LIMITED DISTRIBUTION ONLY

INTERNATIONAL MONETARY FUND

SEMINAR 72/9

10:10 a.m., March 22, 1972

P.-P. Schweitzer, Chairman
F. A. Southard, Deputy Managing Director

Executive Directors	Alternate Executive Directors
L. B. Brand	R. van S. Smit
E. Brofoss	S. Jónsson
R. Bryce	D. O. Mills
W. B. Dale	C. R. Harley
N. Deif	
P. Y. Hsu	
A. Kafka	B. Martins
B. Kharmawan	C. P. Caranicas
P. Lieftinck	T. de Vries
C. Massad A.	R. H. Arriazu
	R. H. Gilchrist
	J. B. Zulu, Temporary
	C. Bustelo
P. S. N. Prasad	S. S. Marathe
G. Schleiminger	L. Fuenfgelt
H. Suzuki	K. Satow
L. Ugueto	
	H. G. Schneider
	C. Beaurain
A. W. Yaméogo	

R. V. Anderson, Acting Secretary
J. A. Kay, Assistant

Also Present

Administration Department: P. Thorson, Director. African Department: A. R. Bengur, M. Guen. Asian Department: L. De Silva. Central Banking Service: G. Dorrance, D. R. Khatkhate. European Department: H. Ponsen, C.-H. Tretner. Exchange and Trade Relations Department: E. Sturc, Director; C. D. Finch, Deputy Director; H. Gerhard, S. Mookerjee, T. Sweeney. Fiscal Affairs Department: W. A. Beveridge. Legal Department: J. Gold, General Counsel and Director; G. P. Nicoletopoulos, Deputy General Counsel; N. S. N. Chari, J. G. Evans, J. V. Surr. Middle Eastern Department: A. S. Gerakis, M. M. Hassanein. Research Department: J. J. Polak, Economic Counsellor and Director; J. M. Fleming, Deputy Director; C. F. Schwartz, Deputy Director; R. R. Rhomberg, G. B. Taplin, T. G. Underwood. Secretary's Department: J. W. Lang. Treasurer's Department: W. O. Habermeier, Treasurer; F. C. Dirks, D. Williams, G. J. Wittich. Western Hemisphere Department: S. T. Beza. Office in Europe: J.-P. Sallé, Director. Personal Assistant to the Managing Director: L. F. T. Smith. Advisors to Executive Directors: F. K. Hussein, S. Nana-Sinkam. Technical Assistants to Executive Directors: V. Barattieri, C. J. Batliwalla, B. Brock, A. Doizé, B. P. Eap, F. García-Palacios, L. Halfmann, P. C. Hayward, K. Kjaer, E. Leung, R. W. Ley, H. Oyarzábal, C. C. Ozumba, A. Pipino, A. Seminario, E. W. Shann, N. Tsukagoshi, J. R. Vallet, M. A. Wasfy.

1. SPECIAL COMMITTEE OF THE BOARD OF GOVERNORS

The Executive Directors resumed from Seminar 72/8 (3/20/72) their consideration of memoranda on a Special Committee of the Board of Governors (SM/72/21, 1/25/72, and Sup. 1, 3/8/72, and SM/72/62, 3/13/72).

Mr. Massad, speaking personally, recalled that when the establishment of a committee of Governors had been considered in 1969, his chair had taken a negative position. It had done so for reasons most of which had been put forward again during the present round of discussions and which he believed were still valid. However, apparent changes in circumstances had made it worthwhile to take a fresh look at the matter. There was widespread dissatisfaction with the working of the decision-making process, which had not facilitated the participation of all interested parties in important decisions. It was reassuring to hear so many voices at the present time recognizing the need for the participation of developing countries at stages earlier than the purely formal endorsement of decisions already taken by others elsewhere. In that connection, the core of the arguments put forward by his predecessor had been that regardless of the forum for discussion, real participation by developing countries, particularly the smaller ones, depended more on the decision to accept such participation than on the way in which a given forum might be established. Naturally, the individual features of a given forum might influence the attainment of its objectives, but they could not have more influence than the political decision to accept the existence of the forum, to respect all points of view, and to abide by any recommendations it might make. A new forum for political negotiations might easily serve only as window dressing for decisions that were taken elsewhere, while weakening the Executive Board. It would be worthwhile examining in depth suggestions with respect to the particular forms that a new forum might take only if a decision had been taken to consider the points of view of developing countries and to accept their full participation in the international economic decision-making process. He would, however, assume for the time being that that was the case.

One of the main defects in the present system, Mr. Massad continued, appeared to be the lack of a forum for negotiation at the political level. Hence, membership of a Governors' committee at a high political level would clearly be necessary; however, it should not be restricted to ministers, but should be so arranged as to leave groups of countries a wider choice of representatives. Moreover, while alternates might be needed to take the place of principaipls, technical discussions of the type carried out by the so-called deputies should be left to the Executive Board. The proposed committee should meet at the level of principal or alternate, and the Executive Board would be responsible for the preparation of studies and the conduct of preliminary exchanges of views. The

Managing Director should be a member of the committee as a principal, and the Deputy Managing Director would act as his alternate. He had no strong views with respect to the chairmanship, except that it would be disadvantageous to have the Chairman of the Board of Governors act as the chairman of the committee. He might indeed not even be a member of the committee. There was no reason for suggesting any minimum number of meetings in any given year. If there were no special reasons for the committee to meet, it should not do so. The relationship between the committee and the Fund staff should be established through the Executive Board.

The function of the committee should be to consider the issues of reform of the monetary system on an ad hoc basis, and the terms of reference should be drafted in that context, Mr. Massad considered. If the terms of reference were made too wide, the committee would be unable to function properly. Subjects like burden sharing of defense expenditure should not be discussed by the committee, which should only handle subjects related to international monetary reform. Different institutions dealt with aid, trade, and monetary problems in the international field; each of them had a different constituency, and it was not to be expected that a single committee established in accordance with the needs of one particular institution could tackle all the problems involved in making international economic decisions. Perhaps it would be necessary to think in terms of similar special committees in different institutions, and to devise a way of bringing them all together at the highest possible level. Indeed, the Special Committee of the Board of Governors might be only "one leg of the elephant."

The General Counsel dealt with three topics raised at Seminar 72/8: voting in the committee; the relationship between monetary matters and trade; and the status of the Deputy Managing Director in connection with the committee.

On the subject of voting, the General Counsel remarked that he would not wish to go into the matter in depth unless serious consideration were given to voting in the committee. Two Executive Directors had expressed some doubt about at least one of the legal conclusions in SM/72/62; the staff had reconsidered the matter and believed that the conclusions could even be strengthened. There were, however, three comments that he would like to make. First, the question of voting in the committee was a matter of the political rights of members of the Fund. He would himself be inclined to tread warily in coming to a conclusion that the prescription of voting was permissible. It would not be wise to assume from the silence of the Articles on the question of voting in committees that members had assented to it. That was a view which he would have great difficulty in accepting. Second, there was no way in which the proposed committee could be given the power to take decisions; that power was at present vested in the organs of the Fund, and the committee could not trespass on their provinces. Third, while voting was conceivable in theory for expressing views or making recommendations without conferring on the committee the power to take decisions, the question would arise whether there was any implied power for the committee to vote for such purposes. That would raise the question of the necessity for voting, both as a legal and as a practical matter. A distinction should also be made between the implied power to establish the committee, and the implied power to vote. In that connection, necessity played a role. The need to appoint a relatively small committee as the Board of Governors became larger was fairly readily discernible; that did not necessarily lead to the conclusion that there was a need for voting in that committee. As a practical matter, any report would show the positions of all the members and anyone could make his own calculations fairly quickly. It would be difficult to sustain an argument that voting was necessary and therefore that the implied power to vote existed.

