repurchase up to a point, but it would raise broader legal and economic problems resulting from Fund ownership of non-member currencies. What would the Fund do with those currencies? How would their gold value be maintained?

(ii) The abatement rule could be repealed solely with respect to the specification of non-member currency. If such a currency were specified, it could be provided that, as at present, any holdings of it by a member would be included in the member's monetary reserves, but any increase calculated on that basis would be allocated solely to gold and convertible currencies. Obligations resulting from increases in the Fund's holdings of the member's currency would also be allocated to these reserve media exclusively.

(iii) If the abatement rule were repealed for cases under Article V, Section 7(c)(iii), it would seem appropriate to apply the same practice of re-allocation as was substituted for abatement to the specification of non-member currency as well. If currency liabilities ceased to be deductible, a corresponding change would be made for these liabilities owed by members to any non-member whose currency had been specified. The effect of the whole of the first sentence of Article XIX(e) would

be nullified. With these two amendments, the specification of a non-member currency would tend to produce a reduction in repurchase obligations only when a member's holdings of that currency declined during a financial year.

54. Sudden increase. The problem of a sudden increase in monetary reserves that has been discussed above in paragraphs 38 and 39 could arise as the result of the specification of a non-member currency under the present provisions of the Articles or under amended provisions. It may be assumed that the Fund would avoid any problem under the present provisions by making the specification effective only as of the beginning of some financial year. It is likely that this would be the result even if this precaution were not taken and specification was given immediate effect. In the latter case, it would seem proper to hold that the holdings of non-member currency were holdings of a currency that had become convertible during the year. Paragraph 3 of Schedule B declares that no account shall be taken in the calculation of monetary reserves and repurchases of any increase "which is due to currency previously inconvertible having become convertible during the year." Under Article XIX(d) a member's holdings of "convertible currencies" includes its holdings of "the currencies of such non-members as the Fund may from time to time specify." If the Fund were to specify a non-member currency with immediate effect, holdings of that currency would be excluded from monetary reserves until the beginning of the next financial year for the purposes of repurchase but would be included for the purpose of charges under Article V, Section 8(f) and calculations under Article III, Section 4. This difference in treatment would result from the fact that Schedule B, Paragraph 3 is confined to repurchase.

Part IV

Capital Transfers

55. Under the heading of Article VI, Sections 1 and 2 in paragraph II.c of the Memorandum, there is a reference to paragraph 8a(iv) of the Monetary Committee Report, which reads as follows:

> "...abolishing the distinction, which is no longer made in practice, between capital transfers and current transactions (Article VI, Section 1 and Section 2; Article VIII, Section 4(a) of the Fund Articles of Agreement)."

The Memorandum continues:

> "If the *de jure* automaticity of the gold tranche is accepted, Article VI, Section 2, ceases to be applicable and a simplification in the text of Article VI, Section 1, might be envisaged."

Two issues are involved in these extracts, and they will be considered in turn.

Use of Fund's resources for capital transfers

56. The Monetary Committee Report mentions Article VI, Sections 1 and 2 and Article VIII, Section 4(a):

> Article VI, Section 1
>
> " Use of the Fund's resources for capital transfers.--(a) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.
>
> (b) Nothing in this Section shall be deemed
>
> (i) to prevent the use of the resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking or other business, or
>
> (ii) to affect capital movements which are met out of a member's own resources of gold and foreign exchange, but members undertake that such capital movements will be in accordance with the purposes of the Fund."

Article VI, Section 2

" Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired."

Article VIII, Section 4

" Convertibility of foreign held balances.--(a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents

(i) that the balances to be bought have been recently acquired as a result of current transactions; or

(ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in the currency of the member making the request or in gold."

57. It is a question of judgment whether or not a distinction between the use of the Fund's resources in respect of payments difficulties attributable, on the one hand, to a deficit on current account and, on the other hand, to capital transfers has disappeared in the practice of the Fund, and this paper will not go into that question. What must be said, however, is that this would not be a correct statement of the law. The legal opinion which was before the Executive Directors when they decided to clarify the Article XVIII interpretation of September 26, 1946 on the use of the Fund's resources did not come to any such conclusion as a matter of law. The legal memorandum explained that the interpretation might be read to deny any use of the Fund's resources in respect of capital transfers. But it concluded that even if any such impression were removed, there would remain a legal distinction between the two categories of use ("Use of the Fund's Resources for Capital Transfers", SM/61/45, 5/24/61). The interpretation of September 26, 1946 is as follows:

> " The Executive Directors of the International Monetary Fund interpret the Articles of Agreement to mean that authority to use the resources of the Fund is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations."

The decision of July 28, 1961 which added a clarification to that decision was taken after detailed debate at Executive Board Meetings 61/31 (June 21), 61/32 (June 23), 61/33 (June 23), 61/37 (July 7), and 61/43 (July 28, 1961), and it declares that:

> " After full consideration of all relevant aspects concerning the use of the Fund's resources, the Executive Directors decide by way of clarification that Decision No. 71-2 does not preclude the use of the Fund's resources for capital transfers in accordance with the provisions of the Articles, including Article VI." (Decision No. 1238-(61/43), Selected Decisions, p. 54).

58. Among the conclusions of SM/61/45 were these. Article V, Section 3(a) does not make fully explicit what are the proper uses of the Fund's resources but instead says that use of the Fund's resources must be for payments that are consistent with the provisions of the Articles. One of the provisions thus referred to is Article VI, Section 1. From this provision the conclusion is drawn that use of the Fund's resources is proper to meet difficulties associated with deficits on current account. Incidentally, for the purpose of use of the Fund's resources, deficits on current account are deemed to include reasonable amounts of the capital transactions mentioned in Article VI, Section 1(b)(i). Apart from use to deal with deficits on current account as thus amplified, the use of the Fund's resources is legitimate to meet an outflow of capital provided that the Fund does not consider it to be large or sustained. SM/61/45 also concluded, after a close study of the text of the Articles and of the legislative history, that the drafters had had in mind no formula or fixed criteria for determining what was meant by "large or sustained", and that they intended to give the Fund a broad discretion to make these determinations in the light of general experience and the particular facts in each case. This did not mean that the discretion was unregulated by any criteria. The opinion concluded that a basic criterion which the drafters seemed clearly to have had in mind was that the financing of capital transfers under Section 1(a) must not interfere with the capacity of the Fund to provide assistance to deal with deficits on current account for the benefit of any particular member or of members in general. In this connection, the size of the Fund's resources, including its actual ability to borrow, was a relevant consideration. Other criteria which could be derived from the legislative history were the extent to which a member was using the Fund's resources and the place of the member

in the world economy. No decisions were adopted by the Executive Directors on criteria, but there were active debates on them, particularly at EBM/61/37, in the course of which Executive Directors supported a number of additional criteria. There was general support, however, for the view that, in permitting the use of its resources for capital transfers, the Fund was required, as a matter of law, to guard against the danger of prejudicing its ability to make its resources available for dealing with difficulties associated with deficits on current account.

59. If it were decided to eliminate the qualification in Article VI, Section 1(a) which prevents the Fund's resources from being used to meet a large or sustained outflow of capital, this could be carried out by abrogating the first sentence of Section 1(a). It would then cease to be one of the provisions referred to in Article V, Section 3(a)(i), and the Fund's resources could then be used for deficits on current account or for capital transfers without distinction of any kind. If the first sentence were abrogated, a decision would have to be taken whether to abrogate or to amend the second sentence. The choice would depend on whether it was thought desirable to retain some authority to request a member to observe some limit on its use of the Fund's resources to meet an outflow of capital. If it were decided that there should be no residual authority of this kind, the second sentence would be abrogated. If it were decided that there should be such authority, the sentence would still have to be rewritten because at present it is drafted so as to refer, in effect, to the first sentence.

60. If Article VI, Section 1(a) were amended in the manner assumed in paragraph 59, there would cease to be any point in Article VI, Section 1(b) also. Section 1(b)(i) is designed to expand the concept of the current account solely for the purpose of the use of the Fund's resources, but this would be unnecessary if the distinction between the current account and capital transfers were eliminated for the purpose of Fund financing. Similarly, Section 1(b)(ii) would become unnecessary because it provides that the use of the Fund's resources is still valid, within the limits laid down by the Articles, even though there is a large or sustained outflow of capital which is met by the member from its own resources of gold and foreign exchange. This assurance to members would become unnecessary because the prohibition of use to meet a large or sustained outflow of capital, against which the assurance of continued use is given, would itself disappear. Furthermore, as indicated in paragraph 64 below, the amendment would deprive Article VI, Section 2 of any usefulness. Finally, the question might be raised whether the distinction between capital and current transactions in Article VIII, Section 4(a) continued to be justifiable. Under that provision, a member has certain duties to convert balances of its currency if they have been recently acquired as the result of current transactions or if, although they have not been recently acquired and therefore have become capital balances, their conversion is needed for making payments for current transactions.

61. The Memorandum raises the question whether there should not be some amendment of the language of Article VI, Section 1 even if the present legal distinction between the two types of payments difficulties

were to remain unaltered. As was said in the course of the debates of the Executive Directors in 1961, Article VI, Section 1 is sufficiently well drafted to express the intention that there shall be a distinction between the use of the Fund's resources for the two types of payments difficulties, with certain restraints on the use of those resources to meet difficulties arising from capital outflow. It is still felt that there is no need to amend the language of Section 1(a) unless there is an intention to change the provision in some substantive respect.

62. It was pointed out in 1961 that it was impossible to conceive of an amendment that simply reconfirmed the present text of Article VI, Section 1(a). It might be considered a minor shortcoming of the present text that it does not refer explicitly to the financing of difficulties on current account and states the use that may be made in respect of capital outflow in negative terms. If it were thought useful, it would be possible to draft a fully explicit and positive formula without changing the present legal position. It would then be necessary to decide to what extent it was desirable to draw on the language of the interpretation of September 26, 1946 and the present text of Article VI, Section 1(a), and to what extent other formulations were preferable even though there was to be no change in substance.

63. It would seem that any difficulty of a legal and textual character that is thought to exist arises more in connection with the decision of July 28, 1961 and its treatment of the interpretation of September 26, 1946 than with the text of Section 1(a). In reaching the decision of July 28, 1961, the Executive Directors concluded that the interpretation of 1946 had not in fact intended to deny the use of the Fund's resources in connection with capital outflow to the extent that this was permitted by Article VI, Section 1 and other provisions of the Articles. Therefore, they concluded that it was not necessary to rescind the interpretation of September 26, 1946 or to amend it by completing it. It was thought that in the circumstances clarification would suffice. Presumably, it is this difference of approach to the treatment of the interpretation in order to make it accord with the generally held view of Article VI, Section 1 which is being raised by the Memorandum and the Monetary Committee Report. At this stage, there is perhaps no need to repeat the details of the two approaches to the treatment of the interpretation in 1961 and the compromise which was reached with some difficulty between the two schools of thought among the Executive Directors.

Special provisions for capital transfers under Article VI, Section 2.

