INTERNATIONAL MONETARY FUND

FINAL MINUTES

Executive Board Meeting 329

1818 H Street, N.W.

10:00 a.m., June 18, 1948

C. Gutt, Chairman

	E. de Selliers
J. W. Beyen	W. Koster
	G. H. Tansley
	G. Cigliana-Piazza
	R. Martinez-Ostos
J. V. Joshi	B. K. Madan
Y. C. Koo	Y. L. Chang
J. de Largentaye	
S. G. McFarlane	R. Wilson
J. V. Mladek	M. Kolovic
A. N. Overby	
	M. S. Falaki
	O. Paranagua

R. L. Horne, Acting Secretary
P. Thorson, Assistant

Present for Items:

2,3,4,7 E. M. Bernstein, Head, Research Department
4 F. Boyer, Research Department
2-3 P. Brand, Operations Department
2-4 R. Brenner, Legal Department
3-4 E. F. Carbo, Operations Department
7 B. Eiriksson, Research Department
2-4 E. P. Hexner, Legal Department
7 G. S. Kielland, Operations Department
2 C. C. Liang, Research Department
3-4 J. Marquez, Research Department
5 D. Stratton, Director of Personnel
2,3,4,7 W. H. Taylor, Operations Department
4 H. M. H. A. Van der Valk, Research Department
2 Y. C. Wang, Operations Department

Approved: Meeting 332
June 30, 1948

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1. Minutes

The minutes of Meeting 324 were agreed as revised.

2. Exchange Situation - China

The Executive Board considered the exchange situation in China and a procedure for dealing with changes in China's exchange rates (Executive Board Document No. 278; Staff Memorandum No. 247).

Exchange Position. Mr. Koo outlined some of the problems confronting China. He pointed out that modernization of the Chinese society and economy was a long-term problem. Even in a peaceful world, the transition might take several decades. Much progress had been achieved by 1937. However, in that year China was invaded and eight bitter years of war followed. At the end, inflation was rampant; poverty and misery were prevalent.

The inflation would have been brought under control had the Chinese Communists agreed to join in the work of rehabilitation and reconstruction. Instead, they revolted. Now, after two years of the revolt and in the eleventh year of inflation, China's economic distress was greater than ever before. There was a constant flight of capital abroad, a good portion of it through Hong Kong. Despite the friendly co-operation of the Hong Kong authorities, the flow was hard to stop. In the field of trade, hoarding and smuggling were substantial. Internal trade was dislocated, and external trade continued in deficit. Wages of industrial workers and the salaries of public and private employees had been tied to the cost-of-living. Heavy military expenditures added to the severity of the inflation; at the same time, the economic distress hindered completion of the military campaign.

Opinions as to solutions differed widely. However, well-informed Chinese generally agreed that, because the causes were both internal and external, the solution would have to combine both self-exertion by China's government and people and friendly assistance from outside sources. The recent aid from the U.S. was of immense value to the economy. Even so, the amount of aid, in the Chinese estimation, was still inadequate. Both the Government and people were, however, conscious of the urgent need for self-help to implement the outside aid.

Mr. Koo concluded that China recognized she was not at present in a position to draw on the Fund. She did welcome the Fund's constructive advice and looked forward to the not-too-distant date when she could enter into full financial collaboration.

There was a discussion. Others agreed that during the period of civil strife, budget deficits and massive inflation, no exchange system could be expected to succeed fully. They believed the new system of certificates might allow some improvement; but to expect it to solve the difficulties was unrealistic.

Procedure. The point was made that in China's circumstances rapid changes in the exchange rate set by the Exchange Stabilization Board might be necessary from time to time. While the certificate system would take up the day-to-day fluctuations, some changes in the Board's rate would be needed since some imports and invisible transactions went at that rate. Similarly, some changes in the exchange structure might be necessary. The belief was that in

2. <u>Exchange Situation - China</u> (Cont'd)

those circumstances China should be asked to inform the Fund in advance of changes where possible, or in any case at the earliest possible time. While the Fund might express opinions, it could obviously not be expected to pass on the substance of those changes. Mr. Koo, in a separate memorandum to the Managing Director (Executive Board Document No. 278) outlining the necessity for the adoption of a more simple formula.