As to the relationship with trade matters, the General Counsel remarked that there were references to trade in the existing Articles. Article I, paragraphs (ii) and (iv) referred to trade and Article XIV referred to "commercial arrangements." The drafters of the present Articles had certainly recognized that there could be no complete divorce between trade and monetary matters. In that connection, Resolution No. 7 of the Bretton Woods Conference had clearly implied that the purposes and objectives stated in the Articles could not be achieved through the instrumentality of the Fund alone. Hence, there had been a recognition not only that the purposes of the Fund did involve an element of trade, but also that those purposes could not be carried out without a separate institution dealing with trade. Moreover, on July 21, 1944 after agreement had been reached on the Articles, a press release on the purposes of the Fund had made a distinction between those purposes and the methods to be adopted by the Fund. In dealing with those methods, the press release had said in part: "The greater part of the proposed agreement deals with the methods devised for the purpose of encouraging world trade. The principal method is the restoration of exchange stability." Hence, it seemed clear that the Fund was not intended to have jurisdiction in the trade field. The whole issue had been examined in a paper dated 1959 and the conclusion there reached had been that "the Fund does have authority in pursuing its purposes to consider and comment on trade policies and trade practices of its members," although that authority had not been of the same jurisdictional character as the authority conferred by the Articles in relation to what had been called the "method" of the Fund in the 1944 press release. For instance, the Fund did not have power to approve or disapprove of trade practices or trade policies, although it was involved in the consideration thereof.

So far as the terms of reference of the proposed committee were concerned, the General Counsel went on, the conclusion could be that if the terms of reference were defined so as to lie within the scope of the present Articles, the committee could consider and comment on aspects of trade policy insofar as they had a bearing on monetary matters. However, its powers would be limited, it could for instance probably not make proposals of a jurisdictional character under those terms of reference. Ultimately, the question would have to be settled as a matter of judgment and tact.

In what he had said hitherto, the General Counsel explained, he had assumed that the activities of the committee were to be related fairly closely to the existing Articles. However, there might of course be proposals to amend the Articles to go beyond their present scope in relation to trade matters. For instance, there could be proposals to increase the Fund's duties of coordination with trade organizations, or even to give it some jurisdictional powers in trade matters. If that were so, it would be difficult to argue that the consideration of any amendment was beyond the purview of the Fund. The Board of Governors was called upon to approve amendments as a necessary stage in the amendment process. And Article XVII simply referred to amendment in general, without defining any classes of amendment. Hence, it seemed unlikely that a committee would be automatically debarred from examining trade questions, if those questions took the form of proposed amendments of the Articles. Such a view did not indicate in any way the action that the committee could take on those questions. It might, for instance, invite experts to give testimony; it could co-opt experts; or it could collaborate with other bodies of organizations working in the field.

Two conclusions could be drawn from what he had said, the General Counsel considered. First, the terms of reference, whatever they might be, should include some reference to amendments of the Articles. Second, the committee itself should have a residual, though not necessarily a narrow, power to determine its own procedures. If those two steps were taken, the committee would have sufficient leeway to deal with any issues that might arise.

Finally, there was the question of the status of the Deputy Managing Director in relation to any committee, the General Counsel recalled. His status in relation to a committee of the Board of Governors would have to be defined in the same way as his status in relation to the Executive Directors themselves had been defined in the Rules and Regulations. It seemed that the Deputy Managing Director was not automatically the alter ego of the Managing Director in all matters.

The Chairman commented on the role of the Managing Director. SM/72/21 had provided that the Managing Director would be a member of the committee as a principal. However, as far as the chairmanship was concerned, the idea in the staff paper had been that the chairman would be elected by members of the committee, and would be one of the Governors or Ministers. Some Executive Directors had wondered whether it would not be better to have a nonpolitical chairman, or whether the Managing Director should not be chairman ex officio. He was himself not convinced that that would be a very good idea, even leaving matters of protocol aside. In his view, he should participate as Managing Director and Chairman of the Executive Board because the committee of Governors would certainly work on the basis of proposals put forward by the Executive Directors. It would be easier for the Managing Director to represent the Executive Board and the views of the Executive Directors if he did not at the same time have to be an impartial committee chairman. Naturally, that was one of the questions that would have to be decided in the resolution or the relevant by-law, but he thought that the Executive Directors should have his preliminary reaction.

In conclusion, the Chairman remarked that the staff could work on a further revision of SM/72/21 that would narrow down some of the main issues, while still showing variants. The revised paper could probably be available by mid-April.

The Executive Directors concluded for the time being their Seminar discussion of a Special Committee of the Board of Governors.

2. REFORM OF THE INTERNATIONAL MONETARY SYSTEM - A SKETCH OF ITS SCOPE AND CONTENT

The Executive Directors continued from Seminar 72/7 (3/10/72) their consideration of the Reform of the International Monetary System - A Sketch of its Scope and Content (SM/72/56, 3/7/72).

The Chairman invited Executive Directors to address themselves to the general picture and to the relative importance to be attached to each of the five components of the reform set out in the staff paper. While it would of course be in order to discuss individual components, a separate meeting had been scheduled to consider two items, namely, symmetrical intervention and the numeraire. The last section of SM/72/56 dealt with the relation between the international monetary system and development finance, commonly called the "link." The questions concerned in that section were likely to be actively considered at the forthcoming meeting of the Group of 24 in Caracas, and at the subsequent UNCTAD meeting in Santiago, Chile. He himself would be going to Caracas, and it would be helpful to him if Executive Directors would express their views on the subject, which was one on which he would certainly be asked questions. It had been mentioned in the Annual Report for 1971 that the Fund was continuing to study the question; now was the appropriate time to exchange views, if at all possible.

Mr. Lieftinck remarked that he would have preferred to reserve his comments on the international monetary system and development finance to a later date. However, although it was only a part of the whole set of problems, it was an important one. The Economic Counsellor had stated that the reform might involve a number of aspects which, taken by themselves, might be seen by developing countries as potentially disadvantageous to them. As examples, he had cited the effect of the replacement of holdings of reserve currencies by SDRs on countries with large reserves, and the effect of the increase of the SDR interest rate on countries with low reserves. Without discussing those two specific points, he would observe that, like the realignment of currencies that had taken place at the end of 1971, the reform of the international monetary system and of the Fund might have a different impact on individual members or groups of members. The proper approach would be to try to find solutions to the existing problems, and that could only be done by putting forward a package of measures which were on the whole sufficiently beneficial to the whole membership and to the various groups to be acceptable. Nevertheless, it was most important to consider whether it would be feasible or desirable, as part of the reform of the international monetary system and of the Fund, to introduce certain elements, and particularly certain Fund facilities, that would be of special benefit to the developing countries. That was certainly a legitimate proposal, and he well understood the desire of the developing countries to obtain, not just equal benefits, but more benefits than would accrue to the developed countries from a reform of the system.

On Page 17 of SM/72/56, Mr. Lieftinck went on, the Economic Counsellor had put forward a number of suggestions for relating the international monetary system to development finance. Each of those suggestions would have to be carefully explored. The link had already been considered by Executive Directors. The issues had been reviewed, but a detailed staff study had not yet been made available. Nor had the topic yet been discussed within the context of a reform of the international monetary system. However, the time was perhaps approaching when it would be reasonable to do so. It might well be that other and better solutions could be found than the organic link as currently understood. His personal view was that the Fund should be very cautious in entering the field of providing development finance. At the present time he did not favor the deliberate association of the Fund with the provision of development finance, mainly because it was not the Fund's proper function and to enter that field might harm its credibility as a monetary institution. However, what should be considered within the context of a reform of the international monetary system and of the Fund was the more equitable and more useful distribution of the Fund's facilities among member countries, taking into consideration their particular needs and desires, especially those of the developing countries.

