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INTERNATIONAL MONETARY FUND

SEMINAR 72/10

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	R. H. Gilchrist
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H. Suzuki	K. Satow
L. Ugueto	
	H. G. Schneider
	C. Beaurain
A. W. Yaméogo	

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Also Present

African Department: E. L. Bornemann. Asian Department: A. W. Hooke. Central Banking Service: G. Dorrance. European Department: H. Neiss, H. Ponsen, G. Ragazzi. Exchange and Trade Relations Department: E. Sturc, Director; C. D. Finch, Deputy Director; T. Sweeney. Fiscal Affairs Department: W. A. Beveridge, A. A. Tait. Legal Department: J. Gold, General Counsel and Director; G. P. Nicoletopoulos, Deputy General Counsel; J. G. Evans, J. V. Surr. Middle Eastern Department: A. S. Gerakis. Research Department: J. J. Polak, Economic Counsellor and Director; J. M. Fleming, Deputy Director; C. F. Schwartz, Deputy Director; R. R. Rhomberg, G. Taplin, T. G. Underwood. Treasurer's Department: W. O. Habermeier, Treasurer; F. C. Dirks, D. Williams. Western Hemisphere Department: J. Del Canto, Director; S. T. Beza. Information Office: J. H. Reid, Chief Information Officer. 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, J. B. Zulu. Technical Assistants to Executive Directors: V. Barattieri, C. J. Batliwalla, B. Brock, 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. REFORM OF THE INTERNATIONAL MONETARY SYSTEM - A SKETCH OF ITS SCOPE AND CONTENT

The Executive Directors continued their discussion of the sketch on the reform of the international monetary system (SM/72/56, 3/7/72) from Seminar 72/9, (3/22/72).

Mr. Brofoss said that as the paper raised so many important complex and even controversial issues the authorities of the Nordic countries were not yet able to state their positions. Speaking personally, he conceded that there might be a case for a "quantum jump" in the design of the mechanical parts of a new system, but a mental "high-jump" to attitudes more conducive to the smooth functioning of the system was a more urgent requirement. Consequently, attention should be focused on Chapter III, where the problems of the adjustment process were discussed. The problem of attitudes was also particularly relevant to the issues under the heading of "The Exchange Rate Mechanism" in Chapter II.

The whole realignment exercise, Mr. Brofoss observed, was a testimony to the fact that the main industrial countries had failed to translate into practice the message of the study of 1970 which had advocated "acceptance of the principle that the determination of the rate of exchange for each currency is a matter of international concern; and implementation of that principle in the formulation of policy actions by the relevant authorities." It was to be hoped that new technical instruments of constraints and of inducements to change parities promptly could be devised to bear equally on deficit and surplus countries. The ideas submitted by Mr. Schleiminger at previous meeting (EBM/71/117) had much to recommend them in that respect, in particular if combined with Mr. Triffin's suggestions for systems whereby persistent surpluses would release changes in parities. He would welcome comment from the staff on that. Personally, he was still a little skeptical of the possibilities of devising such perfect technical instruments that would correct imbalances more or less automatically. In the field of international monetary reform, there could often be a conflict between domestic considerations and international commitments. An impartial moderator was needed and the Fund, as guardian of the system, was best placed to assume that function. Of course, as Mr. Beaurain had said, in the final analysis the national government must carry the responsibility for exchange rates. On the other hand, it was somewhat surprising that opposition to the idea of giving the Fund a more active role came from members of the EEC. The EEC was an organization where member countries had *de jure* and *de facto* yielded a good deal of their sovereignty to common institutions.

The sketch seemed to envisage, Mr. Brofoss said, a procedure whereby the main instrument of persuasion would be country consultations and it attached a good deal of importance to the exchange model as a "witness for the Crown." He feared, however, that politicians did not share such a reverence for the new masterminds. There would still be within national economies many forces to oppose frequent changes in par values. The realignment exercise had not changed that mentality. Even though considerations of national prestige had been left in the background at that multinational confrontation, the same political forces that had been operative before would make themselves felt once more if the question of one major country changing its par value alone arose. One of the acid tests of the willingness of countries to cooperate with the Fund was whether or not Article VIII countries were prepared to accept recommendations in the form of resolutions on consultation reports. That would bring symmetry in one important area. He wished it were possible to establish a code of conduct as Mr. Schleiminger had suggested a number of times. Unfortunately, the progress achieved on that front even within the smaller OECD did not offer much hope of success.

The Nordic countries remained skeptical about the assumption that a system based on wider margins with an escape clause legalizing temporary deviations from par values was necessary, Mr. Brofoss observed. They still favored the kind of system suggested by Mr. Dale in 1971 which would mean the retention of a 1 per cent norm, and permission for a country to apply wider margins at its own discretion, a practice which could be challenged by the Fund after a definite period of time. Those of his countries who were candidates for membership in the EEC welcomed the endeavors to reduce the margins within the community, but were concerned about the prospect of a wide margin vis-à-vis the dollar. The need for devices to stave off speculation was recognized, but it should not be forgotten that excessively wide margins could become harmful to the orderly conduct of regular commercial transactions. That very important consideration seemed to have been ignored in the sketch. In the deliberations on the new system within the EEC, by contrast, the argument had carried considerable weight.

