

INTERNATIONAL MONETARY FUND

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10:00 a.m., May 10, 1967

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

Executive Directors

W. B. Dale
A. C. Diz
P. L. Faber
T. Friis
J. González del Valle
S. J. Handfield-Jones
A. Kafka

P. Liefstinck
B. K. Madan

J. M. Stevens

B. Tann

E. vom Hofe

Alternate Executive Directors

J. S. Hooker
Y. S. Patrón
L. Williams
J. Aranko
A. Phillips O.

G. Teyssier
H.M.H.A. van der Valk
A. K. Banerji
M. B. Alwie
A. Mansour
C. P. Caranicas

A. M. de Villiers
E. Ozaki
C. L. Chow
H. Biron

L. M. Rajaobelina

W. L. Hebbard, Secretary

Also Present

African Department: M. Touré, Director; C. L. Merwin, Deputy Director. Asian Department: C. C. Liang. Central Banking Service: J. V. Mládek, Director. European Department: L. A. Whittome, Director. Exchange and Trade Relations Department: E. Sturc, Director. Fiscal Affairs Department: J. Saper, Deputy Director. The IMF Institute: C. Tognetti. Legal Department: J. Gold, General Counsel and Director; A. S. Gerstein, Deputy General Counsel; G. Nicoletopoulos, Deputy General Counsel; J. G. Evans, F. Hodel. Middle Eastern Department: M. M. Hassanein. Research and Statistics Department: J. J. Polak, Economic Counsellor and Director; J. M. Fleming, Deputy Director; H. Ezekiel, F. Hirsch, R. R. Rhomberg. Secretary's Department: A. Mountford, A. Wright. Treasurer's Department: W. O. Habermeier, Deputy Treasurer; R. Kroc, Deputy Treasurer. Western Hemisphere Department: J. Del Canto, Director; P. J. Brand. Personal Assistant to the Managing Director: F. L. Hall. Technical Assistants to Executive Directors: R. H. Arriazu, P. D. Fells, G. M. Gill, B. M. F. Hazenberg, W. Y. Hui, C. T. MacDonald, B. Nowzad, E. Schmidbauer, E. Stoffers, W. Stoop, T. Tanaka, J. R. Vallet.

1. INTERNATIONAL LIQUIDITY - COMMENTS ON THIRD JOINT MEETING AND
PLANS FOR FUTURE

The Executive Directors met in informal session to discuss the Third Joint Meeting with the Deputies of the Group of Ten and to consider the future program of work on international liquidity.

The Chairman began by observing that two papers (Deliberate Reserve Creation - Problems Related to Use and Transfer, SM/67/56, 5/5/67, and The Choice Between Merged and Separate Resources for a New Reserve Facility, SM/67/58, 5/9/67) had now been circulated by the staff in response to the requests made at the Third Joint Meeting. They were being made available to the Group of Ten Deputies and to the members of the BEC Monetary Committee. The staff was continuing to work on other papers and the Economic Counsellor and the General Counsel would be representing the Fund at the next meeting of the Group of Ten Deputies, which was scheduled for May 18 and 19. The agenda for that meeting covered the following major substantive issues: conditions of activation and decision making; transferability and use; separation or merging of resources and accounts; and reconstitution of reserve assets.

The Economic Counsellor added that the paper describing the effects of various voting formulae which had been promised before the Third Joint Meeting would be available shortly. It had proved more complicated than had been anticipated to produce meaningful figures.

Mr. Kafka remarked that it had been useful to have available during the Third Joint Meeting the summary record of the discussions which the Deputies had held. He wondered whether arrangements could be made to have the record of their future meetings immediately after they had taken place. He assumed it would be appropriate to make available to the Deputies the journal of the Executive Board's informal sessions.

The Chairman pointed out that the Economic Counsellor would, as usual, report on the Deputies' meeting as soon as he returned, but, if Executive Directors wished, he would suggest to Mr. Emminger that the minutes of the discussions in the Group of Ten and in the Executive Board should be exchanged as soon as they were available.

Mr. González del Valle asked when the revised versions of the two illustrative schemes, which the staff were preparing, would be ready.

The Economic Counsellor replied that the staff were at work on these two papers. The revised illustrative drawing rights scheme would be based on separate resources and would, therefore, be different from anything the staff had prepared so far. He did not think either of the revised schemes would be ready before the Deputies' meeting on May 18 and 19. However, that might have the incidental benefit of enabling the staff to take into account what transpired at that meeting and so narrow down the possible choices.

Mr. Biron was not sure whether it was a good idea that the staff should be making at this stage a choice between the quite different conceptions of drawing rights which were possible. He recalled that during the Third Joint Meeting, and also during the separate meetings of Deputies and Executive Directors which had taken place on the last day of the Joint Meeting, reservations had been expressed as to the usefulness of producing a revised drawing rights scheme. It was important to avoid making any faux pas and he felt that the preparation of this illustrative scheme might be a faux pas. In answer to a question from Mr. Madan, Mr. Biron went on to explain that he was only repeating what Mr. van Campenhout and Mr. Larre had said on the last day of the Joint Meeting. Many choices were still open on the problem of separate accounts and resources, and he did not see what good could result from a new illustrative scheme in which the staff made a choice between the different possibilities. Mr. Teyssier endorsed the views expressed by Mr. Biron.

Mr. Dale recalled that, in the Board meeting which had taken place on the last day of the Third Joint Meeting, there had been considerable support for the idea that the staff should produce two revised schemes, and sooner rather than later. He had hoped that the revised schemes, perhaps with alternatives, would have been ready before the Deputies' meeting on May 18.