The Fund had taken some steps in that direction in the past by quota reviews, by the introduction of special facilities for the compensation of export shortfalls, and assistance in connection with commodity agreements, Mr. Lieftinck recalled. However, that was not enough. The time had come in particular to reconsider the distribution of quotas, which were still based on the revised Bretton Woods formula. One of the main criticisms of the present allocation of special drawing rights was that it was made on the basis of existing quotas. In those circumstances, there were two possible courses of action: either to allocate special drawing rights not in accordance with existing quotas, or to revise the existing formula for quota distribution. To allocate special drawing rights not in accordance with the existing quota distribution would be very difficult, as it would be almost impossible to find an equitable new formula. Hence, he believed that special drawing rights should be distributed on the basis of quotas. Nevertheless, Executive Directors should turn their attention to a revision of the formula for quotas. The end result could be a substantial improvement in the availability of Fund facilities, both in the General Account and in the Special Drawing Account, to the developing countries.

One of the weaknesses of the system of quota distribution was that quota adjustments were always retrospective, Mr. Lieftinck observed, although they served as the basis for access to the Fund's facilities for the coming five years. Not only were they retrospective, but they were based on historical and often outdated figures. Quota adjustments should be made prospective, and they should be based on projections of growth. It might even be possible to base them on desired growth rates. Such a proposal would mean accepting larger quota adjustments for the developing countries than for the developed countries. For instance, the the desirable growth rate in the developing countries might be put at 6 per cent per year, while that for intermediate countries might be 5 per cent and that for developed countries 4 per cent per year.

Another criticism of the distribution of quotas, Mr. Lieftinck remarked, was the fact that the Bretton Woods formula gave weight to the amount of reserves held by countries at the time that they became members. He wondered whether that factor should not be eliminated if special drawing rights were to be allocated on the basis of quotas, if only because the effect appeared to be cumulative. If special drawing rights were allocated on the basis of quotas, and quotas were determined in part on the basis of reserves, a country would in effect be obtaining a larger increment to its reserves in the form of special drawing rights merely because it already had larger reserves to start with. Another way of improving the position of the developing countries might perhaps be to increase the basic quotas, or to agree to selective quota increases. Whatever was done in that particular field, quota distribution had the advantage of being related to the true functions of the Fund and of affecting the resources available to developing countries both in the General Account and in the Special Drawing Account.

So far as the reform of the Fund with reference to special drawing rights was concerned, Mr. Lieftinck considered that the position of the developing countries would be improved in particular if the definition of "Other Holders" could be enlarged to open the way for an inorganic link with countries that did not feel the need for increasing their reserves by means of additional allocations of special drawing rights. Those countries could then transfer special drawing rights freely and by their own decision to other holders, which might for instance be development institutions. Moreover, the reconstitution provisions reduced the usefulness of SDR allocations in general, but particularly for the developing countries. His list of possible improvements was surely incomplete; the Executive Directors should give full attention to whatever possibilities could be found within the framework of a reform of the international monetary system to meet the legitimate needs and desires of the developing countries, provided that their action did not undermine the sound functioning of the Fund.

Speaking on behalf of Mr. Palamenghi-Crispi, Mr. Bustelo said that he very much agreed with the central characteristics of the future international monetary system outlined by the Economic Counsellor, meaning in particular the introduction of greater exchange rate flexibility and a much reduced role for reserve currencies. One point that had emerged very clearly from the 1970 report on the Role of Exchange Rates in the Adjustment of International Payments was that it was not so much that the Bretton Woods system was stifling with regard to changes in parities, as that countries deliberately chose to act in a manner that caused disequilibria to occur, with all the well-known difficulties of the past ten years. Consequently, to argue in favor of new Articles that would allow for greater exchange rate flexibility was not sufficient per se. What was needed in addition was some sort of criterion that would both make it possible to define what the Economic Counsellor had called "equilibrium zones" and encourage countries to stay within such zones. While it might be too early to try to define the zones in detail, without some such approach little headway would be made toward encouraging greater use of the exchange rate mechanism.

An important question which arose in connection with the issue of a consolidation facility was the extent to which it was linked with convertibility of the dollar, Mr. Bustelo continued. Consolidation was an important precondition for achieving convertibility in that it was not possible to conceive of the U.S. dollar being convertible while the present overhang of dollar balances persisted. Once those balances had been consolidated and the parity changes of 1971 had begun to have some effect, it might be possible to consider how to achieve convertibility of the U.S. dollar, without which the balance of payments adjustment process would continue to be asymmetrical. He himself favored some sort of "Fund-guided" convertibility, the details of which were perhaps still unimportant.

Mr. Palamenghi-Crispi agreed with the Economic Counsellor on the desirability of having only one kind of special drawing right in the future system, Mr. Bustelo went on. On the other hand, it was worth considering whether interest should be paid on holdings above cumulative allocations, or whether it should be paid simply on SDR balances, as it was on dollar balances. Only the second approach would encourage countries to participate in a consolidation scheme. Interest on SDR balances could well be paid by writing up a country's SDR balances at an appropriate market rate of interest. The other restrictive characteristic of the SDR scheme would have to be thoroughly re-examined in view of the substantially different role that special drawing rights would play in future, compared to that originally envisaged for them. A market rate of interest on special drawing rights would not damage the less developed countries insofar as their SDR balances replaced dollar balances; it would of course be disadvantageous if they were to use the special drawing rights allocated to them. The introduction of a link between SDR creation and the financing of development agencies would be one way of offsetting the additional cost of having a market rate of interest on special drawing rights. Another way would be for the Fund to channel to development agencies some part of the interest paid by the United States on the dollar balances that would accrue to the Fund through the consolidation scheme.

Mr. Beaurain said that he would offer comments on SM/72/56 reflecting the initial reaction of his authorities. He would, however, have to start by indicating that they doubted whether the so-called "seminar formula" was desirable. It seemed to them that the Executive Board was not yet in a position to prepare a broad and fundamental reform of the system, if only because a sufficient consensus did not yet exist on many important issues. If seminars of the type now being held were to give support to the idea that such a consensus already existed, or that notions such as the inconvertibility of the dollar--to which several members objected--had already been accepted by the Executive Board, his authorities would wish to see the seminar formula dropped.

Turning to the contents of SM/72/56, Mr. Beaurain discussed the major reform components one by one. In section 1 the French authorities agreed with the idea that parity changes should be more frequent than in the past and that they should be decided upon before the peak of a crisis had been reached. Naturally, if that were to be the normal rule of conduct in the future, it should apply to all members without exception. The Economic Counsellor had, however, moved on to establish a link between the need for quicker parity adjustments and the desirability of a permanent regime of wider margins, and that point seemed most debatable. If the basic assumption that the par value system should be maintained was correct, margins should be rather narrow. Margins of 2 1/4 per cent on either side of parity or a central rate were to be considered as an absolute maximum, justified temporarily by exceptional circumstances, but it was to be hoped that the figure could be reduced for a permanent regime. Some parts of section 1 seemed to imply that the Fund would play an increased role in the functioning of the exchange rate mechanism. The French authorities believed that the Fund should not have such a determinant role in individual parity changes, which remained a primary responsibility of the country concerned. Moreover, it might be a sign of overconfidence to believe that the Fund could not only agree on disciplinary rules in the exchange rate field but also enforce them. Present experience could not but give rise to some skepticism in that connection. It was for similar reasons that he found the kind of dilemma mentioned in the fourth paragraph on page 5 of SM/72/56 to be rather illusory.