In discussing consolidation, Mr. Brofoss agreed with Mr. Schleiminger that the questions raised could not be answered before a clearer idea of what was to be the outcome of the discussion of intervention systems and settlement schemes could be formed. If special drawing rights were to play a central role in intervention and settlement, the need for a partial conversion of holdings of reserve currencies into special drawing rights would be clear. But that consideration could not be applied to the "overhang," the excess of reserve currencies held by a small number of the richer countries. In that connection it was worth noting that the six major countries--United States, Germany, United Kingdom, France, Japan, and Italy--held between them SDR 29.6 billion in gold, special drawing rights, or Fund positions. Germany alone held SDR 5.8 billion, France SDR 4.4 billion, and Italy SDR 3.5 billion. There were SDR 9.5 billion in the system already. When the new asset was introduced there had been a general fear that that sum would be too high. But to add another SDR 15 billion or SDR 20 billion might amount to compromising the basic idea that the new asset was to be used to supplement other reserve assets in the event of an overall need to increase liquidity in the system as a whole. There was a danger of rewarding the rich at the expense of the poor countries that really needed special drawing rights. The problem of the overhang was really a question of attitudes. The desire of those countries that felt they held too many dollars to change them into other assets was understandable but the idea still being canvassed in the sketch for the conversion of overhang into special drawing rights was incompatible with the general principle of Article XXV, Section 3, which provided that special drawing rights were not to be used for the sole purpose of changing the composition of reserves. He agreed with Mr. Schleiminger that there were so many other ways of taking care of the "overhang" without giving a few countries the advantage of receiving convertible assets with a stable value in exchange for currency holdings that carried no right of conversion under Article VIII, Section 4 of the present Articles of Agreement.

Regarding II.3 of the sketch, Mr. Brofoss called for a further exploration of Mr. Schleiminger's ideas outlined at EBM/71/117. As he had said, progress must be by stages. First, priority must be given to restoring convertibility on current account or preferably on basic balance. Within the EEC, a system of intercommunity settlements would soon be established, based on a special European Fund for Monetary Cooperation. He would like the staff's opinion as to whether it would be possible to introduce the same kind of system throughout the Fund where similar facilities for mutual assistance already existed. He realized that the European Payments Union system had worked under different circumstances, but even so it should not be impossible to overcome the technical difficulties of a system of settlements through the Fund. Only after a relatively long period of time when the U.S. position had become much stronger could convertibility of all balances be considered. In that respect, he wished once more to ask the question whether the various schemes were based on the assumption that all balances were to be convertible, amounting to a complete revision of Article VIII, Section 4. He asked the question because the Nordic countries wanted to retain their systems of capital controls. He did not quite understand the implications of the idea expressed on page 11 of SM/72/56 of "accommodating such flows." When it was recalled that in the course of 1970-71 and up to the present, more than $20 billion had been transferred from private holdings of reserve currencies and turned into official reserve assets, it was hard to understand that such fluctuations could be accommodated within the framework of a convertibility system based on the concept that all balances carried the right of conversion.

As the question of the link was now being discussed in the context of the reform of the system, Mr. Brofoss suggested that it might be possible, through an amendment of the Articles of Agreement, to give the Board of Governors the authority to decide not only the total amount of new issues, but also the relative allocations between the industrial countries as a group and the developing countries as a group. Developing countries now received less than 25 per cent of the total allocations. It might be possible to take a decision that, say, 40 per cent would go to the developing countries and 60 per cent to the industrial countries. Then an allocation on the basis of quotas could be made within each group. In that context, he agreed with Mr. Lieftinck that the basis for establishing quotas should be modified by leaving out the reserve criteria. He added that in a future system with special drawing rights at its center, there could be no place for reconstitution.

Finally, Mr. Brofoss endorsed Mr. Bryce's warning that a system that might exert deflationary pressure not only on the United States but on the world in general must not be contemplated.

Mr. Suzuki said that, in their approach to international monetary reform, the Japanese authorities were guided by a philosophy which called for a one-world solution. As the Governor of the Fund for Japan had put it at the 1971 Annual Meeting, the system should "evolve into one managed by the collective wisdom and responsibility of all member countries." The unhappy experience of the interwar period had adequately demonstrated the hazards on both the political and economic fronts of separating the world into a number of blocks. His authorities, however, had not yet reached any clear position on the many difficult issues that arose in achieving a world solution. They were conscious of the fact that, unlike the creation of special drawing rights, the examination of reform would include the operations of private transactors and not only economic management and the behavior of monetary authorities, and would therefore call for more thorough and painstaking consideration. They were willing to consider the creation of a new international monetary system in which special drawing rights would play a pivotal role, provided that that would contribute to finding a one-world solution.