Mr. Kafka thought it would be useful to have revised illustrative schemes because it would give Executive Directors a peg on which to hang their discussion. He considered that the Group of Ten would be interested in having the Board's views on the subject, and he hoped that the record of the Board's discussion would be available in time for the meeting of the EEC Monetary Committee. He was sure the staff could be trusted to exercise all due caution in preparing the revised schemes. Perhaps the papers could be transmitted to the Ten or the Six not officially, but in the guise of something which had been discussed in the Board.

Mr. Madan considered that it would be helpful to have revised versions of the illustrative schemes which would incorporate such consensus as appeared to be emerging on a number of items, such as direct or indirect transfers, reconstitution, and guidance. Without revised schemes it would be difficult to see how to proceed.

Mr. vom Hofe was not sure whether it was wise to produce revised illustrative schemes at this stage, but in any case he felt that they should not be sent to the Ten or the Six before they had been discussed by Executive Directors.

Mr. de Villiers asked whether it was the intention to continue with informal discussions conducted on a personal basis until a very large measure of agreement had been reached. From the chair which he occupied, a large number of questions had been posed during the past year or so on the need for reserves and these would have to be answered at some stage. They could not be ignored indefinitely; the outside world was awaiting answers to these questions. Was it the intention that they should remain unanswered until the discussion was taken out of the personal exchange of views stage and became a matter of negotiation between countries. He would be happy to follow whatever procedure was suggested, but this was something which should be clarified.

The Chairman thought two main questions emerged from the discussion so far and from the informal session held on the last day of the Joint Meeting. First, there was the question of how far an updated illustrative scheme should be taken. He did not think any one had envisaged a fully worked out scheme, especially in the case of the drawing rights version. The intention was rather to concentrate on the main issues that remained open. The two technical papers which had been circulated (ibid.) were a first step in that direction. He did not think it would be possible to illustrate anything on decision making at the present stage; the intention was only to describe the effects of various possible solutions. The second question concerned timing. It would not be possible to have the revised schemes ready before the Deputies' meeting on May 18. But, as the Economic Counsellor had indicated, this probably did no harm as the issues might be rather clearer after that meeting.

The Chairman then suggested that it might be useful to discuss on May 24 the two technical papers the staff had already circulated. At that time, Executive Directors could also have a report from the General Counsel and the Economic Counsellor on what had happened at the Deputies' meeting. He did not think it would be possible to make any other definite plans at the present time. It was probable that work would go on continuously in the Fund Board until the Fourth Joint Meeting and it was unlikely that either the Six or the Ten would reach any final agreement in the very near future. Therefore, it was probably best to keep the schedule of work flexible. It would not be reasonable at the present stage to attempt to draw up schemes which could be considered as fully worked out proposals. All possible alternatives should be left open, at least on the main issues.

Replying to Mr. de Villiers question about whether the program of future work would cover the longer-term questions he and Mr. Stone had raised about the need for reserves, the Economic Counsellor said that the staff had work in hand which would deal with at least some aspects. For example, a long chapter on the development of reserves was in preparation for the Annual Report. It would analyze what had happened in this field in recent years and would provide a broad basis for discussion of the important issues in that field. A paper was also being prepared on the question of gold. It would deal with such matters as production and absorption.

Mr. de Villiers was pleased to learn about the work the staff was doing, but he pointed out that his question had been related specifically to the Joint Meetings. What he wanted to know was when these issues would be considered in the Joint Meetings. He had hoped they would be dealt with at an early date. Was it intended that the whole process of discussion should be gone through again at a national government level and that these questions should only be answered at that stage?

The Chairman thought that the question of the need for additional reserves and its urgency had been practically exhausted at the Third Joint Meeting and he did not expect it to be on the agenda of the next one. However, it would be necessary to discuss at some stage the language which would be used in any future scheme to describe the various considerations which would have to be taken into account when taking a decision on the creation of reserves.

Mr. Kafka regretted that the Chairman did not think it would be physically possible to prepare the revised illustrative schemes sooner. He thought that the earlier they could be made available and discussed in the Board, the more useful they would be. He suggested that the informal record of the present discussion should be made available to the Deputies when they met on May 18 in Paris.

Mr. Ozaki asked whether, in view of what was said on page 6 of SM/67/56 and in the footnote on page 2 of SM/67/58, he was right in thinking that the staff considered that a drawing rights scheme with segregated accounts under a noncurrency pooling approach was in effect the same thing as a unit scheme. He also asked whether the staff envisaged direct transfers of the drawing right itself under a scheme with segregated resources (currency pooling approach).

The Economic Counsellor replied that the staff had been thinking primarily along lines which Mr. Ossola had made during the Third Joint Meeting, namely, that it should be perfectly possible for a drawing rights scheme to give rise to only one kind of asset. In a scheme with merged resources as previously envisaged, there would be two kinds

of assets, namely, drawing rights on one side and loan claims arising under lines of credit on the other. Under a drawing rights scheme with segregated accounts, a member would start off with a certain number of drawing rights which would be equal to its net cumulative distribution. It could use up all its drawing rights or, if it accepted drawings by other members, its position could go up to twice or three times its net cumulative distribution, depending on the maximum acceptance limit that was set. This approach to a drawing rights scheme did not, however, make it the same thing as a unit scheme.

Mr. Handfield-Jones thought the two papers the staff had circulated on use and transfer and merged or separate resources dealt with two of the main issues on which further work might be needed. He found it gratifying that the staff had been able to produce these helpful and stimulating papers so rapidly. He then raised a number of points, the clarification of which he thought might help the further progress of thought on these subjects.