Dealing with the Economic Counsellor's comment regarding the continued use of the adjective "fundamental" in connection with disequilibria, Mr. Beaurain stressed once again the importance that the French authorities attached to the concept of fundamental disequilibrium, especially as it was increasingly necessary to distinguish between current transactions and capital movements as sources of balance of payments difficulties. It was clear to them that a country should not be obliged to revalue its currency simply because of an inflow of short-term capital if at the same time its competitive trading position did not justify such action. Capital controls, including the dual market mechanism, rather than exchange rate manipulations, were the appropriate remedy for destabilizing capital flows, both inward and outward.

On the subject of consolidation, Mr. Beaurain recalled that the French authorities believed that the consolidation of official holdings of reserve currencies was likely to be necessary if some measure of safety were to be introduced into the future international monetary system. However, consolidation should be limited to no more than a part of the outstanding balances, and the arrangement should provide for a detailed schedule of amortization spread over whatever period of time might prove necessary. The purpose was to ensure that consolidation should not be wholly in favor of debtor countries, even if it was offset by an increase in the external assets of creditor countries; it should be a simple rescheduling of debts. Furthermore, consolidation should clearly not be applied to new additional balances. Nor should it necessarily take the form of special issues of special drawing rights, as some consolidation might accrue from bilateral agreements between creditor and debtor countries.

Dealing with the section of SM/72/56 referring to the financing of balance of payments deficits and surpluses of reserve centers, Mr. Beaurain expressed very strong reservations against the idea that convertibility of the dollar was sufficiently ensured by the exchange market mechanism. Formerly, the convertibility of the dollar into gold was offset for the United States by exemption from the need to defend the par value of the U.S. dollar on its territory. At the present day, the United States was still exempt from the need to defend its currency, while the U.S. dollar was no longer convertible into gold. If dollar convertibility was not to be restored, the United States should clearly be obliged to intervene in the exchange market like other countries. The proposal for symmetrical multicurrency intervention on page 8 of SM/72/56 made a great deal of sense in that connection.

Continuing, Mr. Beaurain said that he could not accept the idea that once all holdings of reserve currencies had been consolidated, the former reserve centers should be in a position to acquire net reserve assets equal to the surpluses of their balance of payments. In the same way as they opposed full consolidation, they considered that part of the surpluses should be used to redeem some of the remaining balances not covered by the consolidation arrangements. Finally, no mechanism should be envisaged that might lead in any way to some kind of permanent consolidation of additional balances resulting from further deficits of the former reserve centers.

Discussing section 4 on page 8 of SM/72/56, Mr. Beaurain remarked that a symmetrical multicurrency intervention system was most interesting, especially because it would apply the same kind of obligation to all members without exception. However, his authorities did not believe that a system in which each member country would be entirely free to choose its own system of intervention would be wholly satisfactory. They wondered whether it would not be better for the Fund both to prescribe and enforce some kind of rule that would state quite unambiguously that any country whose currency was offered in net terms would support that currency at its lower level. However, he would keep further comments for the future discussion which he understood was to be held on that subject.

On the topic of gold, Mr. Beaurain was pleased to note that a more realistic attitude had finally been adopted by the staff. It had indeed been unrealistic to think that gold could be replaced by special drawing rights, and he congratulated the Economic Counsellor on the change of stand represented by the words on page 13 of SM/72/56.

With reference to the rate of interest on special drawing rights and other changes in the drawing rights system, Mr. Beaurain remarked that as long as the future of special drawing rights remained as imprecise as it was at the present time, debates on possible changes in the system were of no interest. Naturally, if it were decided to change special drawing rights into something else, it would be necessary to review every aspect of the scheme; but it was precisely on what special drawing rights should be that there was no consensus. As to the so-called "link" between special drawing rights and development finance, it was clear that consideration of the technical aspects should not take place before the discussion on the purposes of the link, which would undoubtedly be held in other forums. However, the mere creation of international liquidity in the form of special drawing rights should assist in maintaining and increasing public efforts by developed countries in favor of developing ones. It was in that spirit that his authorities were prepared to accept the creation of a link between special drawing rights and development finance, which should be devised in such a way that its most immediate effect would be to encourage donor countries that had not yet reached their aid targets to do so.

Mr. Prasad said that he would limit his comments to the link between special drawing rights and development finance, and to consolidation and its impact on the link. In the first place, he welcomed Mr. Lieftinck's statement to the effect that it might be well to review the relationship between quotas and the situation of the developing countries. That topic was one that had been suggested for discussion by the Group of Ministers that was to meet in Caracas, Venezuela, shortly. So far as the Fund was concerned, he hoped that Executive Directors would be able fairly soon to examine the proposals. In general, the distribution of quotas between the developing countries and the developed countries was sadly out of balance in terms of the real needs of the two groups. Anything that could be done to rectify the situation would certainly be a step in the light direction.

With respect to consolidation, Mr. Prasad considered it doubtful whether it was necessary to arrange for the holders of the consolidated currencies to receive an immediately usable asset. He doubted whether all the assets held in dollar form by developed countries were considered as immediately available for use. It might be better to talk in terms of assets that were likely to be needed for use, leaving the remainder to be settled between the country that had given rise to the outstanding balances and the countries that had accepted them. In putting forward that proposal he had in mind the situation of the United Kingdom following World War II. The very large outstanding sterling balances were run down over a period of time by establishing two separate accounts, the so-called No. 1 Account and the No. 2 Account. The No. 1 Account had consisted of convertible sterling, and the No. 2 Account only of sterling that was convertible over period of time; the balances were eventually run down with assistance from the United States, the Fund, other central banks, and so forth. He had therefore been considering whether it would not be possible to think in terms of consolidating the dollar overhang in two stages. In the first stage, dollars would be consolidated to the extent that the holders would need to use them fairly shortly; while the remainder would be consolidated by bilateral or multilateral arrangement between the United States and dollar holders, or even between third countries. His proposal was given more force by the fact mentioned by the Economic Counsellor, namely, that reserves tended to accumulate in certain areas, and thus not to be available where they were more urgently needed in the developing countries. He feared that the consolidation arrangements proposed by the Economic Counsellor would directly aggravate the situation, a possibility that had been recognized by the Economic Counsellor himself.

Moreover, Mr. Prasad mentioned, while the U.S. dollar had become somewhat unattractive to certain countries, it might still be very acceptable to others. Hence, it might be worth considering whether, after a portion of the dollar overhang had been consolidated to provide immediately usable reserves needed by the developing countries, the remainder could not be made available also to the developing countries in such a way that those countries could use them either to create additional demand for dollar-based goods, or to purchase goods through third countries. The aim would be to shift some of the surplus dollars from the reserves of the developed countries into development financing for third countries, thus to some extent reducing the constraints on the dollar.

Dealing with the Economic Counsellor's point that raising the interest rate on special drawing rights might adversely affect developing countries, Mr. Prasad said that he was willing to accept the point that at some stage special drawing rights would have to carry interest at a rate rather higher than the present one. On the other hand, a bolder step toward the creation of a link between special drawing rights and development finance might not be so disastrous as it could appear at first sight. Ultimately, the desirability of the international system was as much related to an expansion of trade as it was to stability in the existing pattern. If that growth had to be stimulated, some kind of link, both organic and inorganic, between the monetary system and development finance could not be avoided. Naturally, the allocation of special drawing rights for development purposes could have to be organized through efficient channels. One of those channels would certainly be the allocation of special drawing rights to development institutions such as the IBRD, the regional development banks, and others already in existence, which had efficient systems for channelling funds into suitable development projects. In those circumstances, action by the Fund to make available prudently calculated amounts of finance to the developing countries might not be as risky as it seemed at first sight. He hoped that those avenues might be explored without the feeling that too much risk was being incurred either by the Fund or by the individual members.