Continuing in his personal capacity, Mr. Suzuki agreed that the general approach to the exchange rate mechanism under which par value changes should be related to disequilibria of a basic nature was still valid. However, as had been stated in DM/72/18 the difficult task of avoiding any large divergence of exchange rates from their long-term equilibrium positions must be undertaken. The long-term equilibrium was not merely a function of trends in the balance of payments, but reflected a complex set of forces in the economy as a whole. For that reason, any automatic criteria that might be established must, of necessity, be very complex and difficult to apply in practice. In short, it would not be wise to have a rigid institutional provision for prompter exchange rate adjustment, although more effective international surveillance might be necessary. Reliance would have to be placed once more on the prudence and willingness of national authorities in that field.

When the necessity for adjustment had been established, Mr. Suzuki went on, the question of allocating the responsibilities for adjustment between surplus and deficit countries would arise. Even if the 1971 realignment had created the basis for a common understanding on that matter, the delay involved in such negotiations might not be much shorter in the future.

With respect to wider margins, Mr. Suzuki noted with interest the remarks of Messrs. Brofoss, Beaurain, and Kafka to the effect that prompter adjustment would obviate the need for margins as wide as 2.25 per cent. While he had not yet adopted a position on the size of margins in a permanent regime, he thought that inasmuch as wider margins had been introduced to deal with short-term capital flows, their success in that respect since December 1971 ought to be closely investigated. Furthermore, a symmetrical intervention scheme would seem to call for narrower margins since, under such a scheme, intervention would take place only at the outer limits of the permissible margins and the rates could consequently fluctuate through the full width of the margins from day to day.

As to consolidation, Mr. Suzuki agreed with Mr. Schleiminger that the question of consolidation was subordinate to that of convertibility. The chosen method of consolidation would closely influence the future form of convertibility. Since he had expressed his views on consolidation previously, he would not now enter into further details. However, while he understood that consolidation with special drawing rights would be the most clear-cut approach to the problem, he would urge that other methods, such as bilateral arrangements incorporating the use of Roosa bond type assets, or a combination of bilateral arrangements and special drawing rights consolidation, be considered.

Turning to the financing of deficits and surpluses, Mr. Suzuki thought that, if deficits and surpluses were confined in that context to those on basic balance as Mr. Brofoss had suggested, financing might be accomplished without much difficulty. That would not be the case, however, if the financing of imbalances arising out of short-term capital movements were to be undertaken. Capital controls or the dual market mechanism advocated by Mr. Beaurain formed one way of dealing with short-term capital movements, but on the assumption that many countries would be reluctant to rely on such measures, some means of accommodating short-term capital movements must be devised. A large amount of liquidity creation might be required, which, if it were too large, might cause the total neglect of discipline, while, if it were too small, the system itself might collapse. In any event, the present rate of liquidity creation might prove to be inadequate if short-term capital movements were not effectively controlled: the growth of world trade might not be a sufficient criterion for judging the adequacy of global liquidity.

His remarks on symmetrical multicurrency intervention and the numeraire would be made at the immediately following Executive Board Meeting (EBM/72/27), Mr. Suzuki stated. He wondered why those items were to be discussed in formal session rather than in seminar.

Finally, Mr. Suzuki said that while the Japanese authorities had no objection to a thorough study on the link between special drawing rights and development aid, they regarded the link as part of the broader question of development finance in the new international monetary system. Many possibilities other than the link as well as many forms of the link would have to be examined.

Mr. Schneider said that his authorities were still studying the complex problems presented in recent staff papers. He wondered, however, how long it would take before the new monetary order could become a reality. Of course, there could be no question of making a precise forecast at the present, but he was concerned that if the Smithsonian realignment worked out over time so as to bring the U.S. balance of payments close to equilibrium in two or three years, the rest of the world would have to accumulate further dollar balances in the meantime and there would be no increase in U.S. primary reserve assets, if one disregarded further allocations of SDRs. Considering the low level of those reserves, he doubted that the United States would then actually be in a position to undertake all the obligations inherent in such a new system, even if it was willing to do so.

Regarding the problem of the link, Mr. Schneider thought that, for fear of untoward consequences, special drawing rights as monetary instruments should not be burdened with the additional functions of development assistance in the present transitional period. Other ways could be found to help developing countries, but that would require careful consideration.

Mr. Kharmawan thanked the staff for the comprehensive sketch of the monetary system. He recalled that he had been among the few who had advocated such a sketch in the past. Now the time had apparently come to produce a detailed plan. He had not yet had official response from his authorities, but he had some idea as to their general attitude. He began by drawing attention to the passage in SM/72/56: "whether the working of the system will in fact improve will of course depend on countries' willingness to make the system work." If that wisdom had been applied to the now scoffed at Bretton Woods system, and to the crisis of 1971, the system itself might have survivied. Now an effort was being made to establish a new system which would reflect the altered political reality, the lack of political determination to maintain the structure of the Bretton Woods system. In that respect, a more general remark seemed appropriate: the Bretton Woods system had been preached to developed and developing countries alike. He believed that the developing countries had tried to shape their economies along the lines indicated by the Bretton Woods system; any new system, they felt, should, as Mr. Suzuki had said, be through a one-world approach.