64. The second idea connected with Article VI which is advanced in the Memorandum is that with de jure automaticity for the gold tranche, Article VI, Section 2 ceases to have any function. Before this proposition is examined, it must be said that if the distinction between the use of the Fund's resources for the two types of payments difficulties discussed above were eliminated, there would certainly be no role left for Article VI, Section 2. Whatever may be the precise

meaning of that provision, one purpose seems to have been to permit the use of the Fund's resources for capital transfers in certain circumstances without falling foul of the qualification in Article VI, Section 1(a) with respect to the use of the Fund's resources to meet a large or sustained outflow of capital. In short, if a member can bring itself within the scope of Article VI, Section 2, a use of the Fund's resources in accordance with that provision cannot be objected to on the ground that the use would be to meet a large or sustained outflow of capital. The word "net" in Article VI, Section 1(a) was intended to make that point. Obviously, if the first sentence of Article VI, Section 1(a) were eliminated, there would be no need any longer to provide protection against its operation.

65. Article VI, Section 2 gives a privilege only in certain circumstances and subject to certain conditions. A member can have the benefit of the provision only if the Fund's holdings of its currency have remained below 75 percent of the member's quota for an immediately preceding period of not less than six months. The member can purchase currencies pursuant to the provision only to the extent that the Fund's holdings of the member's currency will be increased to but not beyond the level of 75 percent of quota. In addition, the only currencies that the member can purchase are the currencies of members held by the Fund above the level of 75 percent of the quotas of these members and the purchases of these currencies cannot reduce them below that 75 percent level. None of these limitations would apply if Article VI, Section 1(a) were amended in the way that has been discussed. The privileges that would result from the amendment would be more valuable than those now available to a member under Section 2 whatever may be the meaning of that provision.

66. If Article VI, Section 1(a) is not amended and the only amendment relates to the de jure automaticity of the gold tranche as discussed earlier in this paper, it is still possible that in contemplation of law Article VI, Section 2 could have some value for members. Moreover, this would be true whatever view was taken of the correct interpretation of the provision. In SM/67/41 (pp. 10-11), a summary was given of at least three prima facie meanings that can be attributed to the provision. The first view is that the sole function of the words "for any purpose, including capital transfers" is to add capital transfers of all kinds to the other purposes for which purchases may be made under other provisions. On this view, the function of the words would be to exclude any possibility that purchases for capital transfers under the provision could be regarded as an improper use of the Fund's resources to meet a large or sustained outflow of capital. The second view is that a member in the position described by Article VI, Section 2 is permitted by that provision to purchase over-75 percent of quota currencies for capital transfers, and even for transfers that might otherwise be considered large or sustained, but is also given an unchallengeable right to purchase any currencies for any of the purposes compatible with the other provisions of the Articles.

A third view would parallel the second one except that any currencies could be purchased for "any purpose" whether or not compatible with the other provisions of the Articles.

67. The drafters certainly thought that Article VI, Section 2 provided some facility for members that they would not have had under Article VI, Section 1. This is apparent from the words "notwithstanding the provisions of Section 1(a) of this Article" in Section 2. It is true that if a request to use the Fund's resources in the gold tranche were unchallengeable, a request that was not compatible with Article VI, Section 1 could not be challenged. Nevertheless, the presence or absence of Article VI, Section 2 might have consequences in connection with ineligibility. If it is assumed that the present ineligibility provisions of the Articles remain in effect but that Article VI, Section 2 is repealed, a member might be subject to ineligibility under Article XV, Section 2 because it had made a use of the Fund's resources which could not be reconciled with Article VI, Section 1 in circumstances in which it would not be subject to ineligibility if it could continue to rely on Section 2. Because Section 2 was intended to defend a member against the charge of improper use under Section 1 in certain circumstances, and because it is assumed that the ineligibility provisions continue to apply to gold tranche purchases, it cannot be said as a matter of strict analysis that the adoption of *de jure* automaticity by the same stroke deprives Article VI, Section 2 of all legal efficacy. It must be repeated that this result is reached on the basis of analysis, and it is no part of the purpose of this paper to determine the value of the privileges created by Article VI, Section 2 or the likelihood of the Fund's resort to ineligibility.

68. One final point must be made in relation to this difficult question. The legislative history of Article VI, Section 1 shows that the word "net" was inserted in that provision after Article VI, Section 2 was agreed and in order to provide a cross-reference to Section 2. The argument in paragraph 67 assumes that the word "net" would be deprived of its rationale and therefore would be deleted if Section 2 were repealed. If, however, the word were not deleted, it would seem that the reverse of the argument in paragraph 67 could be asserted. That is to say, it could be argued that members, far from losing a privilege by the repeal of Section 2, would gain one. If the word "net" stood alone, with no Section 2 to give it content, it would seem that no use of the Fund's resources in the super gold tranche could ever be found to be a large or sustained use of the Fund's resources to meet a capital outflow whereas at the moment it would seem that the only use for capital outflow which surely cannot be held to be for the purpose of meeting a large or sustained outflow is one that can be brought within Article VI, Section 2.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

Mr. J. J. Polak

Room 504 F

#1

EBD/67/97
Supplement 1

September 8, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Suggestions for Certain Reforms in the International Monetary Fund

Attached is a memorandum which Mr. van Campenhout has sent to the Managing Director supplementing the document relating to the suggestions for certain reforms in the Fund made by the European Community at the Monetary Committee in April 1967, previously circulated in EBD/67/97 (6/26/67).

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

EBD/67/97
Supplement 1

Memorandum Relating to Suggestions for Certain Reforms in the International Monetary Fund (complementing a memorandum of June 22, 1967)

We refer to our memorandum of June 22, 1967, entitled "Suggestions for certain reforms in the International Monetary Fund", by which we submitted, as a whole, to the consideration of the Executive Board the proposals contained in the report of the Monetary Committee of the European Economic Community of April 11, 1967. We also requested that studies be made by the staff on the operational aspects of the suggestions contained in the above-mentioned report. A legal study on these points has now been made.

As we indicated in our memorandum of June 22nd, the financial authorities of the European Community were of the opinion that in addition to certain improvements to the rules which govern the operations of the Fund, it would equally be opportune now to examine modifications to certain institutional aspects which would appear desirable in the light of experience and, we may add, in view of the contemplated extension of the functions of our organization.

The points which in the opinion of the Governors of the Fund for the countries of the European Economic Community require the attention of the Executive Board in this respect, are those mentioned in the report of the Monetary Committee.

It is obvious that they are not all equally important. The examination we have requested the Board to undertake, as part of the tasks which the Executive Directors are going to recommend to the Board of Governors to entrust to them, will facilitate the choice of the suggestions which would be useful and reasonable to retain.

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBD/67/97

June 26, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Suggestions for Certain Reforms in the International Monetary Fund

Attached is a memorandum from Mr. van Campenhout to the Managing Director relating to the suggestions for certain reforms in the Fund made by the European Community at the Monetary Committee in April 1967.

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

EBD/67/97

June 22, 1967

To: The Managing Director

From: A. van Campenhout

Subject: Memorandum Relating to Suggestions for Certain Reforms in the International Monetary Fund

On behalf of Messrs. Lieftinck, Larre, Siglienti, vom Hofe and myself, I am sending you herewith a memorandum relating to the suggestions for certain reforms in the Fund made by the European Community at the Monetary Committee in April 1967.

It would be appreciated if you would circulate this memorandum to the members of the Executive Board.

Memorandum Relating to Suggestions for Certain Reforms
in the International Monetary Fund

Our colleagues, as well as you yourself and the Fund staff, are aware of the Communiqué of the Ministers of Finance of the European Community, dated April 18, 1967 and with the Report of April 11, 1967 of the Community's Monetary Committee. As you know, this Report was approved by the Ministers of Finance in concluding their meetings of April 17 and 18.

We refer in particular to the portion of this document relating to certain improvements that could be made in the Fund within its present structure (see paragraphs B and C of the Monetary Committee's Report). The matters dealt with in this Report are a part of the current studies of improvements needed for the proper functioning of the international monetary system, of which the Fund has become a central instrument.

Since its inception--that is to say, for more than twenty years--it has gradually developed policies and practices that have now proven themselves.

It is, therefore, possible and desirable to bring out the principles underlying these policies and practices, to harmonize them and thus clearly confirm the basis of their authority. The time has also come to adapt certain rules governing the administration of the Fund in the new circumstances.

This improvement--which is justified in itself--is especially desirable at a time when it is envisaged to create new resources within the framework of the Fund. The particular suggestions contained in the aforementioned paragraphs of the Monetary Committee's Report are in response to these considerations. An exchange of views on these suggestions should, in our opinion, take place in the Executive Board in the new future.

In view of these discussions, the staff of the Fund might usefully undertake now a study of certain subjects corresponding to those of the suggestions of the Monetary Committee which, because of their operational character, raise technical questions.

We would be grateful if you would see that a study of these subjects, which are indicated below, is undertaken. We may in due time submit additional information with regard to the other suggestions of the Monetary Committee.

I. <u>Status of the Gold Tranche</u>
(Paragraph 8a (i) of the Monetary Committee Report of April 11, 1967)

This matter has already been raised. We have seen the legal study of April 12, 1967 (SM/67/41) according to which the <u>de jure</u> automaticity calls for amendment of the Articles of Agreement of the IMF. Such amendment should be based on the following concept:

A. Members eligible to use the Fund's resources would have the right to draw within the limits of their gold tranche position[1] only in case of need and not for the sole purpose of changing the composition of their reserves. In no case would the Fund have authority to prevent such a drawing. This applies to the Fund's right to challenge the representation envisaged in Article V, Section 3, whatever the legal basis of the right to challenge.

B. In view of A above, the representation in respect of drawings within the gold tranche could be eliminated.

C. Subject to what has been stated under A above, the present Articles on ineligibility (Article V, Section 5; Article IV, Section 6; and Article XV of the Articles of Agreement) should not be altered.

D. The repurchase obligations prescribed in Article V, Section 7, would remain in force.

E. The charges provided for in Article V, Section 8 (a) would be abolished. The super gold tranche positions would bear interest (within maximum and minimum limits that might be specified).

F. Scarcity of Currency

There does not seem to be any practical purpose in modifying the provisions of the Articles of Agreement in this respect.

II. Use of the Fund's Resources

A. Conditions for drawings within the credit tranches (Paragraph 8a(ii) of the Monetary Committee Report)

The suggestions contained in that paragraph should, at a convenient time, be examined by the Executive Board, both with respect to the schedule of charges, and the Fund's policy regarding the conditions applicable to drawings within the credit tranches. On the other hand, it would be advisable to state explicitly in the Articles of Agreement that the Fund has authority to determine the principles which are necessary to ensure that the use of the Fund's resources is in conformity with the Articles of Agreement and that such use is of a temporary nature.

B. Rules governing the conditions for repurchase of drawings on the IMF (Monetary Committee Report 8a(iii)

One should ensure the effectiveness and equal application of members' repurchase obligations.

1/ "Gold tranche position" also refers to the "super gold tranche position.

To this end, the following is suggested:

(a) abolishing the deduction of currency liabilities provided for in Article XIX (e) in calculating the amount of the monetary reserves that form the basis for determining the repurchase obligations.