Mr. Schleiminger considered that the time had certainly come for the Executive Directors themselves to try to put flesh on the bones of what was after all a skeleton scheme presented by the staff in SM/72/56. In that connection, he found the seminar discussions extremely useful, and hoped that they would continue. Naturally, all that the Executive Directors could do was to explore the ground as fully as they were able; he agreed with Mr. Beaurain that any decision making would have to be left for the political level. Nevertheless, very careful preparation was required, and that the Executive Directors could undertake.

Turning to the section dealing with the exchange rate mechanism, Mr. Schleiminger noted with satisfaction the statement by the staff that the reform in the exchange rate mechanism would have to be more fundamental than had generally been envisaged at the time of the 1970 report. Some Executive Directors had of course taken exactly that view during the discussions on the 1970 report, but he was glad that they were taking a fresh look at the whole situation, starting the following week with the discussion of DM/72/18, The Exchange Rate Mechanism, An Analysis and a Possible Scheme. He hoped that certain interim results of that discussion could find their way into a more elaborate version of SM/72/56.

Any amendment of the Articles, Mr. Schleiminger considered, should give greater weight to defining member countries' obligation to declare and maintain realistic rates of exchange. He felt very much as Mr. Palamenghi-Crispi had done regarding the need to obtain more refined criteria for the fulfillment of that task. It would also be necessary to decide what action by the Fund would be useful in seeing that the objectives were met. Finally, the concept of fundamental disequilibrium, to which Mr. Beaurain had referred, would have to be reviewed. Naturally, some ground would have to be covered that had been covered already, but at least the Executive Directors would have the advantage of hindsight following the events of 1971.

As to consolidation, Mr. Schleiminger remarked that he would have preferred to see the section on financing of balance of payments deficits and surpluses come before that on consolidation. Consolidation was, after all, a supplementary matter, not an end in itself. While the subject was of the greatest interest it was no more than complementary to the financing of balances; in a later version of the sketch, that might be indicated by reversing the order of presentation. As to the form of consolidation, he had been rather surprised to see that the staff offered no intermediate solution between bilateral funding on the one hand and a special allocation of special drawing rights on the other. In any event, it would be interesting to hear what views the Economic Counsellor had regarding the form of bilateral funding that might fit into a reform program as a whole, even if his own interest in bilateral funding was rather platonic for the time being.

Naturally, the desire of the United States to receive primary reserve assets if the United States developed payments surpluses in future, to which he was rather sympathetic, could be met in many ways, quite apart from an allocation of special drawing rights, Mr. Schleiminger observed. For instance, the United States could receive a claim similar to that arising under the General Arrangements to Borrow or a gold tranche holding. The staff appeared to consider that consolidation should be obligatory. While it might be true that if there were consolidation it should be binding on all, it was by no means certain that such an arrangement was the only possible one, or indeed that it would be the most politically acceptable. Regarding Mr. Prasad's point that there were a number of willing dollar holders in the world who might be prepared to receive dollars if others considered them a less valuable asset, he was not certain that Mr. Prasad's corollary, that the dollars could then be used for providing aid to developing countries would work very satisfactorily. His own feeling was that the recipient countries would be likely to return the dollars to their starting place, thus simply increasing the rate of international inflation, unless of course it were laid down that they should be used only for purchases within the United States. Some surplus countries had indeed given considerable thought to the concept of a negative tying of aid, but he believed that it was a rather artificial device. It seemed likely to lead to considerable distortions in the flow of international trade, and it might even be considered a multiple currency practice.

The future financing of balance of payments balances Mr. Schleiminger considered to be the heart of the reform exercise. The crux of the matter was that the staff proposals would require annual or quarterly compulsory conversion by the reserve center of any increase in balances of its currency that might arise from its overall payments deficits. While that sounded quite straightforward, it would be difficult to translate the proposal into complete settlement arrangements. It might, of course, be fairly simple to deal with U.S. surpluses, which would take the form of a reduction of liabilities--that would have to be more closely defined--and the receipt of primary reserves of whatever kind might be thought appropriate. However, there might be shifts between official and private liabilities and the decision as to whether those should give rise to settlements or not might be quite difficult in itself. The position would, moreover, become more complicated in the event of U.S. deficits, which were the most likely outcome in the near future. Such deficits would represent an increase in liabilities for the United States, but it would be difficult to ascertain precisely which countries held the corresponding claims, because some increases in dollar liabilities might be the consequence of shifts between various non-dollar countries, while other such increases might originate with a genuine U.S. deficit.

Some settlement arrangements would probably be necessary regardless of the nature of the reforms finally accepted, Mr. Schleiminger considered. Having had experience with the European Payments Union, he was by no means frightened of the technical implications, but it was certain that the single sentence in the Economic Counsellor's paper would give rise to a whole set of mechanical arrangements, to which consideration should be given early in the whole process. He himself had a strong preference for the settlements being on a multilateral basis. The staff had apparently envisaged a bilateral settlement arrangement under the administration of the Fund. He would not like to see such a proposal adopted; it was something from the past that ought not to be revived.

The financing of balances could be implemented in stages, Mr. Schleiminger remarked, although the Economic Counsellor had apparently preferred to make a clean sweep, perhaps in order to see how the various components of the new system could be fitted together. His own views were nearer to those expressed by the Economic Counsellor himself in EBS/71/299, in which it had been suggested that parts of the reform would be implemented earlier than others. Similarly, in that paper the Economic Counsellor had suggested that perhaps any future deficit of the reserve center could be financed partly in reserve assets and partly in dollars, with the percentage paid in reserve assets rising gradually to 100 per cent. It might be as well in any future version of the sketch to avoid giving the impression that all the changes proposed would be introduced on a single "D-day."

As to the adjustment process, Mr. Schleiminger regretted that it appeared to have received what he might call "lukewarm treatment" from the Economic Counsellor on the present occasion. He understood the theory that the adjustment process was never complete, but he thought that the introduction of the reform might be an opportunity to re-examine the process and to consider the introduction of certain behavioral rules, of which his chair had always been a strong supporter.

As the Chairman had invited Executive Directors to exchange views on the link, he would make a number of preliminary comments, which would come close to those expressed by Mr. Lieftinck earlier, Mr. Schleiminger explained. At Seminar 72/7 he had inquired why so little reference had been made by the Economic Counsellor to the General Account, because he had thought that some modifications therein might go far toward meeting certain desires of the less developed countries. Like Mr. Lieftinck, he had thought that by adjusting the General Account and the quota structure it should be possible to give the less developed countries greater access to the Fund's traditional resources. By the same device, the allocation structure for SDRs would be altered in a logical fashion and voting rights would be adjusted. Hence, the General Account might be an even better starting point for strengthening development finance than the special drawing rights. He had never had much liking for the link in its original rather crude form, whether organic or inorganic, because if special drawing rights were to be the instrument of reform and further evolution of the system, it was most important that they should not be used for purposes which would necessarily be incompatible with that purpose. Also like Mr. Lieftinck, while he had originally been inclined to think that development finance should be a separate issue, he had come to the conclusion that it properly belonged to the reform of the system.

The discussion of reform had, for instance, shown that the link was certainly not the only method of introducing new forms of development finance, Mr. Schleiminger considered. In any event the full scope of those new instruments should be examined, something which could only be undertaken as part of the discussion on reform. The more that the Bretton Woods system was examined, the more alternatives to the original proposal for tackling development finance through special drawing rights and future SDR allocations seemed to come to light. In conclusion, it was interesting to reflect that in the few months during which reform had been discussed, the Economic Counsellor had been able to list four possible techniques, which were not to his mind exclusive, and he wished particularly to demonstrate his interest in Mr. Lieftinck's proposal with respect to quotas and the examination of the General Account as an instrument for development finance.