After discussion the decision was:

The Fund has been informed of China's adoption of an exchange certificate system operating as follows:

(a) Exporters, on selling exchange at the Exchange Equalization Fund rate, will receive an exchange surrender certificate equal to 100 per cent of the exchange sold.

(b) Importers must buy certificates equal to the value of their import licenses in order to buy exchange at the Equalization Fund rate. Importers of rice, wheat, flour, cotton, and fertilizer will not require certificates.

(c) The Central Bank of China, on instruction from the Equalization Fund Committee, will operate in the certificate market, buying and selling in order to control the price of certificates.

(d) The official rate of 12,000 yuan per U.S. dollar will be abolished. In the future, the Exchange Equalization Fund rate will apply to transactions to which the official rate applied.

The Fund is aware of the unusual difficulties which confront the monetary and exchange authorities of China. In the circumstances the Fund will interpose no objection to the exchange certificate system. At the same time the Fund recognizes that because of the unusual circumstances, China may not be able to inform the Fund well in advance of changes in the exchange rate for the yuan and the exchange structure; similarly the Fund ordinarily will not be in a position to pass upon the substance of the change. Accordingly, the following procedure is agreed to replace the usual procedure of consultation in such cases: The Fund understands that China recognizes the responsibility of notifying the Fund of contemplated changes in exchange rates and the exchange structure sufficiently in advance of such action to give the Fund an opportunity to express its views if it so desires. Until new arrangements are made between China and the Fund, any such notification will be given to the Managing Director, and so far as possible he will reply at once on behalf of the Fund. If the Managing Director prefers to raise the matter with the Executive Board, he will not reply immediately but will endeavor to obtain the most rapid possible action by the Executive Board.

3. Multiple Currency Practice - Chile

The Executive Board considered certain modifications which Chile had suggested in the wording of its agreement with the Fund regarding exchange practices (Meeting 291, Item 2; Staff Memorandum No. 208, Supplement 2). The recommendations which the staff had made were approved and the decision was:

The Fund notes the communication of Chile indicating concurrence with all but two passages of the revised agreement between Chile and the Fund (Meeting 291, Item 2). The following position should be communicated to Chile on the two changes proposed:

(a) The Fund is prepared to accept the modification proposed by Chile in the last sentence of Paragraph (1) of the second WHEREAS clause, with the deletion of the word "now" since its reference is not clear. The sentence would then read: "The Chilean Government will attempt to reach sufficient domestic stability before the end of 1948, to be able to establish for the transactions which are effected at the free market rate through the commercial banks a definite rate which can be maintained."

(b) The Fund is prepared to accept the second proposed modification in Paragraph (2) of the same clause so that the passage would read: "The Chilean Government will try to eliminate gradually the mixing system during the current year ..." provided that this part of the agreement would be interpreted in accord with the following language from the Ministers' letter to the Banco Central de Chile: "Such a beginning of the sentence together with the rest of it and with the final sentence of the same paragraph, will make it clear that during the year 1949 this system may be applied only to the most eligible cases as shall have the approval of the Fund." Chile should confirm such an understanding to the Fund.

Alternatively the Fund would accept elimination of the entire sentence so that the Paragraph (2) would read as follows:

The establishment of the so-called mixing system whereby part of the proceeds of non-basic exports are bought by the monetary authorities at the rate of 31 pesos to the dollar and part will be sold through the commercial banks at the new rate. The percentage of proceeds which would be bought at the official rate would vary with each product according to its competitive position. The mixing system will not be continued beyond 1948 for any particular export or exports without the Fund's approval.