Mr. Handfield-Jones' first point was that one theme which had run through the Third Joint Meeting had been the importance of creating an asset which would be a desirable reserve medium and have qualities and attributes which would make it comparable with existing forms of reserve assets. The consequence of creating such an asset would be that some countries would wish to hold it in significant amounts. He had discussed this question of differing reserve preferences in the paper he had circulated some time previously (EBD/67/53, 3/27/67) and the one point on which he thought the emphasis in the two staff papers (SM/67/56 and SM/67/58) should be rather different was the extent to which they recognized that some countries were likely to want to hold the new assets in amounts which would result in their having a higher ratio than average of reserve assets to total reserves. This meant that the guidance mechanism visualized in the paper on use and transfer (SM/67/56) ought not to be based on the principle of equalizing the ratio of new assets to total reserves. It ought rather to be directed toward increasing the holdings of those countries with the lowest ratios of new assets to total reserves. In Section C(b) on page 2 of SM/67/56, the staff had said that the primary quantitative criterion for directing transfers would be the achievement of an approximately equal ratio of holdings of new assets. He assumed that this would not mean that those countries which wished to hold more than the average would be expected to reduce their holdings. Mr. Handfield-Jones recognized that the distinction he was drawing was essentially a matter of wording, but he thought it did have some significance.

Another point on which Mr. Handfield-Jones thought further clarification would be useful was whether countries making voluntary transfers should be subject to some balance of payments test. The staff had suggested in SM/67/56 that such transfers should comply with some flexibly defined concept of need. He was unsympathetic to the idea of imposing any such test, however flexibly it was formulated. It could not be ruled out that some countries might voluntarily seek to acquire additional new assets and increase their proportionate holdings. If they were to be permitted to do this, then why should another country be prevented from voluntarily providing those additional assets? He agreed that there might well be a case for applying some sort of discipline to countries which appeared to be directing their reserve policies in ways which constituted, over time, an excessive use of new reserve assets, but, to the extent that there was such a case, he thought that the problem should be solved by means of reconstitution rather than by imposing a limitation on the freedom of voluntary transfers.

Turning to the reconstitution question, Mr. Handfield-Jones thought that the staff had made an important contribution to the discussion. They had built firmly on the foundations laid during the Third Joint Meeting, particularly by Mr. Emminger. He noted that the last paragraph on page 3 of SM/67/56 referred to the question of whether the principles to be laid down in the legal provisions for the new asset should go beyond the obvious obligation to reconstitute in order to meet the needs of other members. It implied that there should also be reconstitution in circumstances where this would not be necessary for the liquidity of the scheme. He had some difficulty in accepting the idea of such an extension. He thought there had been a widely shared feeling at the Third Joint Meeting that the need for reconstitution obligations stemmed from the need to ensure the liquidity of the scheme and safeguard its operation. The suggestion that reconstitution obligations should be designed to impose some form of balance of payments discipline on members had been criticized. It had been recognized that some obligations would be necessary, but only to ensure that the new asset would not be abused in a way which would impair its soundness.

In order to clarify what form of reconstitution the staff had in mind, Mr. Handfield-Jones asked what its reaction would be if a country which was so small that its impact on the system as a whole would be relatively insignificant, made excessive use of the new asset. It could be argued that, because the country was relatively small, it would not impair the liquidity of the scheme and, therefore, there was no need to impose any reconstitution obligations on it. He wondered whether this was the sort of situation the staff had in mind when it spoke of requiring reconstitution in circumstances where this would not be necessary for the liquidity of the scheme. In other words, all participants should meet certain standards of behavior which, if not

observed universally, would result in the impairment of the scheme. If individual countries abused the privileges of the scheme or their access to it, it would create unfortunate precedents and lower the whole standard of behavior and performance, even though the direct effect of this would not be a source of concern. Mr. Handfield-Jones said he would be grateful if the staff could explain its thinking on reconstitution obligations more fully.

Mr. Handfield-Jones then referred to the second paragraph on page 4 of SM/67/58, where it was stated that if separate resources were provided or the new asset were created within an affiliate, it would be possible for the Fund, as now constituted, to conduct transactions in the new asset and such transactions could help to strengthen the liquidity of the new scheme by underpinning it with part of the Fund's resources. Mr. Handfield-Jones said he was in full agreement with this concept. Important transactions could take place between the Fund accounts as now constituted and the new scheme even if their resources were only segregated to the extent of being separate accounts within the same entity. The Fund could, in this way, make a contribution to the liquidity of the new asset and this would be of the first importance, particularly in the early days when the asset would be unfamiliar to the world at large. Mr. Handfield-Jones did not think, however, that the liquidity assistance involved in this technique would be a one-way street as SM/67/58 suggested. The new scheme would not, of course, be able to acquire claims against the Fund, but there would be an important, though indirect, return to the Fund. If the new asset was endowed with the appropriate attributes, it would become highly liquid and thereby increase the liquidity of the international monetary system as a whole. Moreover, it could prove to be more liquid than any other asset which the Fund might hold and thereby strengthen the liquidity of the Fund itself.

The Economic Counsellor replied to the various points Mr. Handfield-Jones had raised. With regard to the question about whether the staff envisaged the task of guidance as equalizing the holdings of all participants or only as raising those with the lowest ratios to total reserves, he pointed out that there were a number of relevant considerations. Obviously, if some countries voluntarily exceeded the average ratio, the scheme would not be aimed at reducing their holdings in order to bring them in line with the average position. However, to talk in terms of increasing the lowest ratios implied that the agent would have to single out the country that happened to have the lowest ratio and direct all transfers to it until its holdings reached a certain level. It seemed preferable to have a more flexible approach, as expressed by the general terms about aiming at equalizing. But this was, as Mr. Handfield-Jones had said, essentially a matter of wording. If the new scheme was equipped with some kind of repurchase provision, there would be a substantive difference because the

agent would have to equalize downward as well as upward and the process would be different from increasing the ratios of the countries with the lowest holdings. He hoped, however, that the scheme would not become that complicated. He emphasized the importance of flexibility.