Mr. Prasad commented that, while he shared Mr. Schleiminger's misgivings about his proposal for the use of overhang dollars, he was hopeful that if the device were examined with care, at least the elements of a solution might be discovered. It was certainly true that if the dollars ended up where they had started, the result would be disadvantageous. However, it was not inevitable that they should do so. For instance, there was a substantial volume of trade between many of the developing countries themselves, and additional financial assistance might open up still further avenues for exchange which could not now be used for lack of liquid funds. Moreover, there must be ways of preventing dollars from ending up where they started--for example, by placing them in a "No. 2 Account" if the United States would accept such a classification--and there could be a limitation on the extent to which aid was tied. From the standpoint of the developing countries, dollar aid was less unattractive than tied aid. The disadvantage to certain developed countries whose relations with developing countries would be altered by the proposal would surely only be temporary, and would in any event not be large. The proposal should not only assist the developing countries in expanding their trade but also in redressing the balance of payments deficit of the United States, though perhaps only to a small extent. There were therefore in his view sufficient merits in the proposal to argue against it being discarded without further discussion. After all, when the idea of using local currencies accumulated by the United States through PL 480 and other forms of aid for assistance to developing countries had first emerged, there had been a great deal of scoffing. Nevertheless, many countries had derived substantial benefit from the channelling of funds made available in that way into agricultural and other forms of development. He would therefore be interested in sitting down with the staff and looking into ways of absorbing the dollar overhang which would at the same time assist the developing countries.

Mr. Kafka, before entering into the substance of SM/72/56, noted that the Economic Counsellor had expressed the fear that there was a risk that an unplanned new system would come into existence, probably one that would involve the separation of the world into a number of currency blocs. He believed that the world would in fact sooner or later split into such blocs; the real problem was to determine how those blocs would come about and what their nature would be.

Turning to the substance of the paper itself, Mr. Kafka agreed with Mr. Schleiminger that attention would have to be devoted particularly to the adjustment process. One thought that had occurred to him was that the more frequent or the prompter parity changes were, the less necessary would wider margins become because the scope for profitable speculation would be reduced. He had certainly to agree with Mr. Beaurain that if the parity system were to be preserved, margins that were nominally 2.25 per cent on either side of par and which in practice might be much more could not be entertained for long. In addition, ideally countries would have to accept more detailed obligations as to when to alter their exchange rates. He had, however, certain doubts as to whether the Fund would be able to persuade countries to accept such criteria, or to push both surplus and deficit countries into following them. It might even be difficult to persuade different types of deficit countries to follow the criteria in the same fashion. If his doubts on those points could be overcome, he would have no objection to spelling out the criteria the staff had in mind or to making them obligatory on countries. Frankly, however, he could not imagine that such arrangements would ever be possible.

Turning to consolidation and convertibility, Mr. Kafka commented that what was needed for a proper functioning of the monetary system was to deal with the overhang of reserve currencies in such a way that they did not disturb the functioning of the system, without necessarily proceeding to complete consolidation. Rules could be introduced governing the use of currency balances rather like the SDR rules. In addition, it could be imagined that rules would be accepted regarding the proportions in which countries' primary reserve assets would have to be used in settlements, and such rules could surely work without consolidation. He himself would prefer consolidation because it would provide a neater system, but he doubted whether consolidation would work successfully unless all reserve currencies were eliminated from official holdings, a course which would imply intervention with special drawing rights. The conclusion that he would draw from his line of reasoning was that even if there were to be SDR consolidation, whether partial or total, it would be impossible to avoid having rules about the use of reserve currencies and about the proportions in which settlements were to be made in reserve currencies on the one hand and in primary assets on the other for a long time to come.

As to convertibility by reserve centers, Executive Directors should consider for what reason they wished to have convertibility in the first instance, Mr. Kafka considered. It had been said that convertibility was desirable because it would exert discipline over the reserve centers. He was himself rather skeptical about the degree of discipline that could be exerted in that way. If reserve centers wished to borrow from the rest of the world, they would find ways of doing so, although they might not be as convenient as creating reserve liabilities themselves. It was conceivable that the creation of reserve liabilities could be made less attractive by coming to an agreement with a reserve center that it should pay relatively high interest rates on its liabilities, offer purchasing power guarantees, or undertake other similar obligations. Nevertheless, the main argument for convertibility was that the less reserve currencies the world held, the more likely it was that the world would be prepared to consent to a parity change by the reserve center, Mr. Kafka observed. It should not be forgotten that the reserve center was not, and had not in the past been, in an easy position as far as parity changes were concerned. If reserve currencies could be eliminated from the reserve holdings of other countries, one of the arguments preventing countries from allowing the reserve center to change its parity would be removed. If Executive Directors wished a reserve center to finance its deficits through primary assets, they would have to give it a chance of earning those assets for itself. And if it were to be in such a position at an early stage, as he considered desirable, Executive Directors would have to consider some form of stabilization loan, as he had already mentioned on several occasions. They should give the reserve center every opportunity to earn the maximum possible amount of primary reserve assets; for that reason he was rather skeptical about Mr. Beaurain's idea that the reserve center should for some time amortize its liabilities by being paid partly in primary reserve assets and partly by a reduction of outstanding liabilities. He wondered whether Executive Directors would be prepared to meet the deflationary impact that was likely to flow from the amortization by the reserve center of any substantial amounts of its reserve liabilities.

While he would reserve discussion of multicurrency intervention to a later meeting, Mr. Kafka remarked that from the standpoint of the less developed countries such intervention had one great defect. The countries in whose currencies intervention would take place--perhaps five or fewer--would still be in a privileged position, and would still have greater ease of borrowing from other countries that had accumulated their currencies than would the developing countries. He was not certain that at a time when efforts were being made to limit the ability of one reserve center to borrow from the world, Executive Directors ought to open up greater possibilities of borrowing from the world for a limited number of developed countries.

On the subject of gold, Mr. Kafka wondered whether it would be disadvantageous if countries started selling gold in the free market, so long as the currencies earned in that way could be converted into primary reserve assets. If that were so, the fear that sales of gold might reduce international liquidity would be greatly reduced. The same would apply if the currencies earned by the sale of gold could be used for intervention purposes.

Dealing with the relationship between monetary reform and development, Mr. Kafka recalled that his chair had always been cautious in its attitude toward "the link." On the one hand, as the SDR facilities was gradually becoming rather more established than it had been previously, and if the main accruals to international liquidity were to be in special drawing rights, the arguments for caution could be reduced, and his position would approach that adopted by Mr. Beaurain. On the other hand, quite apart from any reflection on the allocation of special drawing rights and the assistance that could be provided thereby to the less developed countries, there were very strong arguments for a change in the Bretton Woods formula for quota determination. In that connection, he wished to recall the studies presented to the Executive Directors by Mr. Arriazu, who had suggested the possibility of basing quota increases not on a formula which went back to 1944, but on what had happened to the relevant variables since the latest quota increase. Such a change should prove extremely helpful to the less developed countries. Finally, he hoped that the formula for the reconstitution of special drawing rights would be reviewed because in the last analysis it had the disadvantage of making the Fund appear to create more usable special drawing rights than it actually did, and might thus frighten it out of creating enough.