(b) abolishing the abatements in cases of repurchases calculated in currencies which the Fund may not accept.

(c) including the currencies of non-member countries that are recognized as convertible by the IMF in the calculation of reserves.

C. Article VI, Sections 1 and 2 of the Articles of Agreement (See paragraph 8a (iv) of the Monetary Committee Report)

If the *de jure* automaticity of the gold tranche is accepted, Article VI, Section 2, ceases to be applicable and a simplification in the text of Article VI, Section 1, might be envisaged.

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FOR AGENDA

Mr. J. J. Polak

Room 504 F

#1

SM/67/41

April 12, 1967

To: Members of the Executive Board

From: The Secretary

Subject: Legal Aspects of Reform of the Gold Tranche

The attached memorandum on the legal aspects of reform of the gold tranche is circulated for consideration by the Executive Directors in the near future, together with the two memoranda on distribution of net income (SM/66/130 and SM/66/131).

Att: (1)

Other Distribution:
Department Heads
Division Chiefs

SM/67/41 Legal Aspects of Reform of Gold Tranche

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INTERNATIONAL MONETARY FUND

Legal Aspects of Reform of the Gold Tranche

Prepared by the Legal Department

Approved by Joseph Gold

April 10, 1967

Introduction

For some time past, suggestions have been made that if the legal characteristics of the gold tranche were modified in certain ways, more members would regard it as a component of their reserves and worthy of inclusion in the official presentation of those reserves. Among the suggestions for reform, special mention should be made of the memorandum from Mr. van Campenhout circulated as EBD/66/176 (11/28/66).

The present memorandum examines the legal aspects of the gold tranche and of the suggestions that have been made for modifying its characteristics, but does not discuss the policy aspects of particular reforms.

Under the present rules, policies, and procedures, members that wish to make a drawing in the gold tranche are given the overwhelming benefit of any doubt in accordance with E.B. Decision No. 102-(52/11), adopted February 13, 1952 (Selected Decisions, pp. 21-24) and, in addition, receive the benefit of the special procedure for gold tranche drawings established by E.B. Decision No. 1745-(64/46), adopted August 3, 1964 (Selected Decisions, p. 49). These two Decisions constitute the formal basis of the Fund's gold tranche policy. The resulting status of the gold tranche has variously been called "de facto automaticity", "virtual automaticity", or "quasi automaticity". This language reflects the high degree of confidence in the availability of the gold tranche that members enjoy in practice as a result of the Fund's assurances and procedure, and the following discussion should not be taken to imply that this confidence cannot be safely entertained.

The meaning of the term "gold tranche" has been affected for some purposes by the recent amendment of the Decision on Compensatory Financing of Export Fluctuations. Traditionally, the gold tranche was equal to the amount by which the Fund's holdings of a member's currency were below its quota. This followed from paragraph 3 of E.B. Decision No. 102-(52/11) which established the gold tranche policy in relation to drawings "which would raise the Fund's holdings of its [a member's] currency to not more than its quota." For the purpose of applying the gold tranche policy, this description must now be modified to take account of the second part of paragraph (10) of E.B. Decision No. 1477-(63/8), adopted February 27, 1963 (Selected Decisions, pp. 40-43) as amended by E.B. Decision No. 2192-(66/81), adopted September 20, 1966 on the Compensatory Financing of Export

Fluctuations, which provides: "Moreover, the Fund will apply its tranche policies to drawing requests by a member as if the Fund's holdings of the member's currency were less than its actual holdings of that currency by the amount of any drawings outstanding under paragraph (5)." As a result of this provision, the gold tranche policy now applies to the amount by which the Fund's holdings of a member's currency are less than the member's quota after deducting from those holdings the amount of any drawing outstanding under paragraph (5) of the Compensatory Financing Decision. It is in this sense that the term "gold tranche" is used in this memorandum in relation to the Fund's policies on the use of its resources. It should be noted, however, that for other purposes, e.g., the application of provisions of the Articles in which levels of holdings are mentioned, there is no exclusion of any holdings, and the gold tranche for these purposes represents the amount by which actual holdings are less than quota.

It should also be noted that the term "gold tranche" traditionally has applied to the whole of the amount by which the Fund's holdings of a member's currency are less than the member's quota. However, it is convenient to distinguish between the situation in which the Fund's holdings of a currency are below 75 per cent of quota and the situation in which holdings are above 75 per cent but below quota. In accordance with the terminology of SM/67/25 (2/28/67), these parts of the gold tranche are referred to as the "super gold tranche" and the "basic gold tranche" respectively.

Outline of memorandum

This memorandum discusses the legal aspects of possible reforms of the gold tranche in connection with the following topics:

1. Automaticity. The present law and practice on the basic and super gold tranche are set forth, after which amendment is considered in order to introduce some form of *de jure* automaticity by

(a) making the representation involved in a request for a gold tranche drawing unchallengeable;

(b) eliminating the representation;

(c) preventing ineligibility from interfering with gold tranche drawings.

Further topics considered are whether:

(d) there would remain any role for Article VI, Section 2;

(e) a group of other provisions should be modified in the light of any amendments under (a) to (c) above;

(f) corresponding amendments should be made in the Fund's borrowing arrangements.

2. Repurchase. The topics considered are: (i) the elimination of any obligation to repurchase in respect of gold tranche drawings; (ii) the elimination of representations as to repurchase without affecting the obligation to repurchase.

3. Interest. The topic under this heading is amendment in order to give an assured remuneration on the super gold tranche and the basic gold tranche.

4 - 6. The legal aspects of reforms connected with the service charge on gold tranche transactions, the unit of value in which the Fund's accounts are presented, and the transferability of gold tranches are considered in these sections of the memorandum, which then concludes with a note (7) on the technique of amendment.

1. Automaticity

Present law

Perhaps the most basic suggestion for reform of the gold tranche has been that the automaticity given to requests to draw the gold tranche should be enhanced. In order to understand the possibilities for this, it is necessary to set forth those limitations that may exist under the present law on the ability of a member to draw its gold tranche.

(a) Basic gold tranche

(i) Ineligibility

One of the conditions under which a member may purchase the currency of another member under Article V, Section 3(a) is that:

> "(iv) The Fund has not previously declared under Section 5 of this Article, Article IV, Section 6, Article VI, Section 1, or Article XV, Section 2(a), that the member desiring to purchase is ineligible to use the resources of the Fund."

It may be useful to quote the provisions referred to because legally any one of them could prevent a member from drawing its gold tranche.

Article V, Section 5

> "Ineligibility to use the Fund's resources.--Whenever the Fund is of the opinion that any member is using the resources of the Fund in a manner contrary to the purposes of the Fund, it shall present to the member a report setting forth the views of the Fund and prescribing a suitable time for reply. After presenting such a report to a member, the Fund may limit the use of its resources by the member. If no reply to the report is received from the

member within the prescribed time, or if the reply received is unsatisfactory, the Fund may continue to limit the member's use of the Fund's resources or may, after giving reasonable notice to the member, declare it ineligible to use the resources of the Fund."

The Fund has adopted the following decisions with respect to the meaning of this provision:

" The Fund has, in the case of a member which has had a previous exchange transaction with the Fund, power to declare the member ineligible or limit its use of the resources of the Fund if the member is, in the opinion of the Fund, using the resources of the Fund in a manner contrary to the purposes of the Fund." (E.B. Decision No. 284-3, adopted March 10, 1948 (Selected Decisions, p. 32))

" A member 'is using' the resources of the Fund within the meaning of Article V, Section 5, where it is either actually disposing of the exchange purchased from the Fund, or, having purchased exchange from the Fund, the Fund's holdings of its currency are in excess of 75 per cent of its quota." (E.B. Decision No. 292-3, adopted March 30, 1948 (Selected Decisions, p. 33)) 1/

Article IV, Section 6

"Effect of unauthorized changes.--If a member changes the par value of its currency despite the objection of the Fund, in cases where the Fund is entitled to object, the member shall be ineligible to use the resources of the Fund unless the Fund otherwise determines; and if, after the expiration of a reasonable period, the difference between the member and the Fund continues, the matter shall be subject to the provisions of Article XV, Section 2(b)."

Under this provision, a member becomes automatically ineligible to use the Fund's resources in the circumstances described, i.e., without the declaration by the Fund which is necessary to produce ineligibility under other provisions, and the Fund must make a determination if it wishes to prevent that result.

1/ It is not altogether realistic to assume that the Fund could take action under the provision because the member was making an improper disposition of exchange purchased from the Fund. In this memorandum, the discussion of the provision will be confined to the other situation in which a member "is using" the Fund's resources.

Article VI, Section 1

"Use of the Fund's resources for capital transfers.--(a) A member may not make net use of the Fund's resources to meet a large or sustained outflow of capital, and the Fund may request a member to exercise controls to prevent such use of the resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the resources of the Fund.

(b) Nothing in this Section shall be deemed

(i) to prevent the use of the resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking or other business, or

(ii) to affect capital movements which are met out of a member's own resources of gold and foreign exchange, but members undertake that such capital movements will be in accordance with the purposes of the Fund."

A member is making "net use" of the Fund's resources when the Fund's holdings of the member's currency exceed 75 per cent of its quota (SM/61/45 (5/24/61), pp. 8-10).

Article XV, Section 2(a)

"Compulsory withdrawal.--(a) If a member fails to fulfill any of its obligations under this Agreement, the Fund may declare the member ineligible to use the resources of the Fund. Nothing in this Section shall be deemed to limit the provisions of Article IV, Section 6, Article V, Section 5, or Article VI, Section 1."

(ii) Limitation

Under Article V, Section 5 the Fund has powers to limit a member's use of the Fund's resources instead of declaring it ineligible. The procedure for limitation is prescribed by the provision. As in the case of ineligibility, a member can be limited in its use of the Fund's resources only if it is "using" the Fund's resources as that concept is understood in E.B. Decision No. 292-3.

There is no express mention of limitation in the other provisions under which ineligibility may occur, but the Fund has understood that they too comprehend limitation on the theory that the greater sanction includes the lesser. This was made clear in Rule K-2 of the Fund's Rules and Regulations:

"K-2. Whenever the Executive Board would be authorized to declare a member ineligible to use the resources of the Fund it may refrain from making the declaration and indicate the circumstances under which, and/or the extent to which, the member may make use of the resources."

(iii) Postponement of initial use

Article XX, Section 4(i) reads as follows:

" The Fund may postpone exchange transactions with any member if its circumstances are such that, in the opinion of the Fund, they would lead to use of the resources of the Fund in a manner contrary to the purposes of this Agreement or prejudicial to the Fund or the members."

This provision was the subject of E.B. Decision No. 284-2, adopted March 10, 1948 (Selected Decisions, p. 106):

" The Fund has, in the case of a member which has had no previous exchange transaction with the Fund, the power to postpone exchange transactions with it if its circumstances are such that, in the opinion of the Fund, they would lead to the use of the resources of the Fund in a manner contrary to the purposes of the Agreement or prejudicial to the Fund or its members. This power did not lapse as of the date the Fund began exchange transactions."