As Mr. Kharmawan saw it, the new system would center around the exchange rate regime and convertibility. As far as the exchange rate regime was concerned, there appeared to be a consensus that the par value system should remain in operation in more flexible form. Flexibility had, however, been incorporated in the Bretton Woods system, but had apparently not been compatible with political realities. A new form of flexibility would be expected by his constituent authorities, although they favored the stability of the par value system. They recognized that stability should not connote rigidity, but feared that too much flexibility might introduce great instability. Most observers now approved of the idea of having small and frequent adjustments of exchange rates. The problem was what form they should take. A provision for exchange rate changes had been incorporated in the Bretton Woods system, but some degree of automaticity was now being urged. His constituent authorities retained an open mind on that topic, and he himself had found the proposals in DM/72/18 of great intellectual interest. Whether or not that paper's "equilibrium zones" could be applied for regulation of the system, the study involved in their determination could be most fruitful. As was well known, the developing countries did not, in general, favor excessively wide margins. From that point of view it was difficult to understand why wider margins seemed to form the cornerstone for every scheme presented to the Executive Directors, and he invited an explanation.

Turning to the second element lying at the heart of the reform, Mr. Kharmawan went on to say that convertibility necessarily involved consolidation. If the outstanding balances were not taken care of, the overburdened system would collapse, the problem of convertibility would become insoluble. As far as the latter problem was concerned, he noted that in the sketch it was envisaged that holders of reserve currencies would be obliged to present them for conversion, by contrast with the trend of earlier discussions, when presentation had been seen as optional. The periodic conversion of outstanding balances by their issuers had been mooted and a multicurrency intervention system would make such conversion more or less automatic. The key point to be remembered in that respect was that any system adopted must be realistic. He feared that balance of payments developments in the current year would not differ much from those of 1971 so that large surpluses and deficits could be expected. In such circumstances, the relevant countries could hardly be expected to undertake convertibility. The conclusion to be drawn was that the balance of payments trends of major countries should become the focus of attention. An objective of near equilibrium in the balance of payments of major countries would permit a move away from the recurrent crises of the past. Without a change in those underlying factors, whatever system might be invented would be in danger of collapse.

Regarding intervention, Mr. Kharmawan interpreted the attitude of his authorities as being favorable to a simple intervention method. The sophistication of the proposed systems entailed complexity and would have the further undesirable effect of splitting the world into two blocks. After all, if the underlying trends in the balance of payments could be checked, an asymmetric system would not generate the huge balances now threatening the system. In general, his authorities seemed to favor such an asymmetric system of intervention.

His authorities, Mr. Kharmawan said, did not have any definitive views on consolidation into special drawing rights. They would like to see first a study of all aspects of special drawing rights in the new system so that the effects of consolidation on special drawing rights could be clearly seen: their role as numeraire, as reserve asset, and the question of the interest payments which, as a burden on users of special drawing rights, were not favored by the relevant authorities. They would also like to examine alternative schemes such as those hinted at by Mr. Prasad and Mr. Suzuki.

Another prospective feature of special drawing rights, Mr. Kharmawan continued, was the link between them and development finance for which the developing world was committed to make a plea. Mr. Lieftinck had made a welcome breakthrough in suggesting that developing countries could be better accommodated in the calculation of quotas. The developing countries had been long concerned about those calculations with their backward-looking techniques. Some countries had been victimized in that the relevant data collected had pertained to some of the worst periods in their development. Their subsequent growth had not been reflected in the quotas. The new suggestion to look forward instead of backward was worthy of study. In addition, of course, any method of allocating special drawing rights so that developing countries could get a fairer share would be a welcome means of accommodating them in their need for development financing. Whether that would satisfy the developing countries, he could not say. The forthcoming meetings (of the Group of 24 in Caracas, and the UNCTAD in Santiago) would not omit a discussion of the link. One point that should be repeated had been made by Mr. Bryce, namely, that the payment of interest on special drawing rights might hamper the establishment of a link between special drawing rights and development financing. In general, a thorough and comprehensive study on the problems of establishing the link was needed.

In conclusion, Mr. Kharmawan called attention to the forthcoming establishment of a strong currency bloc. He urged that in the formation of such blocs, care should be taken not to discriminate against nonmembers.

Mr. Brand explained that his absence of comment so far reflected the fact that his authorities were still considering the matters raised by the sketch. He thought it fair to say they did not agree with several aspects of the general thrust of the paper. They agreed with the U.S. views on the need to avoid coming to hasty conclusions. He would, however, like to congratulate the staff for producing exactly what the Executive Directors had asked for. He thought it would find the response of the Executive Directors gratifying. He himself disagreed with some parts of the paper, as he had previously made clear.