The Economic Counsellor considered that the second point Mr. Handfield-Jones had raised was a very important one, on which it would be helpful to have a clearer indication as to the views of Executive Directors. It was the question of whether voluntary transfers should also be subject to the expectation that they would only be made if the transferring country had some suitably defined need. Various views had been expressed on the issue during the Third Joint Meeting. Mr. Emminger had initially thought that it was not a good idea, but toward the end of the meeting, he had come to the conclusion that it might be useful, provided it was not excessively policed.

The Economic Counsellor thought it might be helpful if he listed some of the arguments for this requirement. The paper on use and transfer which Mr. Emminger had circulated prior to the Third Joint Meeting had suggested that it might be more convenient if countries in currency areas were entitled to unload on their reserve centers the new assets they received if they preferred to have, say, dollars or French francs. It would make a considerable difference to the system if it was stated in advance that this would be permitted and that, in fact, it would be more or less expected that these countries would seek to earn higher rates of interest by holding their normal reserve assets rather than the new assets, on which the rate of interest would be low. If, on the other hand, it was stipulated that these countries should not transfer unless they had some kind of a need, the nature of the system would be altered radically. The difference of approach would clearly affect not only the countries that might be interested in making such transfers but also the accepting reserve center. If the scheme followed the pattern envisaged in the staff paper, the reserve center would, on the whole, dissuade countries from transferring to it unless they had some reasonable need. On the other hand, if no criterion of need was applied to voluntary transfers, the reserve center might simply let it be known that all the countries within its currency area could transfer their new assets to it if they wished. If a large number of countries would not normally hold the new assets, this would have a profound effect on such questions as whether they should vote on the creation of additional assets and the extent to which they should participate in other aspects. This was an important political facet of the question which ought to be considered carefully.

As a second consideration, the Economic Counsellor doubted whether the absence of any form of needs test was compatible with the logic of reconstitution. If countries were in some general way expected to reconstitute their positions when they could or when it was necessary, this surely implied that they would not get rid of the assets in the first place unless there was some kind of need to do so.

The Economic Counsellor pointed out, thirdly, that complete freedom of transfer would have some effect on the liquidity of the scheme. Statistically it might not be a very important effect, but if a large number of small countries decided that it was preferable to unload most of their new assets onto the reserve centers, the initial absorption capacity of the countries onto which these assets were unloaded would be reduced. In other words, the acceptance limits of the reserve centers would to that extent be filled up. Moreover, if a reserve center were in deficit, it could absorb the assets being transferred from the countries in its currency area, but, being in deficit, it would be entitled to pass them on. In this way it might, for example, be possible for all the new assets distributed to Latin American countries to end up compulsorily in Europe since the United States could agree voluntarily to accept the assets and would then be entitled to pass them on to other holders if it was in deficit at the time.

The Economic Counsellor thought that, for all these reasons, it would be safer if the system were based on the principle that any transfer should be subject to need. The principle would not have to be heavily policed, but it should be there.

Turning to Mr. Handfield-Jones' remarks about whether there would be a case for reconstitution when that was not required for the liquidity of the scheme, the Economic Counsellor said that he agreed that this point could perhaps be better expressed in the Kantian way suggested by Mr. Handfield-Jones. Some of the countries which strongly favored reconstitution, would probably want to argue that this was also necessary to improve the adjustment process. The solution might be in deciding on a particular reconstitution provision and then saying that it was necessary both for the liquidity of the scheme and to enhance the adjustment process.

On Mr. Handfield-Jones' comments about the advantages to the Fund of holding some of the newly created assets, the Economic Counsellor said that the staff, in describing the process as a one-way street, were not implying that it was in any sense a dead-end street. He very much agreed that there would be considerable benefits for the Fund and for the international monetary system as a whole.

Mr. Diz considered that the two staff papers (SM/67/56 and SM/67/58) had helped to clarify many issues. He had a number of questions, however, on which he hoped the staff would be able to throw more light. He was very much in agreement with the blend of willingness to accept and some sort of obligation to accept which would give the asset some kind of legal tender, as was suggested in SM/67/56. In his opinion this built upon familiar ground. In most countries of the world today it was only currency which carried the quality of legal tender, while the most important part of the domestic money supply, namely, bank deposits, was usually based on willingness to accept. Its acceptance did not derive from any legal ability to cancel obligations. The whole question of use and transfer revolved around this problem of acceptability. Another interesting characteristic of this area of the discussion was that, even while the whole exercise hinged on stock demands for reserves to hold, rather than to use, when the problem of transfer and use was being discussed the emphasis was put more on the flow or excess demand for reserves to use, than on the stock demand for reserves to hold. This did not mean that even in this area many provisions were not aimed at safeguarding the interests of holders--not only those of the users--and this could be seen in several parts of the papers being considered.

Turning to Section C on page 2 of SM/67/56, Mr. Diz noted that, in connection with the question of guidance, there was a reference to the fact that a number of general principles would be followed, perhaps along the lines of the present Fund policy for selection of currencies for drawings. His understanding of that policy was that there were three main principles, namely, the balance of payments position, the reserve position, and the Fund's holdings of currencies. In addition, there was the size of the transaction. Although this could not be considered a principle or a criterion, it was an important constraint. He thought it would improve the understanding of the mechanism for any new scheme if some specific reference were made to the question of the size of the transfer and especially the particular provisions which might be made for dealing with large ones.

Another area in which Mr. Diz thought that a little more clarification would be needed was the kind of currency which would generally be offered in exchange for the new assets. The reference in Section C (a) to the fact that transfers would normally be directed only to countries with sufficiently strong balance of payments or reserve positions had its origin in the idea that strong currencies would preferably be used. In this area he thought it would be interesting to specify what options would be open to the countries which wanted to transfer the new assets and who would exercise those options. It would be helpful if the staff could examine these issues more specifically.