It will be observed that whereas an exchange transaction with the Fund is a condition precedent to a declaration of ineligibility under Article V, Section 5, postponement under Article XX, Section 4(i) is possible only if the member has not yet engaged in an exchange transaction with the Fund. A prior exchange transaction is not a condition precedent under Article IV, Section 6 or Article XV, Section 2(a). The position is more ambiguous under Article VI, Section 1, but a prior transaction would be necessary if "net use" under this provision were understood in the same way as "is using" in Article V, Section 5.

(iv) Challenge

One of the conditions on which a member may purchase exchange from the Fund under Article V, Section 3(a) is that:

"(i) The member desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement;"

The Fund has established that it has a power to challenge such a representation, and this is true even though the representation relates to the gold tranche. The decision establishing the power reads as follows:

" The word 'represents' in Article V, Section 3(a)(i), means 'declares.' The member is presumed to have fulfilled the condition mentioned in Article V, Section 3(a)(i), if it declares that the currency is presently needed for making payments in that currency which are consistent with the provisions of the Agreement. But the Fund may, for good reasons, challenge the correctness of this declaration, on the grounds that the currency is not 'presently needed' or because the currency is not needed for payment 'in that currency,' or because the payments will not be 'consistent with the provisions of this Agreement.' If the Fund concludes that a particular declaration is not correct, the Fund may postpone or reject the request, or accept it subject to conditions. The phrase 'presently needed' cannot be defined in terms of a formula uniformly applicable to all cases, but where there is good reason to doubt that the currency is 'presently needed,' the Fund will have to apply the phrase in each case in the light of all the circumstances." (E.B. Decision No. 284, adopted March 10, 1948 (Selected Decisions, p. 19))

The Fund has also decided that it has the power to challenge a request in order to consider ineligibility proceedings under Article V, Section 5:

" If the Fund receives a request from a member to purchase exchange and either, (1) the Fund is considering sending the member a report pursuant to Article V, Section 5, or (2) the Fund finds when the request is before it that action pursuant to that Section should be considered; then the Fund has the authority, pursuant to Article V, Section 5, of the Fund Agreement, to postpone the transfer as permitted under the provisions of Rules and Regulations G-3 for such time as may reasonably be necessary to decide the question of applying Article V, Section 5, and, if it decides to apply it, to prepare and send to the member a report and subject its use of the Fund's resources to limitations. Under such circumstances the limitations imposed will apply to the pending request for the purchase of exchange as well as to future requests." (E.B. Decision No. 286-1, adopted March 15, 1948 (Selected Decisions, pp. 32-33))

No comparable decisions have been adopted with respect to the other provisions under which the Fund may declare a member ineligible, but there is no apparent reason why any distinction should be made. Accordingly, it would be possible for the Fund to postpone a request, even for a gold tranche drawing, in order to consider ineligibility proceedings under Article VI, Section 1 [2] or Article XV, Section 2(a).

2/ As noted above, however, if "net use" under Article VI, Section 1 is taken to mean the same as "is using" in Article V, Section 5, the power to postpone a request in order to consider ineligibility under Article VI, Section 1 would be exercisable only if there had already been an exchange transaction.

(v) Suspension

In certain circumstances, the Fund is empowered by Article XVI to suspend the operation of various provisions of the Articles. Section 1 provides that:

"Temporary suspension.--(a) In the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund, the Executive Directors by unanimous vote may suspend for a period of not more than one hundred twenty days the operation of any of the following provisions:

(i) Article IV, Sections 3 and 4(b).
(ii) Article V, Sections 2, 3, 7, 8(a) and (f).
(iii) Article VI, Section 2.
(iv) Article XI, Section 1.

(b) Simultaneously with any decision to suspend the operation of any of the foregoing provisions, the Executive Directors shall call a meeting of the Board of Governors for the earliest practicable date.

(c) The Executive Directors may not extend any suspension beyond one hundred twenty days. Such suspension may be extended, however, for an additional period of not more than two hundred forty days, if the Board of Governors by a four-fifths majority of the total voting power so decides, but it may not be further extended except by amendment of this Agreement pursuant to Article XVII.

(d) The Executive Directors may, by a majority of the total voting power, terminate such suspension at any time."

It will be observed that Article V, Section 3 is one of the provisions that may be suspended, so that gold tranche as well as other exchange transactions could not take place during the suspension.

(vi) Declaration of scarcity

Another of the conditions on which a member may purchase exchange under Article V, Section 3(a) is that:

"(ii) The Fund has not given notice under Article VII, Section 3, that its holdings of the currency desired have become scarce;"

Article VII, Section 3(a) reads as follows:

"Scarcity of the Fund's holdings.--(a) If it becomes evident to the Fund that the demand for a member's currency seriously threatens the Fund's ability to supply that currency, the Fund, whether or

not it has issued a report under Section 1 of this Article, shall formally declare such currency scarce and shall thenceforth apportion its existing and accruing supply of the scarce currency with due regard to the relative needs of members, the general international economic situation, and any other pertinent considerations. The Fund shall also issue a report concerning its action."

Under this provision, the Fund could restrict the extent to which members could purchase from the Fund the currency declared scarce.

(b) Super gold tranche

The legal provisions which may affect a member's ability to draw its basic gold tranche apply to the super gold tranche as well, subject, however, to certain qualifications.

First, it has been seen that under E.B. Decision No. 292-3 a member is not using the Fund's resources if the Fund's holdings of the member's currency are at or below 75 per cent of quota. Therefore, if a member is in the super gold tranche, the Fund cannot declare it ineligible under Article V, Section 5, postpone a request to consider ineligibility under Decision No. 284-2, or limit the member's use of the Fund's resources under that provision.

Secondly, a member can be declared ineligible under Article VI, Section 1 only if it is making net use of the Fund's resources. Again, therefore, if a member is in the super gold tranche, it cannot be declared ineligible or limited in its use of the Fund's resources under this provision and Rule K-2. 3/

Although a member cannot be declared ineligible under either of these provisions when it is in the super gold tranche, it does not become eligible merely because the Fund's holdings of the member's currency fall into the super gold tranche after it has already become ineligible under these or other provisions. For the member to become eligible, it would be necessary for the Fund to take a decision terminating the ineligibility.

Under two further provisions the characteristics attached to the use of the super gold tranche are more favorable than those attached to the basic gold tranche. If a member is in the super gold tranche, the amount which it can purchase without a waiver of the 25 per cent limit under Article V, Section 3(a) is increased by the amount of the super gold tranche. One of the conditions in that provision is that:

"(iii) The proposed purchase would not cause the Fund's holdings of the purchasing member's currency to increase by more than twenty-five percent of its quota during the period of twelve months ending

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3/ See footnote 2.

on the date of the purchase nor to exceed two hundred percent of its quota, but the twenty-five percent limitation shall apply only to the extent that the Fund's holdings of the member's currency have been brought above seventy-five percent of its quota if they had been below that amount;"

The second provision that gives favorable treatment to the super gold tranche is Article VI, Section 2:

"Special provisions for capital transfers.--If the Fund's holdings of the currency of a member have remained below seventy-five percent of its quota for an immediately preceding period of not less than six months, such member, if it has not been declared ineligible to use the resources of the Fund under Section 1 of this Article, Article IV, Section 6, Article V, Section 5, or Article XV, Section 2(a), shall be entitled, notwithstanding the provisions of Section 1(a) of this Article, to buy the currency of another member from the Fund with its own currency for any purpose, including capital transfers. Purchases for capital transfers under this Section shall not, however, be permitted if they have the effect of raising the Fund's holdings of the currency of the member desiring to purchase above seventy-five percent of its quota, or of reducing the Fund's holdings of the currency desired below seventy-five percent of the quota of the member whose currency is desired."

There are a number of difficulties in the understanding of this provision that have never been resolved. One view of the provision is that the sole function of the words "for any purpose, including capital transfers" is to add capital transfers of all kinds to the other purposes for which purchases may be made under other provisions. On this view, the words would be understood to exclude any possibility that purchases for capital transfers under the provision could be regarded as an improper use to meet a large or sustained outflow of capital. Moreover, this view would imply that Article VI, Section 2 was intended to be solely a replenishment provision. This would follow from the fact that the only drawings contemplated by the provision would be for capital transfers and under the second sentence only currencies held by the Fund above the 75 per cent of quota level could be purchased. This conclusion would be reinforced by the fact that a member could take advantage of the provision only if the Fund's holdings of the member's currency had been below the 75 per cent level for six months preceding the drawing. In short, according to this view, drawings for capital transfers would be permitted without being questioned on that score, in order to bring into the Fund currencies in short supply by disposing of those in greater supply.

This is clearly not the only view that can be taken of the language of the provision. A second view is that a member in the position described by Article VI, Section 2 is permitted by that provision to purchase over-75 per cent currencies for capital transfers, including those that are large

or sustained, but is also given an unchallengeable right to purchase any currencies for any of the purposes compatible with the other provisions of the Articles. A third view would parallel the second one except that any currencies could be purchased for "any purpose" whether or not compatible with the other provisions of the Articles.

It has obviously not been of practical importance in the operation of the Fund to arrive at a final view of Article VI, Section 2 and this will not be attempted within the confines of this memorandum.

Present practice

The present policy of giving the overwhelming benefit of any doubt to requests for purchases within the gold tranche is without prejudice to the ineligibility provisions. The intention of the policy was to convey the idea that in practice the Fund would be unlikely to employ its power to challenge such requests. Nevertheless, the Fund did not, and could not legally, assure members that it would in no circumstances challenge requests to draw the gold tranche. This was the reason why the Fund adopted the cumbersome language of the overwhelming benefit of any doubt.

The tranche policies can be considered as indicating the degree of examination which the Fund thinks it appropriate to give to a request under the purpose of Article I (v):

> "To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."

The Fund has concluded that the adequacy of safeguards can range from the overwhelming benefit of any doubt through examinations that become progressively stricter with larger cumulative use in terms of quota. It has never been thought that the Fund could forego its power to challenge requests in the gold tranche so that there would be no challenge even where it was apparent beyond controversy that a request was inconsistent with the provisions of the Articles. A policy of never challenging requests could not be reconciled with E.B. Decision No. 284-4 and the concept of adequate safeguards, both of which apply at present to all purchases from the Fund.

Although it is recognized that the present gold tranche policy gives members a high degree of assurance that they will be able to make drawings in the gold tranche without challenge, it has been argued that one respect in which this assurance is less valuable than a de jure assurance is that nothing would prevent the Fund from rescinding its present policy. As a legal proposition, it must be agreed that the Executive Directors have the power to amend or rescind a policy decision, although this has nothing to do with the likelihood or unlikelihood of the amendment or rescission of

any particular decision. If the Fund were to announce that it would not abrogate the gold tranche policy, this would be subject not only to the criticism that the decision might be reversed but also to the objection that it was of doubtful validity because it could be regarded as the attempted abandonment of the Fund's powers and not simply the exercise of them.