Recalling that the Chairman had asked for views on the link, Mr. Brand observed that his own country already applied considerably more than 1 per cent of GNP to aid and that all government aid was in the form of nonrepayable noninterest-bearing grants. His authorities would agree that ways should be found for increasing the contribution of the rest of the world, but whether special drawing rights in their present form were a suitable vehicle for that was, to say the least, debatable. In any case, the type of special drawing rights envisaged by the sketch would seem to be wholly unsuitable for the situation proposed for them under the link scheme. If the Fund was to play any part in the aid field or in special treatment for less developed countries, it would be better to concentrate on a review of the method of calculation of Fund quotas at the next quota review. As far as special drawing rights were concerned, he agreed with Mr. Kharmawan that it would be most useful to have a paper setting out the role special drawing rights might play in the new system and what form they would take, as it was in that area he found his greatest differences with the sketch.

Mr. Yaméogo welcomed the encouraging approach adopted in the sketch particularly toward the link. He wondered whether, in the light of the imminent Caracas meeting of the Group of 24, the statements made in the course of the present discussion, particularly those of Messrs. Brofoss, Lieftinck, and Brand, could be made available for circulation at that meeting.

Mr. Omwony thanked the staff for its paper and expressed satisfaction at hearing such a large number of new ideas relating to reform, notably the suggestions of Messrs. Brofoss, Lieftinck and Suzuki. He noted in particular the shift in the Japanese stance with regard to the link. He thought the ideas, which had never been discussed in the Executive Board before, merited the consideration of all.

Mr. Lieftinck remarked that nowhere in the paragraph on consolidation in the sketch was there any reference to another possible method of eliminating the reserve currency overhang or replacing it with a more manageable asset, namely, liquidation of foreign investments which had been among the main causes of the present problem. Niether the United Kingdom nor the Netherlands had hesitated to liquidate foreign assets in the past and such a contribution by the United States, which would, of course, require the cooperation of all members involved, could be helpful in the present circumstances. A press report to the effect that U.S. foreign investment in the present year would be of the order of $13 billion had stimulated his interest in the possibility.

Mr. Lieftinck called attention to the passage in the sketch: "The consolidation facility should apply to all reserve currencies and measures should be taken to discourage the growth of official balances in such currencies. This would involve abolishing guarantees on such balances and perhaps agreement that, insofar as reserves continued to be held in reserve currencies, Fund members should refrain from shifting from one reserve currency to another and would hold currency balances only in the reserve center concerned, as distinct from Euro-currency markets." The consolidation problem referred primarily to officially held balances and since much of the uncertainty in exchange markets was created by the large amount of privately held currency balances, mainly in the Euro-currency markets, the rather tentative suggestion which he had quoted was worthy of support and examination as it would help to clear up the present disturbing situation.

Mr. Dale suggested that the figure of $13 billion mentioned by Mr. Lieftinck might include foreign financing by U.S. corporations for investment abroad. It certainly did not represent a realistic estimate of the balance of payments impact of U.S. foreign investment for the coming year.

The Economic Counsellor indicated that he would do no more than answer some of the questions raised by Executive Directors and bring up some points which did not appear to be clear from the discussion. The matters would, in part, be technical, but he believed that the clarification of technical features of the system could make an important contribution in facilitating the negotiation of policy issues.

Beginning with Mr. Schneider's inquiry as to the time dimension of reform, the Economic Counsellor observed that although the basic balance of the United States would not respond immediately to the currency realignment and might remain in deficit for two to three years, it did not follow that the overall U.S. balance of payments should be expected to be in deficit for that period. In fact, there had been a fairly general assumption that the overall U.S. balance of payments would be in very large surplus in the initial quarters of the realignment and that assumption might only have erred in its timing. As to the duration of reform, it would take as long as was needed to reach agreement on the various issues. One of the reasons for cutting out the areas of reform that did not seem absolutely essential was in order to reduce the time needed to reach that agreement. Of course, at the present stage, when the views of all countries that had a major interest in the reform had not yet been heard, it was impossible to say whether agreement could be reached at all; but, assuming an early start to serious negotiations or discussion with full participation, his own time horizon would be in the order of two to three years.

The Economic Counsellor recalled that Mr. Brofoss had asked what hope the staff had that surplus countries, in particular, could be induced to make the necessary parity changes. Although Mr. Brofoss' pessimism on that score could not be discounted entirely, one could hope that the international community, i.e., the Fund as an institution and the members concerned, would be willing to put pressure on the country whose currency ought to be adjusted. After all, in recent years, deficit countries had also been able to prolong the delay before exchange rate changes, mainly because there had been no international pressure applied to them. At the Bonn meeting of November 1968, for example, there had been no international pressure on the deficit countries. Going further back, as late as the week before the 1967 devaluation of sterling, the largest among the other countries involved still took the very strong view that sterling should not be devalued and that everything possible should be done to avoid the devaluation. If that climate could be changed, the views of the international community and of the Fund might become effective in achieving parity changes when they were due. In such circumstances, private capital movements might also turn out to be very helpful, especially if the Fund began to put pressure on surplus countries. Of course, he still took a modest view as to the possibility of knowing when parity changes were due.

In answering the question why wider margins were seen as a cornerstone of the new system, the Economic Counsellor explained his view that all possible assistance was needed in controlling capital movements. Capital controls, which he in no way underrated, would have to be supplemented by wider margins. Furthermore, with wider margins relatively small par value changes could be made in such a way that the new parity was not far from the old market rate and the yield to speculation on parity changes would thereby be reduced.