Mr. Ugueto said that he would mainly examine what might be called "constitutional issues." As a starting point he would say that the staff had been overambitious in considering that the new system would function for 15 or 20 years. The Executive Directors should restrict themselves to planning the best possible system for overcoming the problems as they now saw them, but they should introduce a form of flexibility that would make it easier to change the mechanism than it had been hitherto. They should try to avoid the accumulation of rigidities, and the consequent possibility of the traumatic changes that had been experienced in the past. The establishment of central rates with wider margins following the Smithsonian Agreement of December 18, 1971 pointed to at least one very important conclusion in that field. If there was wide agreement among members on the establishment of new measures, they could be brought into effect by a body such as the Executive Board and, if they were found satisfactory, they could be incorporated into more permanent arrangements. As part of the reform of the monetary system, the Executive Directors should try to include the possibility of such transient decisions, which could be taken by any decision-making body that could be devised to implement innovations in the system as they became necessary.

Continuing, Mr. Ugueto noted that in SM/72/56 the Economic Counsellor had contemplated the possibility of lapses from the legal regime. He himself believed that in reforming the monetary system, an effort should be made to include different codes of conduct reflecting different institutional and economic problems within a single framework as a means of protecting the world community from the lapses that had occurred. As far as possible, all deviations from the Fund Articles of Agreement hitherto tolerated or even encouraged by the Fund should be incorporated into the new framework, which would then contain all acceptable codes of conduct and allow the members of the community to act in the knowledge that they had the protection of a known and generally accepted code.

One of the central purposes of the system proposed by the Economic Counsellor was the establishment of a more rational means of creating and controlling international liquidity, Mr. Ugueto considered. A much larger role was envisaged for special drawing rights, and the Economic Counsellor had proposed consolidation and symmetrical intervention as, in essence, devices for establishing discipline over the issuers of reserve currencies. If those new mechanisms were adopted, all countries alike would have to finance their disequilibria by the use of reserve assets, and all countries would be able to use the more flexible exchange rate policy that was being proposed. However, in an effort to have all the main countries adopt a similar discipline, the Economic Counsellor had introduced a possible conflict of interest which could make the proposal impractical. For instance, it seemed unrealistic to suppose that a major reserve center would adopt internal measures of adjustment in reaction to external disequilibrium if those measures were to conflict with national interests. The reserve center would be likely rather to make greater use of the exchange rate mechanism and in so doing pose difficult options for its main trading partners, which in general had a larger foreign sector in relation to the total size of the economy than the reserve center. The reserve center would then be less free to use its exchange rate policy without evoking reactions from its trading partners; and the system would either have to revert to inconvertibility or else rely on negotiated changes in par values similar to those undertaken in the Smithsonian Agreement.

At the center of the proposed reform lay greater flexibility in the operation of the exchange rate system, Mr. Ugueto went on. If the par value system was maintained, the permanent widening of margins would give less meaning to the fixed exchange rate concept hitherto adopted. His chair had consistently opposed a widening of margins, and had only reluctantly accepted the 2.25 per cent margin recently established. Experience since December 1971 did not yet show any strong evidence that the new arrangements were more equilibrating than the previous ones. He therefore believed that although a greater degree of flexibility was necessary, there was no need to widen the margins.

As the conclusions on the exchange rate mechanism set out in SM/72/56 broadly coincided with those in DM/72/18, to which Executive Directors were to turn their attention later, he would only remark on a change in the role of the Fund that appeared to be implied, Mr. Ugueto stated. DM/72/18 proposed the creation of broad equilibrium parity zones, to be established between the Fund and each member in a multilateral context. Even though he found the idea appealing, such a proposal could only be acceptable to smaller countries if they were able adequately to protect themselves from impositions made in the name of international equilibrium, which could have harmful national implications. The Fund should consider as a normal code of conduct the acceptance of a fixed exchange rate system, but a number of atypical procedures should perhaps be permitted if the economic conditions of individual members appeared to warrant them. For instance, temporary deviations from par values should be legalized in order to enable countries to protect themselves against speculative flows, to seek new parities or equilibrium zones, or even to prevent overvaluation of a national currency against those of the rest of the community. All such atypical conditions should be provided for within the system, and legislated for accordingly.

So far as consolidation was concerned, Mr. Ugueto explained that his chair was diffident of accepting any mandatory scheme that would force monetary authorities to maintain all their reserve holdings in special drawing rights. He had noted that on page 10 of SM/72/56 the Economic Counsellor had stressed the need for the main countries to be consistent in their approach to the consolidation facility, and he took that to mean that a consolidation scheme should be workable among the main countries without affecting the rest of the members. He had the same problem with multicurrency intervention. The proposal was too complex for many members of the Fund; and he noted that it was probably only intended to refer to a small group of countries with highly developed exchange markets.

The proliferation of controls on movements of capital in response to destabilizing short-term capital flows posed an unsolved problem which the Executive Directors would have to tackle, Mr. Ugueto stressed. The institution of capital controls of the sort that had recently appeared in some of the main countries, although intended more to keep money out than to prevent funds from leaving the countries, could result in difficulties in the movement of capital to less developed areas. He would therefore favor emphasizing the need to find new ways of improving the financing of capital movements. Although he would not advocate tampering with the freedom of monetary authorities to establish swap arrangements between themselves, the Fund should be provided with sufficient powers both to assist in financing capital movements and to supervise and regulate the flows of capital, even going so far as to look into the swap network.

Naturally, Mr. Ugueto stated, he agreed with the Economic Counsellor that the system would only improve to the extent that members, and especially important members, were willing to improve it. One of the fundamental points for the future would therefore be whether the more powerful members would in fact allow the Fund the authority that it would need in order to achieve a substantial improvement in the adjustment process and in the control of the growth of international liquidity.

On the subject of special drawing rights, Mr. Ugueto remarked that many of the improvements proposed in SM/72/56 were consistent with a system based on reserve currencies. On the other hand, if additional liquidity were to be provided by community-controllable instruments such as special drawing rights, the whole SDR scheme would necessarily have to be re-examined and many of the suggestions made by the Economic Counsellor for expanding the role of special drawing rights would have to be adopted. Countries were perhaps not being completely consistent in rejecting the role that reserve currencies had so far played in the system, without accepting the necessary conclusion that the role of special drawing rights would have to be enlarged and given new forms. His own position was that there should be a much enlarged role for special drawing rights, that they should take one form only, and that there should be sufficient flexibility in the rate of interest on special drawing rights to make them not only comparable to other reserve assets, but also capable of performing a regulatory role. Special drawing rights would among other things have to become the numeraire of the system, so that it would be necessary to reassess both the reconstitution provisions and the requirement of need. Finally, it would be worthwhile seeing whether an enlargement of the universe of SDR holders should not be considered. He had spoken only on broad issues; several further meetings would surely be required to deal with technical points.

Mr. Gilchrist said that his authorities were very interested in SM/72/56 as giving a fairly complete picture of what was involved in reform. They were most grateful to the Economic Counsellor; they accepted the need for a quantum jump and quite a number of the changes which that involved. There were a number of difficult questions that could be left aside; he agreed with Mr. Beaurain that demonetization of gold was one such question, and the extension of SDR holdings outside official circles could well be another. Nevertheless, it would be preferable not to create a system that might turn out to be incompatible with some of the points that might be left for discussion at a later date. It was quite true, as the Economic Counsellor had said, that if demonetization of gold were left to one side, the problem of Fund liquidity might still arise.

There were several points on which the staff had left the options open, and he would express views on two or three of those, Mr. Gilchrist went on. There had been some difference between the U.K. thinking and that of the staff on the degree of international control over increments in foreign exchange holdings, and the extent of supervision that might be needed over special drawing rights through designation and the requirement of need. Naturally, views on those matters would affect the concept of the role which the Fund might play in the new system. With reference to what the Economic Counsellor had said on page 16 of SM/72/56, the U.K. authorities would still prefer a rigid system for convertibility in which all increases in holdings of reserve currencies would be presented to the issuer for conversion into special drawing rights; if that were done, it would be possible to relax the designation procedure and to abandon the requirement of need for the use of special drawing rights. If the special drawing rights ended up in what might be termed the "wrong places," they would not be doing so because countries were making particular choices for or against holding special drawing rights. In brief, his authorities preferred an approach which would eliminate the need for multilateral settlements to be supervised by the Fund.