A distinction could be drawn between a declaration that the Fund would not abandon its gold tranche policy at any time and a declaration that if it were to abandon the policy this would be without prejudice to gold tranches existing at the time of the change. Assurances about how an existing policy would be liquidated should it ever be terminated should not be regarded as being beyond the powers of the Fund. The Fund must have the legal authority to declare that it would not make an abrupt transition from an old to a new policy where it considered that an orderly transition was advisable. It might be objected that an assurance of the kind that is here discussed, although within the powers of the Fund, could again be impaired by subsequent action of the Fund. While this is true, the Fund's repudiation of such an assurance would be a breach of good faith, and therefore it cannot be contemplated as more than a theoretical possibility.

It is concluded that although the Fund's gold tranche policy already gives a very high degree of _de facto_ assurance to members, it would be possible to give it a certain amount of further underpinning by the adoption of a decision on the liquidation of the present gold tranche policy. This could declare that although liquidation was not envisaged, liquidation, should it occur, would be without prejudice to the then existing gold tranches of members. The effect of a liquidation of the policy would be that existing gold tranches would continue to be governed by the old policy; once they had been drawn, members could draw any subsequently arising gold tranches only in accordance with the new policy.

Amendment

Even the further policy pronouncement that has been discussed above would not give _de jure_ automaticity. That is to say, such automaticity as gold tranche drawings would enjoy in practice would continue to depend on Fund policies which were legally revocable, and in addition drawings would be subject to the legal powers of the Fund to interpose impediments to drawings under the various powers that have been set forth above. This has led to the suggestion that the automaticity of the gold tranche be given some legal basis, and it is this suggestion which might be regarded by some as the most important single improvement in the reserve quality of the gold tranche. This would be done by amendment, but the suggestion covers a range of possibilities. Some of these are considered in the succeeding paragraphs, but it is not pretended that the possibilities will be exhausted.

(a) It might be provided that the representation of a member under Article V, Section 3(a)(i) made in connection with a request to make a purchase in the gold tranche, whether the super or basic gold tranche,

would not be subject to challenge. Appropriate language would have to be found to define the gold tranche for this purpose in such a way that holdings resulting from outstanding drawings under the compensatory financing facility or under any new facility of a comparable character were excluded from the calculation of the gold tranche. Presumably, this would have to be done by language which enabled the Executive Directors to determine from time to time which holdings (in terms of facilities) should be excluded for this purpose.

If the representation were unchallengeable, this would set aside the power to challenge requests to draw the gold tranche under Article V, Section 3 coupled with E.B. Decision No. 284-4. It would not follow of logical necessity that the power to challenge under Article V, Section 5 coupled with E.B. Decision No. 286-1 should also be repealed by amendment because the exercise of this power is a prelude to the consideration of limitation or ineligibility and it might be decided not to affect the present provisions on limitation or ineligibility. However, there could be no legal objection to the repeal of the power to challenge requests under Article V, Section 5 if that were so decided. Whatever was decided on this question would presumably be applied to powers to challenge under Article VI, Section 1 and Article XV, Section 2(a).

If this last course were adopted, it would follow that a request to purchase the gold tranche would have to be honored even though the Fund might otherwise be disposed to consider ineligibility because the member had been using the resources of the Fund in a manner contrary to the purposes of the Fund, or the member had been making a net use of the Fund's resources to meet a large or sustained outflow of capital, or the member was failing to fulfill any of the obligations under the Articles.

(b) If the amendment took the form that requests to purchase the gold tranche were unchallengeable, the member would still be bound to make the representation of Article V, Section 3(a)(i). However, an alternative technique is conceivable. This is an amendment which would eliminate the necessity for the representation. A member would then be free to use its gold tranche as it saw fit, and in particular it could do so without any color of "need". This in turn would imply that ineligibility should not be available to the Fund as a sanction on the basis of an improper use of the Fund's resources drawn in the gold tranche. This brings the discussion, therefore, to the question of amending the Articles by eliminating ineligibility as a bar to gold tranche drawings. The question of the elimination of ineligibility could arise, however, whether or not the representation of Article V, Section 3(a)(i) were abolished for gold tranche drawings.

(c) If the power to challenge requests in the gold tranche were abrogated, as is discussed in (a) above, it would be possible logically to leave the rest of the provisions on ineligibility (i.e., as distinguished from the power to challenge in order to consider ineligibility) as they stand at the moment. In such circumstances, provided that the representation

of Article V, Section 3(a)(i) were not abolished, a member that drew its gold tranche inconsistently with its representation might be subjected to the sanction of ineligibility for that reason after it had become clear that the drawing was not consistent with the representation. The sanction would have to be imposed after the event, if at all, even where it was clear at the time of the request that it was inconsistent with the representation.

If it were agreed that ineligibility should not prevent gold tranche drawings, it would have to be decided whether or not to apply this to all the provisions under which ineligibility may occur. It would be possible to conclude that even if a member were ineligible under Article IV, Section 6, or Article V, Section 5, or Article VI, Section 1, or Article XV, Section 2(a), the member would nevertheless be able to draw its gold tranche. It would also be possible to make a distinction between the super gold tranche and the basic gold tranche, with more favorable treatment for the former. Another possible approach would be to hold that ineligibility under Article V, Section 5 or Article VI, Section 1 should not prevent gold tranche drawings, but ineligibility under other provisions could still prevent these drawings.

In this connection, it should be made clear that there are many possibilities in modifying the application of the ineligibility provisions to the gold tranche. Under Article V, Section 5 and Article VI, Section 1, a member cannot be declared ineligible at a time when the Fund's holdings of the member's currency are below 75 per cent of the member's quota. However, if a member is declared ineligible under either provision when the Fund's holdings are above the 75 per cent level, ineligibility does not cease automatically when the Fund's holdings fall below 75 per cent. This emerges clearly from the text of Article VI, Section 2. Under Article IV, Section 6 or Article XV, Section 2(a), a member may become or be declared, and remain, ineligible without reference to the level of the Fund's holdings. Accordingly, if it were agreed that ineligibility should not preclude gold tranche drawings, this would mean presumably that the quota level would be substituted for the 75 per cent level under Article V, Section 5 and Article VI, Section 1, and a member could not be declared ineligible if it were anywhere in the gold tranche. The present rule under which ineligibility under those provisions persists, unless terminated by the Fund, even though the level of the Fund's holdings of a member's currency falls below 75 per cent of quota might be amended, if that were thought desirable, so that the ineligibility would be without prejudice to the member's ability to draw the gold tranche that had emerged. An alternative to this might be to provide that ineligibility ceased automatically once a gold tranche developed, but there would seem to be less in the way of logical argument to support this. Finally, it would be necessary to decide whether any change should be made in the present rule that a member might become or be declared ineligible under Article IV, Section 6 or Article XV, Section 2(a) whatever might be the level of its currency in the Fund, although again there would seem to be no compelling logical reason for this change as an incident of any reform of the gold tranche. However, the question would arise once more, if the present rule remained otherwise unchanged, whether gold tranche drawings under these

provisions should be permitted notwithstanding ineligibility. If they were permitted, it would be on the same basis of automaticity as all other gold tranche drawings, but it is conceivable that if the member had become ineligible, gold tranche drawings could be allowed by the Fund on some less automatic basis. Another distinction that could be made for the purposes of seeing to what extent ineligibility under these provisions should preclude drawings in the gold tranche would be between the super gold tranche and the basic gold tranche.

(d) If any of the foregoing reforms were adopted, it would be appropriate to consider the impact on Article VI, Section 2. If the representation of Article V, Section 3(a)(i) were abolished for gold tranche drawings, no obvious function would be left for Article VI, Section 2. [4] The gold tranche facility would then be more extensive and more readily available than the facility offered by Article VI, Section 2, however that provision might be interpreted.

This conclusion would be less obvious if the reform of the gold tranche took the form of the amendment of the legal provisions relating to challenge or ineligibility or both. Under these reforms, the member would still be required to represent that the transaction requested was "presently needed for making in that currency payments which are consistent with the provisions of this Agreement." In those circumstances, Article VI, Section 2 could be considered to provide an additional facility for a member in the super gold tranche because it declared that drawings might be made notwithstanding the limitation on drawings included in one of "the provisions of this Agreement", namely Article VI, Section 1.

(e) The question of the extent to which automaticity should be given for gold tranche drawings would arise in connection with other provisions of the Articles, including the following:

<u>Article V, Section 3(b)</u>. Under this provision,

> "A member shall not be entitled without the permission of the Fund to use the Fund's resources to acquire currency to hold against forward exchange transactions."

This provision applies to all requests to purchase exchange from the Fund. If the representation of Article V, Section 3(a)(i) were eliminated, presumably this would be done with the intention that Article V, Section 3(b), among other provisions, should no longer apply to gold tranche drawings. If the representation were not abolished, it would be necessary to decide whether Article V, Section 3(b) should be made inapplicable to gold tranche drawings by some other amendment.

4/ It is assumed that the purpose of abolishing the representation would be to enable the member to draw its gold tranche notwithstanding any provisions in the Articles and that the amendment would be drafted so as to make this clear.

Article VII, Section 3(a) has been quoted above. If Article V, Section 3(a)(ii) were not eliminated as a condition for gold tranche drawings, any apportionment of the scarce currency by the Fund would affect requests for gold tranche, as well as all other, drawings.

Article XVI, Section 1(a) has been quoted above. It enables the Executive Directors to adopt a temporary suspension of exchange transactions under Article V, Section 3 and Article VI, Section 2 in the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund. For good order, it would be necessary to decide whether an exception should be made for gold tranche transactions under this provision also.

Article XVI, Section 2. Gold tranche transactions can be suspended by the operation of this provision as well:

"Liquidation of the Fund.--(a) The Fund may not be liquidated except by decision of the Board of Governors. In an emergency, if the Executive Directors decide that liquidation of the Fund may be necessary, they may temporarily suspend all transactions, pending decision by the Board.

(b) If the Board of Governors decides to liquidate the Fund, the Fund shall forthwith cease to engage in any activities except those incidental to the orderly collection and liquidation of its assets and the settlement of its liabilities, and all obligations of members under this Agreement shall cease except those set out in this Article, in Article XVIII, paragraph (c), in Schedule D, paragraph 7, and in Schedule E.

(c) Liquidation shall be administered in accordance with the provisions of Schedule E."

Article XX, Section 4(d), etc. Under this provision the Fund may permit members whose metropolitan territories had been occupied by the enemy to engage in exchange transactions before the establishment of an initial par value:

" (d) In the case of a member whose metropolitan territory has been occupied by the enemy, the provisions of (b) above shall apply, subject to the following modifications:

(i) The period of ninety days shall be extended so as to end on a date to be fixed by agreement between the Fund and the member.

(ii) Within the extended period the member may, if the Fund has begun exchange transactions, buy from the Fund with its currency the currencies of other members, but only under such conditions and in such amounts as may be prescribed by the Fund.

(iii) At any time before the date fixed under (i) above, changes may be made by agreement with the Fund in the par value communicated under (a) above."