On consolidation, the Economic Counsellor agreed with Mr. Schleiminger and others that that feature was ancillary not only to convertibility but to all other objectives of the new system, including greater exchange rate flexibility. It had deliberately been put after exchange rate flexibility and before convertibility in the sketch, mainly because some of its technical points had to precede the discussion of convertibility. He would undertake the task of refreshing his mind on what had happened in the early 1940's with respect to sterling, as Mr. Prasad had suggested, to see what that might offer for the present situation. Mr. Lieftinck's point concerning the liquidation of foreign investment should be seen in the light of the current opposing tendency: namely, that European companies were still being offered to foreigners for sale. Furthermore, if European markets were anxious to turn their dollars into equity, there was no difficulty in doing that in the U.S. stock market.

Apart from consolidation in special drawing rights, the Economic Counsellor went on, the only options for consolidation that had been suggested were some kind of bilateral lending and an earlier staff suggestion for deposits in the United States denominated in special drawing rights which had not been received with much enthusiasm and which he had consequently dropped. A number of intermediate variants as had been suggested by Mr. Schleiminger were, of course, possible. There could also be consolidation in some other multilaterally arranged asset, but the bulk of dollars at present held in the reserves of member countries were needed as reserves, and if they were to be turned into some other asset, that asset must be as usable as the dollars were now. For that purpose, nothing other than special drawing rights would suffice. As for the excess reserves, for which Germany, Japan, and Switzerland must account for a very large proportion, they could be consolidated in Roosa bonds or long-term paper. Roosa bonds it would be recalled, had initially been created as short-term paper to tide over a temporary deficit in the U.S. balance of payments and to give the creditor an asset other than dollars. The assumption that the mark-Roosa bonds or yen-Roosa bonds which could replace Germany's or Japan's dollar holdings, would be paid off on maturity in gold or special drawing rights seemed unrealistic. It was more likely that they would be paid off with dollars which would belatedly be put in a consolidation plan, if there was one. The gain would be an optical one--a temporary reduction in the stock of special drawing rights--unless it were envisaged that, by bearing less favorable terms, the bonds would provide additional short-term relief to the United States.

The Economic Counsellor agreed with Mr. Brofoss that consolidation in special drawing rights would involve a new and enlarged role for special drawing rights, over and above their original purpose as a supplement to reserves. That fact should not, however, cause the idea to be rejected. The Articles of Agreement would in any event have to be amended. Another issue that had been raised was that of mandatory as opposed to voluntary consolidation. Although the staff had drawn such a distinction, the issue was, to some extent, a false one, for consolidation would not be introduced before broad agreement about the scale on which it would be used had been reached. Member countries would either judge the extent to which they wished to consolidate their reserve holdings of dollars and then establish a rule accordingly, or, if no rule was to be established, they would at least have agreed indirectly on how much they would consolidate so that each participating country would have a fair idea of what the others had in mind. In that sense, the operation would be partly mandatory and partly voluntary. In any case, in response to a point raised by Mr. Ugueto, the staff did not envisage that the facility would be limited to the major countries. As for the subsequent financing of U.S. deficits, any scheme devised for that purpose would necessarily be mandatory, since the reserve asset to be used by the United States in such circumstances was to be accepted by dollar holders in return for their dollars. Designation might be a means of dealing with that situation, and designation was of course a mandatory system of converting reserve currencies into special drawing rights that was already well established in the present system.

There had been some discussion, the Economic Counsellor recalled, on the question of settlement rules, particularly by Mr. Schleiminger and Mr. Gilchrist. As the former had said, a reporting system on the balances to be considered for settlement would be required and the settlement would have to be organized by the Fund at least to the extent of determining, in the light of the quantities reported, the actions required by reserve centers, currency holders, and the consolidation account. The question to be decided was not multilateral versus bilateral settlement, but the formula to be used by the Fund for that purpose. If, as seemed to be implicit in the U.K. plans, all increases in the dollar holdings of individual countries during a particular period were to be converted into special drawing rights with a provision ensuring that the conversion obligation of the United States would not exceed its overall deficit, the formula would simply be the increases in dollar balances acquired by a country during a certain period. Although the amounts could be determined country by country, the arrangement would not be bilateral. If, on the other hand, the starting point were to be the net U.S. deficit, the procedure would be by means of a designation plan administered by the Fund to cover that amount. The choice between the two techniques involved a number of as yet unsolved problems regarding the optimal principle of settlement.

In reply to the request by Mr. Kharmawan and Mr. Brand for a paper on special drawing rights in the new system, the Economic Counsellor said that the future workings of the special drawing rights system could not easily be described before the intentions of the members with respect to convertibility and consolidation were known. For example, whether designation or rules on holdings of currency balances would be used in regard to financing of future deficits was yet to be decided. Equally, the rate of interest on special drawing rights would depend in part on the scale of consolidation. Agreement must first be reached on how the system was to work before the future features of special drawing rights could become clear.