Mr. Diz had three questions on Section C (c). First, could the organization direct transfers to a member which would be ready, even when reaching the limit of its holdings, to accept more units? Or would the member have to rely only on voluntary transfers if it wanted its holdings to go beyond the limits established? Second, would the acceptance limit, which the paragraph implied would exist, apply only to guided transfers so that voluntary ones could be accepted over and above that limit? Third, would voluntary transfers which had already been accepted be taken into account when considering the direction in which particular transfers should be guided? He thought the reference in the last paragraph on page 2 to the problems which might arise in connection with reserve centers, was rather hazy and made the paragraph very difficult to understand so that more clarification was needed.

Turning to the first paragraph on page 3 of SM/67/56, Mr. Diz asked whether the countries which would make transfers under the terms of Section A (2) simply by referring to the guidance provided by the rules and recommendations, would in fact have sufficient knowledge to be able to do so. This would, of course, not be knowledge of the rules themselves but rather if they would be in a position to know whether certain rules were applicable at a particular point in time or whether they should be applicable to certain countries. He thought that this might mean in practice, that the agent would probably have to act as an arbitrator in a good many instances.

Mr. Diz said he had considerable difficulty in understanding the last paragraph on page 3 of SM/67/56 which referred to the possibility of requiring reconstitution even when this would not be necessary for the liquidity of the scheme. He wondered to what extent such a requirement would run counter to the principle of voluntary transfers and to what extent it might limit the acceptability of the new asset. He recognized that this was mainly a question of extending guarantees to holders rather than users, but he had some doubts about the provision, and, indeed, about the whole idea of reconstitution. One reason was that, if it was intended to follow the same general policy lines as the Fund's drawing mechanism, then an effective substitute for the process of reconstitution was already incorporated in that policy. Moreover, it seemed to him that the principle of harmonizing holding ratios, as the Economic Counsellor had described it, would also to some extent take care of any need for incorporating excessive use as an additional criteria for transfer. He did not think that the argument in the last paragraph of the section on reconstitution (SM/67/56, Part II, p.5) contributed much to the case for reconstitution. He wondered if there was really a need for the new organization to lend its support to the Fund, or if the Fund really needed such support.

Referring to the first paragraph on page 6, Mr. Diz did not think that the entitlement to make transfers should be included in that particular list of rights and obligations of a member. The entitlement to make transfers was not determined on the basis of the record of the organization; it was a basic principle of the whole scheme that a country was entitled to make willing transfers among willing partners. This right came into a different category from the other items mentioned in the list which were all based on the cumulative creditor or debtor position of members.

Turning to the third paragraph on page 6, Mr. Diz wondered whether, under a drawing rights scheme, the resources of which were merged with those of the Fund, guidance would be more natural than freedom of transfer. Such a scheme would seem to imply the same sort of guidance as existed in the Fund.

Mr. vom Hofe intervened to say that he was not yet ready to discuss in any detail the two staff papers which had only just been circulated. He hoped, therefore, that the present session would deal only with comments on the Third Joint Meeting and with the future program of work. Mr. Teyssier supported this suggestion.

The Chairman replied that, as he understood them, the comments which Mr. Handfield-Jones and Mr. Diz had been making were essentially requests for additional clarification. The Economic Counsellor's replies to their questions did not, of course, imply that the Executive Board was taking a view on any of these points, and he thought that this clarification might be useful to Executive Directors and to any other group which might use the two staff papers. As he had already pointed out, it was proposed that Executive Directors should discuss the papers on May 24.

Replying to Mr. Diz, the Economic Counsellor said that it might well be appropriate for the new organization to have some kind of rule about how the size of transactions would affect the transfers. He did not think, however, that this was something which should be included in the statutes of the organization. It was more the sort of question on which the organization should make some practical arrangement or take a general decision at a later stage in much the same way as the Fund had in its decision on currencies to be drawn. It was indeed probable that small transactions might be the only ones which could conveniently be handled by any general rules which the organization might issue. For example, the organization might make a rule rather like the one the Fund had, so that small transactions up to x million dollars could always be carried out with a country's own reserve center without any further reference to the organization. That would do away with a great deal of the most tiresome guidance and would not affect the liquidity of the scheme very much. It was

that sort of transaction the staff had envisaged when it spoke about generalized rules.

Regarding Mr. Diz's question about what the transferor would get in exchange for the units or drawing rights that he had transferred, the Economic Counsellor said the staff had in mind the same proposals that had been made in the illustrative schemes. In other words, the transferor would be able to obtain either the currency of the transferee, or the transferee's main reserve currency, at the option of the transferor.

Turning to the section on acceptance limits in SM/67/56, the Economic Counsellor said the intention was that a member would not be obliged to accept more than three times its cumulative distribution. It would, however, be able to accept assets in excess of that level if it wished, either as a result of voluntary transfers or through guided ones. Clearly, any previous transfers, whether voluntary or guided, would be reflected in the member's position at any particular moment, and would therefore count in connection with subsequent transfers.

The Economic Counsellor agreed that reconstitution could involve involuntary transfers if the system were cluttered up with the equivalent of a repurchase mechanism. Like Mr. Diz, the staff thought that it would be sufficient to have any reconstitution operate through what, in Fund terminology, would be called the drawing mechanism, in other words, through other members requesting transfers.