The question would have to be decided whether a member in this position should be entitled as of right to engage in gold tranche transactions without the necessity for the Fund to establish conditions and amounts (not going beyond the gold tranche). A member must pay its subscription before making a purchase under this provision, and it would continue to be necessary, therefore, for the Fund to establish at least one condition, i.e., the rate of exchange at which a provisional currency subscription should be paid and the gold tranche transaction carried out.

The Fund has decided that it has the legal authority to permit pre-par value transactions even though a member does not fall within Article XX, Section 4(d). The following is the text of E.B. Decision No. 1687-(64/22), adopted April 22, 1964:

" (a) Where the Fund prescribes the conditions and amount of an exchange transaction by a member before the establishment of an initial par value, the member will be required to complete the payment of its subscription on the basis of a provisional rate of exchange for its currency proposed by the member and agreed by the Fund.

(b) In deciding whether to permit exchange transactions before the establishment of an initial par value, the Fund, in accordance with the last sentence of Article I, will be guided by the purposes of the Articles; the Fund will encourage members to follow policies leading to the establishment of realistic exchange rates and to the adoption at the earliest feasible date of effective par values, and will take into account the efforts that are being made to achieve this objective. However, the Fund will give the overwhelming benefit of any doubt to requests for exchange transactions within the gold tranche and members can expect that requests for drawings will be met where they are made in accordance with paragraph 5 of E.B. Decision No. 1477-(63/8), adopted February 27, 1963." (Selected Decisions, p. 48)

The comments which have been made above in connection with Article XX, Section 4(d) would apply equally to this decision.

Article XX, Section 4(i). This provision and E.B. Decision No. 284-2 with respect to it have been quoted above. A member that has not yet had an exchange transaction with the Fund is likely to be in the basic gold tranche if it has already paid its subscription. The question would arise whether it should be permitted to draw its gold tranche even if the Fund might think that this would be "use of the resources of the Fund in a manner contrary to the purposes of the Agreement or prejudicial to the Fund or its members." Postponement under Article XX, Section 4(i) does not correspond

legally to ineligibility, although the criterion for postponement might justify ineligibility in the case of a member that was already using the Fund's resources. Therefore, if gold tranche drawings were to be permitted notwithstanding the ineligibility provisions of the Articles, as now written or as amended, this would be an argument for permitting gold tranche drawings notwithstanding Article XX, Section 4(i).

(f) Reform of the gold tranche in order to create some form of de jure automaticity, which by hypothesis would go beyond the present de facto automaticity, should be considered in relation to the provisions of the General Arrangements to Borrow. Paragraph 11(f) of the G.A.B. was drafted with the intention of giving a participant that had lent its currency to the Fund the same treatment when requesting early repayment as is accorded by the Fund to a request for a gold tranche transaction. The first two sentences of Paragraph 11(f) state that:

> "Before the date prescribed in Paragraph 11(a), a participant may give notice representing that there is a balance of payments need for repayment of part or all of the Fund's indebtedness and requesting such repayment. The Fund shall give the overwhelming benefit of any doubt to the participant's representation."

If these sentences were to be amended so that they corresponded with any increase in the automaticity of the gold tranche, the amendment would be governed by Paragraph 15 of the G.A.B., under which a decision of the Fund and the concurrence of all participants are necessary.

A similar situation would arise under the agreement between Italy and the Fund (EBS/66/167, Sup. 1 (8/15/66)). Under Paragraph 2(c) of that agreement:

> "Before the date prescribed in paragraph 2(a), Italy may give notice to the Fund representing that it has a balance of payments need for repayment of part or all of the amount lent to the Fund and requesting such repayment. The Fund shall give the overwhelming benefit of any doubt to Italy's representation."

No provision for amendment is included in the agreement, but it is obvious that, in accordance with general principles of law, the agreement could be amended with the concurrence of both Italy and the Fund.

2. Repurchase

Under Article V, Section 7(b), a member has no obligation, and indeed has no right, to repurchase the Fund's holdings of its currency if the

member is in the super gold tranche.[5] This is prescribed by Article V, Section 7(c):

> " (c) None of the adjustments described in (b) above shall be carried to a point at which
>
> (i) the member's monetary reserves are below its quota, or
>
> (ii) the Fund's holdings of its currency are below seventy-five percent of its quota, or
>
> (iii) the Fund's holdings of any currency required to be used are above seventy-five percent of the quota of the member concerned."

The same rule applies to repurchases that do not arise under Article V, Section 7(b) (see, for example, E.B. Decision No. 1371-(62/36), adopted July 20, 1962 (Selected Decisions, p. 35)). However, a member is required to repurchase the Fund's holdings of its currency within the basic gold tranche. The most radical proposal for reform of the gold tranche in connection with repurchase would be to eliminate repurchase for the basic gold tranche and make it correspond, therefore, with the super gold tranche. Technically, this would require no more than the elimination of the words "seventy-five percent of" in Article V, Section 7(c)(ii) and (iii) and corresponding changes in the Fund's decisions on repurchase such as the abrogation of Paragraph 2(c) of E.B. Decision No. 102-(52/11), adopted February 13, 1952 (Selected Decisions, p. 23).[6] A variation of this amendment would be to permit the reduction by repurchase of a member's currency held by the Fund from the level of quota to 75 per cent of quota but to give each member the option to repurchase in this way. The Fund would never expect or require repurchase within this range but, as indicated, would leave it to the member's discretion. If the member wished to repurchase in this range, the media of repurchase could continue to be governed by the present law and practice except that the Fund would accept a member's currency in repurchase up to the quota level and, therefore, beyond the present maximum limit of 75 per cent of quota. It is conceivable that the amendment could require the consent to each such repurchase of the member whose currency was to be used in this way.

5/ This is subject to the qualification that if a repurchase obligation accrued under Article V, Section 7(b) and Schedule B in respect of the end of a financial year of the Fund but is not calculated until some later date, at which time the Fund's holdings of the member's currency have fallen to or below 75 per cent of the member's quota, the member must nevertheless discharge that repurchase obligation. (E.B. Decision No. 419-1, adopted April 11, 1949 (Selected Decisions, p. 51))

6/ The question whether this should lead to a similar amendment of the other provisions of the Articles in which the 75 per cent level appears is not considered in this memorandum.

Although it would be logical to raise the 75 per cent level to the quota level for the purpose of both repurchase and the acceptance of currency in repurchase, the former could be done without the latter.

A more modest proposal has been that the Fund could dispense with representations as to repurchase in connection with transactions under its gold tranche policy. Under paragraph 2(e) of E.B. Decision No. 102-(52/11), adopted February 13, 1952 (Selected Decisions, p. 23), members are expected to state, when requesting a transaction, that they will comply with the principles of the Decision. In accordance with paragraph 2(a), this means that a member will not delay repurchase beyond the period reasonably related to the payments problem for which it made the purchase, and that it will do this within an outside range of three to five years after the purchase. Under paragraph 2(c), if the Fund's holdings of a member's currency resulting from a transaction in the basic gold tranche have not been reduced to 75 per cent within three years after the purchase, the member is requested by the Fund to agree upon an arrangement providing for the reduction of the Fund's holdings to 75 per cent within five years of the purchase unless they are otherwise reduced. These representations made on the occasion of a transaction in the basic gold tranche are expressions of intent and are not obligations.

The modification of E.B. Decision No. 102-(52/11) so as to eliminate the need for a representation as to repurchase for gold tranche drawings would not require any amendment of the Articles. It would not follow from such a modification, however, that the member's only obligation to reduce the Fund's holdings from 100 per cent to 75 per cent of quota would be confined to repurchase in accordance with Article V, Section 7(b). In addition to that provision, the other provisions of the Articles which are intended to ensure a proper use of the Fund's resources would apply. 7/ One of these is Article V, Section 5 under which a member can be declared ineligible to use the Fund's resources if the Fund is of the opinion that the member is using those resources in a manner contrary to the purposes of the Fund. An unduly protracted use of the Fund's resources would be an improper use. At the moment, the Fund's policy in application of the concept of temporary use is that repurchase should be made when the problem for which a member made the purchase is solved and that this period should fall within an outside range of three to five years after the purchase. Therefore, if E.B. Decision No. 102-(52/11) were amended so as to eliminate the need for representations as to repurchase in connection with drawings in the basic gold tranche, members would continue to be bound to make a temporary use of the Fund's resources in the gold tranche. The Fund would continue to expect the member to see that the Fund's holdings of the member's currency were reduced to 75 per cent of quota within five years, unless that period were itself changed.

7/ Clearly, this statement and the succeeding discussion might have to be qualified in the light of any amendments adopted in the interest of de jure automaticity.

Although members are obliged to make no more than a temporary use of the Fund's resources, the Fund can determine what is meant by temporary. It could legally decide that some longer period than five years was still a temporary one. Moreover, the Fund has decided in practice that within the outside range of three to five years different periods are appropriate for different problems. The Fund has not decided that there may be different maximum periods for purchases in different tranches. This would be possible, however, under the concept of adequate safeguards in Article I (v), but always subject to the limitation that a member should repurchase when the payments problem for which it purchased has been solved, and this would be as true in the gold tranche as in any other tranche.

3. Interest

Article XII, Section 6 deals with the distribution of net income as follows:

> "Distribution of net income.--(a) The Board of Governors shall determine annually what part of the Fund's net income shall be placed to reserve and what part, if any, shall be distributed.
>
> (b) If any distribution is made, there shall first be distributed a two percent non-cumulative payment to each member on the amount by which seventy-five percent of its quota exceeded the Fund's average holdings of its currency during that year. The balance shall be paid to all members in proportion to their quotas. Payments to each member shall be made in its own currency."

The legal aspects of the provision have been discussed in SM/66/130 (12/15/66). As indicated in that memorandum, the provision enables the Fund to make a preferential distribution of up to 2 per cent on average super gold tranches during the year for which the distribution is made. It is not possible to make any other kind of distribution unless 2 per cent is distributed in this way. Any further distribution beyond this 2 per cent must be made to all members in proportion to their quotas as they were in the year for which the distribution is made. The distribution for a particular year is made from the net income for that year, which consists substantially of the difference between receipts and expenditures for that year.

The foregoing conclusions mean, among things, that the provision does not provide for an assured remuneration to members even on super gold tranches. The preferential distribution of up to 2 per cent can be made only if there is net income, and net income for the year in respect of which the distribution is made, but the Board cannot distribute more than 2 per cent as a preferential distribution on super gold tranches. Moreover, even if there is net income in this sense, it is still within the discretion of the Board of Governors to make or not to make the distribution. If 2 per cent

were to be distributed on super gold tranches, any distribution beyond that could not be confined to members that had basic gold tranches, on the average, during the year in respect of which the distribution is made. After the preferential distribution of 2 per cent, any distribution that is decided on must be made to all members on the basis of quotas.

It is possible to conceive of a very large range of modifications of Article XII, Section 6. Among them would be the following, either singly or in various combinations:

(i) A cumulative preferential distribution of 2 per cent on super gold tranches.

(ii) Use of the cumulated General Reserve where necessary to pay preferential distributions in respect of any year.

(iii) The payment of interest on super gold tranches, i.e., a return payable whether or not there is net income or an available General Reserve.