Addressing himself to Mr. Brofoss' question on convertibility, the Economic Counsellor said that settlement through the Fund was, of course, perfectly possible. He believed that the Fund would be an agent in the settlement in any event, the question whether the operation should be through a Fund account or merely administered by the Fund being secondary. However, he did not think that the option of basing a settlement system on current account balances alone really existed. It would involve leaving the remainder unsettled and could not reasonably be administered on either a bilateral or a multilateral basis. Mr. Brofoss had referred to the overall surplus of about $20 billion acquired by other countries in 1971. It should be noted that their aggregate current account surplus had not been much less. In 1970, a year of surplus in the U.S. current account, all other surplus countries had had an aggregate current account surplus of between $10 billion and $15 billion, due to the fact that the surplus position of industrial countries reflected their position not with the United States but with the rest of the world. Since it would not be possible to disentangle the appropriate U.S. current account liability to each country in a Fund administered scheme, there was no real alternative to settlement on the basis of overall balance of payments positions with as much restraint on capital as could be agreed to and as much additional financing as might be required. As Mr. Suzuki had said, the actual amount of additional financing needed would be exceedingly difficult to determine.

Turning to the question of interest rates on special drawing rights, the Economic Counsellor recalled the proposal of Mr. Bustelo, contested by Mr. Bryce, that interest payments should be made on gross rather than net holdings of special drawing rights. That, he thought, would not be an important improvement, involving as it did a mere alteration in the system of levying, using the current year's allocations rather than net cumulative allocations as a base for collecting the revenue to pay the interest. The difference at present would not be significant, although it might become slightly larger if new participants joined the scheme. Furthermore, the difficulty mentioned by Mr. Bryce could arise, namely, that special drawing rights would have to be created even in years when, on other grounds, it had been decided not to create any. There was something to be said for finding some other way of financing interest payments where this involved a deliberate spreading of a burden from some groups to all participants; however, the proposed change did not shift the burden significantly.

Finally, the Economic Counsellor thanked Mr. Lieftinck and Mr. Schleiminger for raising the hitherto neglected possibility of making changes in the General Account in order that the reform as a whole should become more acceptable. He agreed that it was possible that quotas could be made more suitable to some of the purposes they served, including their new function as determinants of allocations of special drawing rights. A distinction should be drawn between the suggestion that quotas be made more appropriate, and the suggestion that development aid be channeled deliberately to developing countries by making a very large increase in their special drawing rights allocations in one way or another. The proposal that special drawing rights should be allocated on the basis of quotas for the developed countries and twice the quotas for the developing countries had been made in the past, and it resembled Mr. Brofoss' idea at the present meeting. While technically easy, such a move would involve an important change in that special drawing rights could no longer be regarded as solely for the purpose of taking care of participants' reserve needs, but would be clearly intended in part for the permanent development use of the developing countries. The result might well be to create permanent debtors in the special drawing rights system, as Mr. Bryce had indicated, with consequent implications for debt burdens in certain countries.

The Chairman, referring to a question raised by Mr. Yaméogo, said that a record of the discussion would be made available to Executive Directors as soon as possible. The statements of the Executive Directors had, of course, been made in their personal capacity and could not be used outside the Executive Board. The record would be for the information of Executive Directors only. Outside the Executive Board, although Executive Directors would be free to report on progress being made and the ideas being put forward, suggestions made by other Executive Directors in their personal capacities should not be attributed to them.

Mr. Yaméogo agreed that each Executive Director had spoken in his personal capacity. He recalled, however, that the question of the link between special drawing rights and development finance had been raised by the developing countries at the outset of the special drawing rights discussion in 1966. Now it was evident that progress was being made and tribute should be paid to the staff and to the Executive Directors representing the developed countries for their willingness to seek a way of achieving some sort of link. The authorities in the developing countries should be made aware of the progress and of the willingness to help each member country in the context of the reform of the system.

If any of the ideas outlined by Messrs. Brofoss, Lieftinck, and Schleiminger to allocate proportionally more special drawing rights to developing countries were adopted, Mr. Yaméogo thought that the resulting investment in productive projects would create a need for further imports and consequently for greater reserves and other means of settling international liabilities.

Mr. Omwony asked for a clarification of the difference between the approach to differential allocations adopted by Mr. Brofoss and that adopted by the Economic Counsellor. Did the latter merely wish to avoid the use of the words "development financing" while not having any objection to the increase in special drawing rights allocations? As he himself saw it, such an increase, particularly if it were to be achieved by an increase in quotas, would not necessarily conflict with the purpose of special drawing rights.

The Economic Counsellor said that the special drawing rights allocations received by developing countries in recent years had amounted to about 7 per cent of their reserves. That figure appeared to represent approximately the need of those countries for reserve increases. In recent years, the aim of developing countries had been to keep the rise in reserves and the rise in their trade roughly the same. If, however, special drawing rights allocations were to be doubled, the conclusion that a part of the allocation was for the purposes of development finance would be unavoidable. He did not think that those who objected to the link on the grounds that special drawing rights should not be used for development finance would wish to facilitate such use through large individual country allocations. For that reason, he assumed that Mr. Lieftinck's proposal was intended to effect a correction of anomalies in the quota formula which, though it would lead to somewhat larger quotas and special drawing rights allocations for developing countries, would still reflect their need for reserves.