The Economic Counsellor then referred to Mr. Diz' remarks about the passage on page 6 of SM/67/56 which said that all the rights of members would be reflected in the books of the organization and went on to mention that among these rights was the entitlement to make transfers. He observed that this was not intended to mean the rules or conditions under which a country would be entitled to make transfers. It was a quantitative concept related to the drawing rights which a member would be entitled to exercise at a particular time and came into the same category as the other quantitative measures mentioned in that passage. The Economic Counsellor agreed with Mr. Diz that, under a system embodying merged accounts, the guidance applied to the new assets would have to be merged with the Fund's normal guidance. Moreover, unless changes were made in the Fund's normal guidance procedures, it would be necessary to follow the same system for transfers of the merged type of reserve drawing rights as was applied to ordinary drawing rights in the Fund.

Mr. González del Valle found it difficult to assess the real progress made in the Third Joint Meeting. It was true that the existence of a consensus had been confirmed on certain fundamental issues, such as the principle of universality, the role of the Fund in the creation of new reserves and the elimination of compulsory reconstitution. It was also true that a considerable convergence of views had been achieved regarding the transfer and use of the new assets, the separation of resources and accounts, and other points of a technical character. However, some fundamental aspects of the contingency plan still remained to be agreed. The outstanding issue was, of course, the form of the new reserve asset and certain associated issues, such as reconstitution and decision making. The importance of this issue had been emphasized by the fact that, for the first time, a number of participants, and particularly Mr. Deming and Mr. Joge, raised the fundamental question of whether there were more risks involved in trying to reach a compromise on a restricted scheme than in abandoning for the time being the efforts to design a truly evolutionary contingency plan. This question remained open. Mr. González del Valle hoped that developments in the next few weeks would provide a clear answer to it.

Mr. González del Valle considered it essential to recognize that the proposals involved in the EEC Ministerial Communiqué had had an important impact on the over-all course of the joint discussions. At the same time, he was encouraged by the fact that the need for further technical work to reconcile the Communiqué with the Monetary Committee's report had been widely recognized. He was particularly impressed by the comments that two of the participants from the EEC countries had made in this connection. He noted that Mr. Ossola, for example, had tried to clarify the differences in the interpretation of the Ministerial Communiqué by saying that "perhaps this result was because the non-EEC participants had concentrated too much on the wording of the Communiqué, rather than on its spirit," and had added that, "the Communiqué had been prepared in a hurry, and maybe it contained some contradictions" (Draft Journal of the Third Joint Meeting, page 59). Mr. González del Valle remarked that it was, of course, difficult enough for the non-EEC participants to understand the language of the Communiqué, and naturally it was much more difficult for them to interpret its spirit.

Mr. González del Valle went on to observe that Mr. van Lennep had confirmed the discrepancies between the Communiqué and the Report when he had said that, "The Ministers had agreed on many fundamental problems, but had left open some problems for the experts to study and to try to find a common view of the EEC countries, so that they could make constructive proposals in the meetings of the Group of Ten Deputies and in the Joint Meetings. After the present

Joint Meeting, the EEC Monetary Committee would start on this work; they were hopeful that they could do what the Ministers expected," and had then added that he hoped that "the Monetary Committee would soon be able to put constructive proposals before the Ministers of the EEC countries, so that they could be taken into account in the future work of the Joint Meetings" (*ibid.*, p. 105). Mr. González del Valle hoped this meant that the views expressed during the Third Joint Meeting would be taken into account by the EEC representatives in their further technical work. He thought it should be recalled, for example, that the question of repurchase or reconstitution had been first introduced by the Ministerial Communiqué, but had not been fully explained in the Monetary Committee's Report, which was otherwise a good technical basis for the Communiqué.

On the question of decision making, Mr. González del Valle confessed that the EEC proposals had introduced an element of uncertainty as regards the progress which might be expected to be made in the future once an agreement on the form of the new asset was reached. The reintroduction of the unit voting proposal was unacceptable for various reasons, but mainly from the political point of view, since it would again give special rights to a limited group of member countries. Since this feature of the voting system would be particularly relevant to the activation of the scheme, which was what would really count in the process of reserve creation, the supposed universality of participation (including the process of creation and distribution of the new assets) would actually become nominal or theoretical, thus undermining the whole substance of contingency planning.

Mr. González del Valle hoped that the study now being prepared by the staff on the alternative methods of voting would be able to illustrate how it ought to be possible to protect the interests of creditor countries under a combined system of voting without resorting to the undesirable feature of unit voting. He was convinced that a combined voting system along the lines of the present system of the Fund could be worked out in such a way as to give all member countries the assurance of a reasonable and adequate protection of their interests. It was for that reason that he had insisted during the Third Joint Meeting that the EEC countries look again into this matter and take a more positive attitude toward the preservation of the principle of universality, which he considered to have been the major achievement of the joint discussions so far.

Mr. Faber thought it was appropriate that, in considering what had happened at the Third Joint Meeting, Executive Directors should also look forward and attempt to assess what further steps should be taken. He considered that the remarks Mr. Handfield-Jones,

Mr. Diz, and Mr. González del Valle had made had been helpful contributions to that assessment. Personally, he had been greatly encouraged by what had happened at the Third Joint Meeting. The role of the Fund was no longer questioned and that was an important achievement. It had also become clear that most, if not all, participants recognized that additional unconditional reserve assets might be needed sooner or later. There was still some doubt as to the form these unconditional assets should take, but it was great progress that the need for an asset to supplement existing unconditional reserves was now acknowledged. There had also been progress in agreeing on what were procedural issues and what were substantive questions. The question of guidance had been one matter of substance on which there had been some progress in narrowing down the differences which had existed.

Mr. Faber had the impression, however, that there had been some aspects on which there had been some retreat from the degree of understanding previously achieved, especially during the Second Joint Meeting. In particular, he regretted that there had been some movement away from acceptance of the principle of nondiscrimination. He hoped that the idea of unit voting would not continue to be given the support it had received at the Third Joint Meeting. He strongly supported Mr. González del Valle's remarks on this aspect. Unit voting was likely to be a self-defeating mechanism for creditor countries because it might well lead to greater fears on the part of debtor countries and tend to reduce confidence in the scheme.