He would also have to differ slightly from the Economic Counsellor on the role of the Fund in the exchange rate regime, Mr. Gilchrist remarked. He was sure that his authorities would wish to give less prominence to the role of the Fund and more to international consultation as the way of initiating parity changes, even though he would not be as pessimistic as Mr. Beaurain had been. While he would certainly wish to see Fund criteria and Fund initiatives examined, it was most important to create a credible system in which it would be known that discipline could really be applied by the Fund when the need arose. It would therefore perhaps be as well to concentrate more on international consultation.

As to the convertibility obligations that might be built into the system, Mr. Gilchrist wondered whether those obligations would help to exert pressure on surplus countries; it might be that the staff paper was not positive enough about preventing surplus countries from accumulating foreign currency balances. Perhaps all the discipline that could be achieved would come from the exchange rate regime itself, but his authorities also believed that it would be essier to police the behavior of surplus countries if convertibility obligations were defined in a way in which all increases in holdings of reserve currencies would be presented to the issuer for conversion into special drawing rights. If that were done, it would be possible to relax the designation procedure and to abandon the requirement of need for the use of special drawing rights. If the special drawing rights ended up in what might be termed the "wrong places," they would not be doing so because countries were making particular choices for or against holdings of special drawing rights. In brief, his authorities preferred an approach which would eliminate the need for multilateral settlements to be supervised by the Fund.

He would also have to differ slightly from the Economic Counsellor on the role of the Fund in the exchange rate regime, Mr. Gilchrist remarked. He was sure that his authorities would wish to give less prominence to the role of the Fund and more to international consultation as the way of initiating parity changes, even though he would not be as pessimistic as Mr. Beaurain had been. While he would certainly wish to see Fund criteria and Fund initiatives examined, it was most important to create a credible system in which it would be known that discipline could really be applied by the Fund when the need arose. It would therefore perhaps be as well to concentrate more on international consultation than on the role of the Fund itself.

As to the convertibility obligations that might be built into the system, Mr. Gilchrist wondered whether those obligations would help to exert pressure on surplus countries; it might be that the staff paper was not positive enough about preventing surplus countries from accumulating foreign currency balances. Perhaps all the discipline that could be achieved would come from the exchange rate regime itself, and that was something on which comparatively little work had so far been done. His authorities also believed that it would be easier to police the behavior of surplus countries if convertibility obligations were defined in a bilateral rather than a multilateral manner. Not only would deficit countries be required to provide reserve assets against their own currencies, but countries accumulating currencies would be required to convert them into reserve assets, so that the obligation would be two-sided.

On the subject of special drawing rights, Mr. Gilchrist noted that the question of whether they could be made more attractive by using part of newly created special drawing rights to pay some of the interest on SDR holdings before allocating the remainder was a point of rather refined detail. That would mean that the SDR scheme would no longer be paying for itself since the use of special drawing rights would not counterbalance their acquisition by others, and interest would have to be created. His authorities were not altogether happy with such an arrangement; their main worry was that any general commitment of that sort to pay interest on all outstanding holdings would not mesh very well with the need to control the growth of international liquidity. There might for instance be times when for general reasons it was considered inappropriate to increase world liquidity, and yet a fairly large number of new special drawing rights would have to be created purely for the sake of paying interest. In general, however, his aims were the same as the Economic Counsellor's in the whole exercise, and he was most satisfied with SM/72/56.

As to the so-called "link," Mr. Gilchrist remarked that he thought ideas were still being assembled and explored. His authorities had for long favored a detailed study of the subject, provided that it would be thorough and comprehensive. Only once they had seen it would they wish to make up their minds, although they had some sympathy with the general idea. Personally, he had the same type of anxiety as Mr. Lieftinck that the Fund might be ill advised to enter the development financing field at all. One possibility that should not be ruled out was that the Executive Directors should decide collectively not to involve the international monetary system in matters connected with aid; there were surely other possibilities outside their sphere. For instance, a 5 per cent income tax in all developed countries would enable contributions to be made to the proper aid organizations such as the IDA. Those were political matters, which did not necessarily have to affect the reform of the international monetary system. As to whether the link was associated with the question of reform, his own view was that it had little to do with the topic and should therefore be considered as only marginal to the present discussions. It did not necessarily have to affect their choice of ingredients in the reform.

Mr. Bryce commented that while symmetrical intervention was intellectually attractive and interesting, and there was doubtless sufficient talent to solve the technical problems, it was nevertheless at the present time a snare and a delusion because it greatly increased the volume of assets that would be needed by the United States to take part in an asset settlement system. If the United States were to be compelled to intervene in the market in the presence of the existing dollar overhang, it was likely to wish to have at least three times the volume of assets that it now possessed. Consequently, if symmetry were to be adopted for the reasons given by Executive Directors, and he did not find them very convincing, the introduction of the new system would have to be put off for many years. He himself did not believe that Executive Directors would wish to pay so heavy a price merely for the sake of symmetry. It seemed unlikely that there would be any interim system between that worked out on December 18, 1971 and the new system; hence, if symmetrical intervention were to be insisted upon, the United States would remain in the "diver's seat" longer than many would wish.

The chief weakness of SM/72/56 was that it did not provide any means for enabling the United States to obtain more assets in an asset settlement system than it could earn, Mr. Bryce considered. Most members had exhibited some reluctance to assist the United States in accumulating reserve assets as rapidly as the U.S. authorities wished to acquire them, and he did not believe that it would be advisable to arrange matters in such a way that excess accumulation on the part of the United States would lead to years of deflation while it amortized its debts to the rest of the world. The countries that had elected him were most concerned about unemployment, and they would certainly wish to feel that any new system would concentrate on financing trade and current payments rather than on the refinancing of reserve assets. Hence, Executive Directors would do well to look for some way in which more assets could be placed in the hands of the United States if they wished to have an asset settlement system; until that was done it would be dangerous to adopt any symmetrical intervention arrangement, whether multicurrency or other.

Regarding the link, Mr. Bryce said that the Canadian authorities were reviewing their policy, so that he could not provide much information on their position. However, he wondered whether, given the situation of the developing countries and their debts in the 1970s, special drawing rights were the appropriate form in which to provide assistance for international development. If the proposals in SM/72/56 were adopted, it was essential that special drawing rights should carry an interest rate close to the market rate. Hence, members that used special drawing rights allocated to them would have to pay interest, and if they used them permanently they would have to pay interest permanently. That seemed likely to represent the kind of burden on developing countries with which there was deep concern in other forums. It was therefore only right to inquire whether the use of special drawing rights for development finance was a sound principle. Naturally, he agreed that if there were to be a link between special drawing rights and development finance the reconstitution provision would have to be dropped. However, what troubled him was that if users started paying interest on special drawing rights indefinitely, there would be a conflict of interest within the Fund between the members that were paying for benefits they had received 10 or 20 years previously, and the other members that were holding special drawing rights as sssets on which they were receiving interest. In brief, it seemed to him that it would be less appropriate for development financing to take the form of special drawing rights than had appeared to be the case two or three years previously.

The Executive Directors agreed to continue their seminar discussion of A Reform of the International Monetary System - A Sketch of its Scope and Content on Friday, March 24.

ROGER V. ANDERSON
Acting Secretary