(iv) A fixed rate of interest; or interest at a rate established by the Fund, with or without a mandatory minimum rate.

(v) Preferential payments on the basic as well as the super gold tranche, at the same or at a different rate, either as distributions from net income or as interest.

Any one of these changes would require the appropriate amendment of Article XII, Section 6.

4. Service charge

The present service charge for purchases of exchange from the Fund has been fixed by Rule I-2 of the Rules and Regulations at 1/2 of 1 per cent. It is imposed pursuant to Article V, Section 8(a):

> " Any member buying the currency of another member from the Fund in exchange for its own currency shall pay a service charge uniform for all members of three-fourths percent in addition to the parity price. The Fund in its discretion may increase this service charge to not more than one percent or reduce it to not less than one-half percent."

It will be observed from this provision that a service charge is mandatory, even for super gold tranche as well as basic gold tranche transactions, and that it is now at the minimum which can be imposed. It follows that the service charge could not be eliminated or reduced below the present minimum for any category of exchange transactions with the Fund without an amendment of the Articles. Article V, Section 8(a) could be amended to

provide a lower service charge for gold tranche transactions than for other transactions, or to provide that no service charge shall be levied at all for the former category of drawings or for super gold tranche drawings, or to provide for a discretion on the part of the Fund to reduce the rate to zero.

5. Fund unit of account

It has been suggested that the accounts of the Fund might be kept in units that reflect the gold value of gold tranches and not in U.S. dollars. A change of this kind would not require any amendment of the Articles. However, it would require the amendment by the Board of Governors of one paragraph of By-Law 20, which reads as follows:

> " All accounts shall be summarized in United States dollars; and for this purpose gold shall be valued in terms of United States dollars at the par value of the United States dollar, and all members' currencies shall be converted at their par values or in accordance with a decision of the Fund pursuant to Article IV, Section 8(b)(ii) of the Articles of Agreement."

This is an accounting convenience, expressing the Fund's transactions and countries' positions in the Fund in the unit most commonly used by members themselves to express their other external financial transactions and to record their reserve assets, including gold. It is understood, however, and specifically stated in Membership Resolutions adopted by the Board of Governors, that the term "dollar" or "$" means the United States dollar of the gold weight and fineness in effect on July 1, 1944. 8/

The underlying Fund unit of account, for all calculations under the Articles of Agreement, including those relating to the Fund's holdings of currencies, is this United States dollar of 1944, subject to all of the provisions of Article IV, Section 8 for the maintenance of the gold value of the Fund's assets. It might be considered misleading legally if presentation of the accounts were modified without some reference to these provisions along the following lines:

> " The accounts are expressed in United States dollars of the weight and fineness in effect on July 1, 1944, i.e., of 0.888671 grams of fine gold, subject to the provisions of the Articles of Agreement of the Fund."

8/ Cf. Article IV, Section 1:

"Expression of par values.--(a) The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944.

(b) All computations relating to currencies of members for the purpose of applying the provisions of this Agreement shall be on the basis of their par values."

In accounts relating to the Fund's borrowings of currency a different notation could be employed, which would simply refer to the United States dollar of the weight and fineness in effect on July 1, 1944, as specified by Paragraph 12(a) of the General Arrangements to Borrow (E.B. Decision No. 1289-(62/1), adopted January 5, 1962 (Selected Decisions, p. 63)) and paragraph 6 of the Agreement between Italy and the Fund.

6. Transferability

Suggestions have been made for the transferability of gold tranche positions in some more direct manner than is possible at present. Gold tranche positions are now transferred, in effect, under the existing Fund mechanism by one member's purchase of the currency of another member when both have gold tranches. A more direct transferability of gold tranches could be carried out in either of two ways. The first could involve transfers of currencies to and by the Fund as at present, but this would be done as the result of agreement between the members and on notice given to the Fund. The alternative technique could involve a payment of the transferor's currency by the transferor to the Fund and a return by the Fund of the transferee's currency to the transferee. Under this latter technique, A would not draw B's currency as at present, but A would pay its currency to the Fund, and the Fund would return an equivalent amount of B's currency to B. The first of these techniques would require no amendment of the provisions of the Articles relating to the existing mechanism of exchange transactions with the Fund. The second technique would require amendment of those provisions. In either case, it would have to be decided whether the representation called for by Article V, Section 3(a)(i) should continue to be required. It would also have to be decided whether the transfer of gold tranches should continue to be subject to the guidance which the Fund now gives under its Decision on Currencies to be Drawn and to be Used in Repurchases (E.B. Decision No. 1371-(62/36), adopted July 20, 1962 (Selected Decisions, p. 33)).

7. Amendment

It is difficult to be precise about the technique of amendment without knowing the precise amendment that is contemplated. Some of the most complex issues might arise in connection with *de jure* automaticity, but once these were resolved, they might be the easiest to handle as a technical question of amendment. It would probably be possible to let the Articles remain in their present form and to provide in a new Article XXI or in some annex to the Articles that notwithstanding any other provisions of the Articles certain stated dispositions were to apply to the gold tranche, which would be appropriately defined. To the extent that this technique could be adopted, it would be a considerable simplification because it would avoid the introduction of detailed and repeated qualifications throughout the Articles. This technique would not be available for all of the reforms

that have been mentioned in the course of this memorandum. For example, the amendment of Article XII, Section 6 could be made only by changing the text of that provision.

For convenience, the text of Article XVII, dealing with amendments, is reproduced here:

" (a) Any proposal to introduce modifications in this Agreement, whether emanating from a member, a governor or the Executive Directors, shall be communicated to the chairman of the Board of Governors who shall bring the proposal before the Board. If the proposed amendment is approved by the Board the Fund shall, by circular letter or telegram, ask all members whether they accept the proposed amendment. When three-fifths of the members, having four-fifths of the total voting power, have accepted the proposed amendment, the Fund shall certify the fact by a formal communication addressed to all members.

(b) Notwithstanding (a) above, acceptance by all members is required in the case of any amendment modifying

(i) the right to withdraw from the Fund (Article XV, Section 1);

(ii) the provision that no change in a member's quota shall be made without its consent (Article III, Section 2);

(iii) the provision that no change may be made in the par value of a member's currency except on the proposal of that member (Article IV, Section 5(b)).

(c) Amendments shall enter into force for all members three months after the date of the formal communication unless a shorter period is specified in the circular letter or telegram."

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

April 19, 1967

To: Members of the Executive Board

From: The Secretary

Subject: EEC - Ministerial Communiqué and Report of Monetary Committee

Dr. Emminger, Chairman of the Deputies of the Group of Ten, has asked that Executive Directors be informed as follows: "The communiqué of the Finance Ministers of the Six of April 18, 1967, and the report of the Monetary Committee of the EEC which was approved by the Finance Ministers at their meeting of April 17 and 18, is being distributed as material for the forthcoming meetings."

Accordingly, there are attached English translations of the communiqué and of the report referred to by Dr. Emminger. It should be particularly noted that the translations are not official but are provisional translations provided by the Fund staff for the convenience of participants in the forthcoming joint meetings.

Att: (1)

EEC - Ministerial Communiqué and Report

TRANSLATION

Munich, April 18, 1967

The Finance Ministers of the six member countries of the European Economic Community held a meeting at Munich on April 17 and April 18, 1967, under the Chairmanship of Dr. h. c. Franz Josef Strauss, Minister of Finance of the German Federal Republic. Taking part in the meeting were: Mr. Robert Henrion, Minister of Finance (Belgium); Mr. Michel Debré, Minister of Economic Affairs and Finance (France); Dr. Emilio Colombo, Minister of the Treasury, and Dr. Athos Valsechi, Secretary of State (Italy); Prof. Dr. H. J. Witteveen, Deputy Prime Minister and Minister of Finance (Netherlands); Mr. Pierre Werner, President of the Government and Minister of Finance (Luxembourg); Prof. Dr. Karl Schiller, Minister of Economic Affairs, and Dr. J. Schoellhorn, Secretary of State (German Federal Republic). The EEC Commission was represented by Mr. Robert Marjolin, Vice President, and Mr. Hans von der Groeben. Also present were: Mr. Maurice Pérouse, Chairman of the Short-Term Economic Policy Committee, and Mr. Emile Van Lennep, Chairman of the EEC Monetary Committee.

During the first part of the meeting, in which the Central Bank Governors took part, they discussed international monetary problems, starting from the idea that the EEC member countries ought to occupy a place in the international monetary institutions more in keeping with their actual responsibilities, their growing economic solidarity, the expansion of their trade, and their economic and financial influence ("rayonnement") on outside countries. This state of affairs cannot fail to lead the countries in question to seek a common position in the present discussions on the reform of the international monetary system and to continue a close cooperation in the future, so that they will be in a position, acting together, to safeguard their legitimate interests.

In the spirit of this cooperation, the Ministers of Finance and Economic Affairs taking part in this meeting agreed on the following points:

1. The fact that there is no present shortage of international liquidity does not prevent consideration of the measures to be taken in case there should be a need for additional reserves in the future.

2. Any measures which may be taken to create additional reserves, or any alternative solutions adopted for the same purpose, should be dependent upon a common judgment that a shortage exists, upon a better functioning of the adjustment process, and upon the achievement of a better equilibrium in international financial transactions. They should not be based on the balance of payments requirements of certain countries, thus excluding any special treatment benefiting a single country or group of countries.

3. These measures should not be related to short-term cyclical phenomena but to long-term requirements.

4. The present strength of the Six and their union in the EEC must, in any event, ensure that they have a proper influence in the IMF, particularly in the voting procedures. The Monetary Committee has made suitable propositions for this purpose.

5. On these conditions it would be possible, in the event of an agreed shortage of international liquidity, to envisage in the future the creation of both conditional and unconditional drawing rights within the IMF.

6. In connection with the goals mentioned above, the question arises as to whether it is opportune to establish, for the creation of additional automatic drawing rights, accounts and a method of financing separate from the current IMF operations.

7. Automatic drawing rights, should carry an obligation to repurchase for debtors who had used all their drawing rights, or part of them persistently and over a long period, in order to compel them to re-establish their previous position with regard to their automatic drawing rights at the end of a given period. The effect of such an obligation would be to improve the adjustment process. It should also prevent drawing rights being used to alter the composition of reserves.

8. International Monetary Fund drawing rights are not directly transferable. Nevertheless, the question of voluntary bilateral transferability of the new drawing rights, which would have to take place in any event under the control of the IMF and which should not be allowed to affect the repurchase obligation of the original drawing country, requires still further examination.

Translation

EUROPEAN ECONOMIC COMMUNITY

Brussels, April 11, 1967
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Monetary Committee

VERY CONFIDENTIAL

REPORT BY THE MONETARY COMMITTEE*

to the Finance Ministers and the

Central Bank Governors of the EEC

1. During their meeting of January 16 and 17, 1967, the Finance Ministers and the Central Bank Governors of the six countries forming the European Economic Community agreed on a communiqué which contained the following: "the Ministers and Governors, anxious to confirm their solidarity on a question as important as the international monetary problem, have decided, while pursuing the examination of the plans discussed hitherto, to instruct their experts in the Monetary Committee of the EEC to study without delay the improvement of the methods of international credit".