Mr. Faber believed considerable progress had also been made toward agreeing on specific criteria for assessing the need for reserves. He thought the paper submitted by the U.S. delegation had been very helpful in this connection. In the same context, progress had been made in specifying the characteristics which it would be desirable for unconditional assets to have. In addition, the atmosphere at the Third Joint Meeting had, in his opinion, been more relaxed. He thought it was significant that participants had not found it necessary to stress that they were speaking in a personal capacity. This was an indication that they had felt able to express themselves more freely than at the previous meetings.

Mr. vom Hofe made the following statement:

When I asked myself what is the sizable result of the Third Joint Meeting I would rather say not much. And yet I think as Mr. González del Valle and Mr. Faber already said that the detailed discussion of the meaning and interpretation of the Munich protocol--which was not on the agenda--has been of great interest for all of us.

Not that I could say precisely which position the different speakers hold--maybe some do not know that themselves. The only one of the speakers who has spoken out frankly in this direction was Mr. Joge. He told us the first day that he clearly understood that at the moment any practical solution would have to be based on a drawing rights scheme--but he would prefer to stick to the unit scheme and therefore would like to wait and see.

I think Mr. Joge is right to the extent that, after the large step toward a common platform that was taken in Munich, it would have been unrealistic to expect another step at the Joint Meeting or in the near future. Recognition of this fact, in my view, was the reason why the other advocates of a unit scheme--who felt to have less time than Mr. Joge--decided to inform themselves about the contents of the Munich protocol in detail. The discussion led in fact to the interesting finding that units and drawing rights in the form that is now provided can be very much alike, that direct and indirect transfer do not differ very much in practice, and so on. And we agreed that our staff and the Monetary Committee will make further investigations in this respect. This roughly was the course of the discussion as I see it.

But of course there is more behind that. In big conferences usually this is not being expressed so plainly for apprehension that an unfavorable impression might be created. However, I think we in the Board who, due to permanent close cooperation know each other better, should discuss those questions also, without having to be afraid of touchiness of individual members. The most important of these open questions on the part of the unit proponents in my view is whether in case of an acceptance of the Munich compromise it can be taken for granted that new liquidity would be created in the necessary volume. This I regard basically to be the main reason for the question raised by Mr. Deming at the end of the discussion concerning the envisaged volume of future reserve creation.

To me it seems important--if future disappointments are to be precluded--to consider the following: It is my distinct impression that many countries, authorities, and individuals expect support of their

individual interests in many different cases in which a genuine global need for additional liquidity based on a growth in the world economy does not really exist.

There were for instance frequent comments in the American press stating it was expected that a creation of additional reserves would promise a relief to the dollar and to the U.S. Government. I am not informed of whether such considerations have been or are being made in the Treasury. But it is obvious that, if the United States could effect part of its large payments in a newly created international means of payment, the Treasury would not have to fear that these amounts would be returned to it for exchange into gold the next day or the other way round: the Treasury could use the newly created means of payment to redeem dollars. I acknowledge that this would be of extreme importance to the U.S. Government. But this motivation would have no connection with reasons for the creation of additional reserves on account of an expansion of world trade and the monetary requirements this might bring about.

Another example: We all know that, since the memorable declaration of Chancellor Maudling at the 1962 Annual Meeting, the United Kingdom has tended to attribute the difficulties the pound sterling was facing primarily to a scarcity of international liquidity though to the rest of us the necessary assistance given to the pound appeared to be of an individual nature. Therefore, as President Blessing put it at that time it was not deemed useful to elevate the level of the ocean--of global liquidity--to bring afloat a stranded ship.

We all know, too, that there are a number of countries which deem it highly desirable to have an opportunity of investing part of their monetary reserves in an internationally guaranteed reserve medium in due course and which for this reason wish the creation of such a kind of additional reserve.

Indeed, all these are very important reasons for a creation of additional reserves; nevertheless, such reasons have no connection with the expansion in world trade and an additional need for reserves caused by this factor.

I am at all times very much obliged to Mr. Faber for his frankness in identifying the problems. Recently, he stated to the Board of Directors that the countries he represents could not afford to hold reserves. The need of these developing countries for equipment which is indispensable for the development of their economies is so great and so urgent that what they needed would be reserves to spend rather than reserves to hold. It is clear to me what Mr. Faber has in mind: what these countries primarily need is capital. But if they fail to obtain this in the amount deemed necessary, they will take every opportunity which gives them the possibility to finance the desired investment. Since we reached consensus in previous discussions that the newly to be created liquidity will have to be injected into the world economy in such a way that each country will participate in distribution according to its IMF quota, it is self-evident that each of these countries has a vital interest in the creation of additional reserves-- independent of whether the growing world economy as such does need additional liquidity or not.

At the Joint Meeting we heard that some speakers hold the opinion that the necessity to create additional reserves could now arrive faster than was anticipated earlier. I happened to ask for the reasons behind this change of opinion. The answer I received was that the actual creation of a new reserve medium would become urgent because this seems necessary to counteract the increasing gold speculation and its adverse effects. I admit that gold speculation is a reason for concern to every member of the management of a central bank and that it can indeed become a real danger--but there will always be an urgent necessity to fight whatever speculation there is, even at times when the experts agree that the supply of international liquidity is more than sufficient.