4. Gold Certificate Systems - Colombia and Peru

The Executive Board reviewed a staff study on the gold certificate systems in Colombia and Peru (Staff Memorandum No. 246). Mr. Paranagua said he believed the problems which confronted the gold producing industries in those countries might justify the Fund in advancing more positive proposals than those suggested. For instance, he believed some measures like the cost-of-production compensations Canada and Australia had advanced might well be suggested to help overcome the problems of declining gold production.

In reply Mr. Overby said he understood the Fund had gone along with so-called cost-of-production subsidies only with great reluctance and in the light of the particular circumstances. In general he was opposed to subsidies just as he opposed certificate plans. He noted that in the U.S. gold production had declined to roughly half the 1936-38 level; yet the Government did not propose any assistance measures. He believed the Fund should discuss steps which would eliminate the use of certificates in the countries concerned. However, he would be willing as the staff had suggested, not to press for such discussions immediately but wait until talks began on the broad range of exchange problems. It was emphasized that in both cases the need for the certificates did not arise from any action by the Fund but from the large degree of inflation the members had suffered without compensating changes in the par values. Mr. Martinez-Ostos said he believed that in countries such as Colombia and Peru, where free markets already existed, the gold certificate systems offered the only method for easing gold production really consistent with the gold policy advised by the Fund. The problem of gold certificates, he believed, could not be separated from the problem of the members' maintenance of multiple currency practices during the transitional period; for that reason, the Fund should take up the matter when the time came to discuss with those countries the eventual removal of multiple currency practices.

Notice was taken that a mission would leave soon for Colombia and could take up the certificate question along with other problems. The same would be done in the case of Peru when consultations were agreed to.

The decision was:

> The Fund has considered the gold certificate systems which have been adopted by Colombia and Peru. Under such systems domestic gold producers delivering gold to the central banks receive transferable certificates; these certificates may be sold for an amount of local currency which will give a premium above the price corresponding to $35 per fine ounce of gold at the official parity. Such systems have thus resulted in new effective rates of exchange for the currencies concerned.
>
> The gold certificate devices are deemed to be relatively minor elements in the exchange systems concerned, and probably little would be gained by requiring their separate abandonment at this time. The systems are rather to be regarded as part of the general problem with which the members must deal. Therefore, instead of requesting the members to eliminate the gold certificate systems in isolation, the whole exchange problem, including this practice, will be considered as a whole. Continuing consultation on the matter between the members and the Fund is deemed desirable.

5. Staff Personnel - Arrangements for Assignments Abroad

The Executive Board discussed proposed administrative and financial arrangements which would apply to staff members who were assigned abroad for temporary periods (Executive Board Document No. 279). Various questions were raised.

The decision was:

> The Committee on Personnel Policies is asked to consider and report on the proposals for administrative and financial arrangements for staff members temporarily assigned abroad (Executive Board Document No. 279). At the same time the Committee may wish to consider any related matters, but should not on that account delay its report on the proposed arrangements.

6. Applications for Membership - Albania, Liberia, Pakistan and Siam

The applications for membership for Albania, Liberia, Pakistan and Siam were placed before the Executive Board (Executive Board Documents Nos. 280, 281, 282, and 283). In accordance with Rule D-1 the Chairman established one week as a reasonable time for discussion and preliminary investigation by the Executive Board.

7. Exchange Situation - Iceland

As agreed at Meeting 285 (Item 4), the Executive Board again took up the problem of Iceland's exchange position. Note was taken of the report prepared by the staff member who had visited Iceland (Staff Memorandum No. 245). The staff said the data available seemed to show that, even with her high efficiency as a producer, Iceland was nearing the point where she would have to decide whether her exchange position could continue to justify the present level of incomes and imports.

Mr. de Selliers said he had transmitted copies of the report to the Icelandic authorities, but had not yet received information from Iceland in reply. He noted that important deflationary steps had been taken recently. He had also been informed that the authorities believed a favorable herring catch in the next three months would have a decisive effect. A request had been made that consideration be held over until September when the catch would be in and exchange officials would be in Washington. In the meantime, there would be no change in Iceland's status regarding use of the Fund.

Further consideration was postponed on that basis.