2. In carrying out these instructions, the Monetary Committee has tried to work out the main points for a common position by the EEC countries in the current discussions on the reform of the international monetary system. In this connection, it has been guided by the following considerations:

i. If, some time in the future, an increase in international liquidity became necessary, this increase could be based on an extension of the credit mechanisms within the International Monetary Fund.

ii. In order to ensure that any decisions on the creation of liquidity are not taken prematurely and do not exceed the necessary volume compatible with the maintenance of monetary stability, the voting procedures used for these decisions should be arranged in such a way that the EEC countries can exercise an influence corresponding to their economic and financial responsibilities.

iii. Finally, it would be desirable to take the opportunity afforded by the alteration of certain Fund Articles for the purposes mentioned in (i) and (ii) above, in order to make other desirable changes in the Articles, the principles underlying the Fund's operations and in its voting procedures, in particular such changes as could help to improve the functioning of an expanded liquidity mechanism within the Fund.

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* A provisional English translation by the Fund staff.

3. Basing itself on these fundamental principles, the Monetary Committee has made a number of proposals which may be grouped under the following three headings:

A. Expansion of the activities of the International Monetary Fund

B. Changes in certain rules and practices of the International Monetary Fund

C. Rules relating to the procedure for reaching decisions on important questions, and in particular those relating to the various forms of liquidity creation.

A. EXPANSION OF THE ACTIVITIES OF THE INTERNATIONAL MONETARY FUND

4. The Monetary Committee has examined a number of techniques which might meet the needs for liquidity that could arise. These techniques run from the enlargement of the Fund's existing facilities to the opening of new drawing rights which might be partly or wholly separate from the Fund's present activities.

In the first place it was pointed out that general or special increases in quotas, whether as part of the normal quinquennial review, or on other occasions, would make it possible to increase the Fund's resources.

Secondly, it would be possible to extend the drawing rights of Fund members in the credit tranches, hitherto restricted to 125 per cent of quota, provided that there were a general agreement relating to the changes proposed elsewhere regarding the commitments of the drawing countries and the rules regarding the majority required for taking such decisions.

However, it was pointed out that after the large increases, both general and special, in quotas, which raised quotas from 15 billion to 21 billion dollars in 1966, there is no need at the present time to increase the volume of conditional liquidity.

5. In addition to the possibilities set forth in the preceding paragraph, there is the possibility of increasing the volume of automatic drawing rights in the Fund. This possibility was also examined; there are various ways in which it could be implemented--for example, by granting additional gold tranches either against partial payment in gold or without gold payment, or by giving the credit tranches a progressively automatic character.

The members of the Monetary Committee unanimously recalled that the creation of new automatic drawing rights in the Fund should not be undertaken in advance of a collective judgment that there was an over-all shortage of reserves, that the adjustment process was functioning better, and that there was better balance in international payments, with increases in holdings of reserve currencies by the Central Banks no longer contributing toward the financing of the foreign deficits of the reserve currency countries.

The possible increase in the volume of automatic drawing rights could be brought about through the adoption of various institutional, accounting, and financial techniques.

a. It would be possible to bring about this increase either by incorporating new automatic drawing rights in the Fund's quota system, or by means of a system of separate accounts. In this latter case, the new drawing rights could be "floating" (i.e., they could be used either before or after other drawing rights were used up).

b. The additional resources required to finance the supplementary drawing rights could be incorporated in the Fund's general resources, or they could be kept separate. In the former case, the new resources would be part of the Fund's general liquidity.

c. The separation of accounts as at (a) above and the separation of funds as at (b) above could be carried out either within the Fund itself or by establishing a Fund affiliate.

6. One proposal, whose general principles received the support of a number of members of the Monetary Committee, would consist of opening automatic drawing rights, with both their accounting and their financing separate from those of the other drawing rights in the Fund. The new automatic facilities would be (a) usable in accordance with well-defined rules which would have to be drawn up in advance, including a condition that the drawing rights could not be used for the sole purpose of altering the composition of the reserves of the drawing countries, and (b) directly transferable between the monetary authorities of the member countries.

7. The eventual choice of a solution in this field will enable legitimate requirements of the international community as a whole to be satisfied under the most favorable conditions. However, the introduction of techniques of this sort would require changes in the structure and operations of the International Monetary Fund, and in particular an agreement on decision-taking procedures, such as those set out below.

B. CHANGES IN CERTAIN RULES AND PRACTICES OF THE INTERNATIONAL MONETARY FUND

8. The Committee feels that in view of the many far-reaching changes that have taken place, since the establishment of the International Monetary Fund, in the general economic situation, in the relative positions of the member countries and in the functioning of the international monetary system, a number of modifications in the working of this institution appear desirable in order to make it more capable of meeting the needs of the present day.

a. Changes in certain provisions

(i) Status of the gold tranche and the super gold tranche

For many member countries, the drawing rights that they have acquired in the gold tranche and the super gold tranche have become major

assets that have, moreover, taken the place of other reserves. These drawing rights may well become still larger. It is necessary to ensure that they have all the qualities of a true reserve. It would be desirable to improve their status with respect to full automaticity in their use, their expression in terms of a gold accounting unit, and abolition of the commission levied by the International Monetary Fund.

The possibility should be considered of harmonizing the characteristics of the drawing rights in the gold tranche and those in the super gold tranche, of attaching a certain remuneration to the holding of these drawing rights, and of ensuring their direct transferability. It is desirable that the technical studies now being undertaken by the IMF should lead to concrete proposals as rapidly as possible.

(ii) Conditions attaching to drawing rights in the credit tranches

The principles now governing the policy for drawings in the credit tranches should be re-examined in order to make them play a more effective part in the adjustment process, by strengthening the conditional character of these drawings. For this purpose, it is desirable to seek a means of rendering more precise the commitments undertaken by drawing countries, for example, by setting down certain quantitative standards to which they would have to conform, especially with respect to their budgetary, monetary and income policies. A change in the scale of charges could also be envisaged.

If the rules were strengthened in the direction mentioned above, it would be possible to consider abolishing the clause in the IMF Articles of Agreement which limits the amount of drawings in a given year to 25 per cent of quota, since this limit is hardly ever respected in practice.

(iii) Rules governing the conditions for repurchase from the Fund

The Fund Articles of Agreement provide that member countries which have made a drawing on the Fund may in certain circumstances be exempt from repurchase obligations. A revision of the Articles in question (Article V, Section 7 (b) and (c) and Article XIX, (e)) should be considered.

(iv) Other changes

If the Fund Articles of Agreement are reviewed, it might be worthwhile considering:

first, adding to the list of Purposes set out in Article I by making specific mention of price stability;

secondly, abolishing the distinction, which is no longer made in practice, between capital transfers and current transactions (Article VI, Section 1 and Section 2; Article VIII, Section 4 (a) of the Fund Articles of Agreement).

b. Maintenance of the gold value of the Fund's assets and expression of par values

It has been suggested that the provision requiring the approval of every member holding 10 per cent or more of the total of the quotas in the Fund for a proposal to make a uniform change in the par values of currencies should be replaced by a clause requiring the approval of at least an 85 per cent majority.

Article IV, Section 8 of the Fund Articles of Agreement lays down that a waiver may be granted from the clause which insures the maintenance of the gold value of the Fund's assets. In order to protect this value as far as possible, it is proposed that a decision in favor of a waiver shall only be taken by a majority of at least 80 per cent of the total voting power.

Finally, the Monetary Committee proposes that the present definition of par values and of the IMF unit of account (Article IV, Section 1 (a)) should be simplified by retaining only the reference to a weight of gold.

C. RULES RELATING TO THE PROCEDURE FOR REACHING DECISIONS ON IMPORTANT QUESTIONS, AND IN PARTICULAR THOSE RELATING TO THE VARIOUS FORMS OF LIQUIDITY CREATION

9. Except for a very small number of decisions which have to be taken by a qualified majority or unanimously, IMF decisions are taken by simple majority of votes cast.1/

Thus, in areas that are significant for the finances both of the organization and of the member countries, decisions might be taken without necessarily having the agreement of the countries which would have to assume the consequent burden. It is therefore desirable that such decisions should be taken with a large qualified majority. In particular, this should be the case for general changes in quotas and for the creation of additional facilities. For these decisions, an 85 per cent majority of all votes should be required; this majority ought to include at least half the major creditor countries.2/

In such a system, the EEC countries, which now hold 17 per cent of the quotas, would exercise an influence comparable to that of the United States in decisions of this sort, provided that they did not become debtors. Assuming that this qualified majority were only 80 per cent, the EEC countries

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1/ These votes are weighted mainly in accordance with the size of the quotas.

2/ Major creditor countries may be defined as those countries whose national currency holdings by the Fund have been on the average during the last five or ten years less than 75 per cent of their quotas, the minimum net contribution for financing drawings on the Fund being x per cent (e.g. at least 3 per cent) of the total volume of financing, on the average over the years.

could have the same protection, provided that taken together their quotas came to more than 20 per cent of total quotas. This would involve special increases in the quotas of the EEC countries. Some of them, whose quota is lower than would be justified by the application of the usual methods of computation, would be prepared to accept such an adjustment. This is clearly not the case for one EEC country, which raised its subscription by more than 50 per cent in June 1966.

10. The Fund Articles of Agreement provide (Article III, Section 5(b)) that for two types of decision (waiver and ineligibility), the voting rights to which a country is entitled shall be adjusted to take account of its creditor or debtor position. It is proposed that a strengthening of the machinery for adjusting voting rights should be studied. It is also suggested that the range of decisions to be taken in this way should be extended to cover all those of a financial nature.

In connection with the possible granting of additional votes to creditor countries, it would be necessary to alter the existing practices regarding the voting rights of drawing countries. The system envisaged in the General Arrangements to Borrow (where drawing countries do not vote) could be considered.

11. The Monetary Committee feels that it would also be desirable to lay down that decisions should be taken by a qualified majority in other fields, and particularly in those listed below:

Fund credit policy (changes in the guidelines for this policy);

Fund gold policy (gold payments by members and Fund investments);

Fund policy on borrowing (Article VII);

Interpretation of the Articles of Agreement.

Consideration could be given to the question whether, among the decisions which ought to be taken by qualified majority, a supplementary clause could be introduced in those involving an increase in the burden falling on debtor countries in the Fund which, in analogy to the clause mentioned above regarding creditor countries, would provide that at least half the major debtor countries should be included in the required majority.

12. Finally, as consideration is being given to increasing the work of the Fund, and as it is desirable to facilitate the taking of important decisions within that institution, it might be worth considering associating the Governors of the Fund more closely with its activities. For this purpose, the establishment of a small group of Governors or of their representatives, which would meet periodically, might be considered. This group would be made responsible for keeping an eye on the general policy of the Fund; in particular, it could carry out the preparatory work for decisions connected with the new tasks that might be entrusted to the Fund. Finally, it could handle questions relating to the interpretation of the Fund Articles of Agreement.