Mr. Kharmawan agreed with the Economic Counsellor that the preparation of a paper on the range of problems connected with special drawing rights would be difficult, as the form of the future monetary system itself was not yet clear. On the other hand, many members would like to know what the place of special drawing rights might be in the future.

Turning to the question of the link, on which he had also proposed that a staff paper be written, Mr. Kharmawan recalled that the Economic Counsellor's objection to Mr. Brofoss' suggestion had been that the original purpose of special drawing rights had not included allocations for development financing. However, the Economic Counsellor had said that consolidation was another item which would have to be added to the original purpose. Besides, he could not see how any clear distinction could be made under the present regime between the use of special drawing rights for balance of payments purposes and for development financing. Further study and clarification was needed on that aspect of the problem.

The Economic Counsellor observed that the staff had already undertaken two studies on the link, which were now underway. He agreed with Mr. Lieftinck that it was perhaps fortuitous that pressure of other work had prevented their completion so far. Meanwhile, it was clear that thinking was progressing on the link pending the appearance of the papers.

On the nature of special drawing rights, the Economic Counsellor said that if the special drawing right were to become the central reserve asset, it would have to be a completely usable asset with the minimum of inconvenience attached to it. Participants had found the use of the special drawing right easy in the past, and they would find it if anything easier under the future system. It would probably bear a somewhat higher rate of interest and reconstitution would probably disappear. Of course there would be no distinction between the use of special drawing rights to meet balance of payments deficits on current account and those due to development expenditure. On matters of detail, it was more difficult to say how special drawing rights would work. "Was a designation scheme necessary or would the special drawing rights simply be surrendered to the Fund in return for reserve currencies?" was only one of the questions to which no answer could yet be given.

Mr. Kafka welcomed the Economic Counsellor's indication that papers on the link were being prepared.

Mr. Brofoss asked whether the staff had a fundamental revision of Article VIII, Section 4 in mind, and observed that the Scandinavian countries would not be alone in strongly opposing any such move, which would prevent them from introducing such capital controls as they desired.

About half of the special drawing rights allocations, Mr. Brofoss went on, went to countries that had no need of them. There was no need to give more special drawing rights to the Scandinavian countries or to the countries in Europe which had sufficient reserves already. In sharp contrast, the developing countries did not have the reserves to allow them to maneuver freely.

Mr. Yaméogo also welcomed the news of studies on the link.

Continuing, Mr. Yaméogo observed that although a differential allocation of special drawing rights would leave the developed countries with fewer special drawing rights at first, the increased exports and growing payments deficits in the developing countries, which would follow, would ensure the rapid redress of that imbalance. The difference was that developed countries would obtain some of their special drawing rights free of charge and some through exports.

The Economic Counsellor said he was not sure whether a revision of Article VIII, Section 4 would become desirable, but it was clear that no currency was convertible on that minimum basis and it was equally certain that convertibility of reserve currencies on the minimum basis with its strict quantitative limits would not provide a workable system for the long run.

Mr. Gilchrist commented that, from the point of view of timing, one could hardly expect to achieve anything before the beginning of 1975. A plan could hardly be produced for the 1972 Annual Meeting, although he hoped that it would be possible to make some kind of interim report for that meeting. Governors could be expected to make comments at the 1972 Annual Meeting and that would be followed by more intensive work in the Executive Board and perhaps elsewhere in various committees. All going well, a real plan could be proposed for the 1973 Annual Meeting. Assuming that that plan was acceptable, it would take a year or more to ratify changes in the Fund Articles, and so those changes could come into operation on January 1, 1975. To meet that sort of timetable a sense of urgency would be required.

Mr. Schleiminger felt doubtful as to the merit of making projections about dates in the distant future. In the first place a distinction should be made between the time required to obtain agreement on an outline--which might be shorter than some thought--and the time required for implementation. As he had mentioned earlier, implementation could take place in stages, beginning with something easily agreed upon and leaving more ambitious schemes until later.

Second, Mr. Schleiminger noted that although special drawing rights were being given to countries that did not need them, the fact that they were being allocated to industrial countries was a necessary step in ensuring their widespread acceptance as a part of the monetary system. He doubted whether central banks, which in some instances were still uncertain as to the solidity of the new reserve, would have accepted special drawing rights as readily if all the allocations had been made to developing countries. The establishment of the special drawing right as a cornerstone of the system was an achievement in itself.

The Chairman agreed that progress should be as expeditious as possible. Such expedition, of course, depended not only on the work of the staff and the Executive Board, but on the readiness of members to reach a position on the various issues.

The Executive Directors concluded for the time being their seminar discussion of the sketch on the reform of the international monetary system.

JOSEPH W. LANG, Jr.
Acting Secretary