And I had a last very interesting conversation at the Joint Meeting with a gentleman who tried to convince me that the recent stagnation in the German economy has its reasons in the lack of international liquidity because the U.S. dollar could not add to world liquidity in 1966. I answered him that the statistical economic data on our economy indeed showed some decline but that the only figure climbing steadily was that of German exports; and that therefore our foreign customers obviously did not suffer from any lack of liquidity. But I did not have the impression that my remarks convinced this gentleman. Apparently, he did not care very much for the validity of his presumption;

what he seemed to be anxious about was growth by all means, and this was his reason to advocate the creation of additional reserves.

In quoting all these different examples I did not have criticism in mind. Rather I wanted to demonstrate by a few current examples how very tempting it is to expect from such an inexpensive and simple method as is the creation of new reserves assistance against various monetary difficulties unrelated to the growth in world trade and to a true need for international liquidity. Under these auspices the demand for additional liquidity will always be much greater than the amounts that can reasonably be created. To me it seems important to point this out distinctly once.

But there is something else to conclude from this: I think it does not mean going too far supposing that under the circumstances prevailing everyone who will suggest an increase in international reserves can count on a solid majority without the necessity for him to claim that real and additional need for global liquidity were existing, nor to prove his case.

But the granting of every monetary claim necessitates financing. This is even more obvious with a drawing right than with a unit. Therefore, it is only natural and those countries which finally have to supply the usable currencies which are indispensable to render the system operative are very much interested in securing that decisions concerning the creation of new liquidity are being taken with a truly adequate majority. When summarizing the results of the Second Joint Meeting, and repeatedly thereafter, I have drawn the Board's attention to the fact that the majority can only be regarded as adequate if the activation requires 85 per cent of votes. A band proposal which actually means circumscribing the fact that a majority of 75 per cent would be sufficient to create additional reserves can, for the reasons mentioned, not be taken as helpful.

Overabundance of newly created international liquidity does not have the same direct inflationary consequences as overabundant printing of money inside a domestic economy, the interrelations in this field must still be studied in more detail. To me it seems obvious, however, that in those cases, in which the conditions for what is called imported inflation are given too high a supply of international liquidity, i.e., of liquidity not necessitated by the

volume of international trade can cause the tide of imported inflation to rise much more dangerously.

I am well aware of the fact that all the statements assembled and summarized here could give further impulse to suspicion already inherent in a skeptical partner that an excuse was being sought to hold up the creation of additional liquidity as far as possible or to keep it low.

Nothing would be more inaccurate than that.

Though it seems advisable to me for the sake of precluding disappointments to point out that many of the hopes and dreams now tied to the creation of additional liquidity will not materialize, I am nevertheless less convinced that nobody nowadays could afford not to satisfy a genuine need for liquidity. And nobody could expect assistance who ventured to propose to disregard economic requirements for political reasons. This applies especially to the European countries. The countries in question are industrialized countries. This means they are vitally dependent on their exports--to a much larger extent, for instance, than are the United States. Should there be a case of where the expansion of world trade would be impeded by a scarcity of reserves these countries would be the first to stipulate an increase in international liquidity for their very own interests.

But let us assume theoretically that these countries would nevertheless refuse to cooperate: I think there is unanimous agreement that without their cooperation the creation of additional liquidity would be impossible in practice anyway. Therefore, a majority requirement of 85 per cent does not mean to give up any position which anyone else would have had otherwise. Such a majority requirement does not involve any discrimination either. The rights of each member are equally concerned. Personally, I strongly hold the view that in practice there will never be such a frontline as 85 to 15. If there is no unanimous consensus, as will be the rule, there will always be different members on different sides.

In summarizing, I want to state in my personal capacity that after this Third Joint Meeting I see a fair chance for a general agreement in Rio if we make use of the special drawing rights now under discussion, and if we agree upon a majority requirement of 85 per cent for all decisions concerned with the creation of additional reserves.

Mr. Kafka felt encouraged by the Third Joint Meeting. Even where he did not perceive any actual agreement, he could see at least the outlines of a compromise. He referred in particular to the apparently general agreement that any new asset that was created should be an unconditional one. On the matter of transfer and use, he thought that a possibility for arriving at a compromise between absolutely free transfer and guidance had been outlined in the remarks made by Mr. Emminger. He also saw a similar possibility of compromise in the discussion which had been taking place on the question of reconstitution. He did not believe anyone thought of reconstitution in absolute terms. They saw it rather in terms of some sort of portfolio balance which would be achieved, not in a mechanical way, but as the result of representations which might be made when clearly excessive use, contrary to the spirit of the agreement, was taking place.

Even on the matter of decision making, Mr. Kafka considered that it had become clear that there might be some means of giving the creditor countries, or those who thought that they might become creditor countries in the future, the assurance they required without departing from the principle of nondiscrimination and introducing anything like a unit voting arrangement which, as Mr. González del Valle had said, would, without any question whatsoever, be unacceptable to the world community as a whole. He added that he had the impression that some sympathy had been expressed during the Third Joint Meeting with an idea which had always appealed to him, namely, that although a high voting majority might be required at the start of a new scheme, this could be progressively reduced over a period of time, as had been done in the EEC.

Mr. Dale referred briefly to Mr. vom Hofe's statement. He pointed out that the Secretary of the Treasury and Mr. Deming had stated that there was no relationship between reserve creation and the U.S. balance of payments position. The benefits which the United States expected to obtain from reserve creation were the same that other members expected to obtain, namely, a better functioning of the international monetary system and not, to any significant extent, balance of payments financing. He considered that the attitudes of the international financial community, as it was represented, for example, on the Fund's Executive Board, were much more conservative than Mr. vom Hofe apparently believed.

Mr. Stevens shared many of the views Mr. González del Valle had expressed. He thought this was another indication that some real progress had been made and that a great deal of consensus had been achieved. His impression was that there was a chance now that a final solution would be reached. The main problem still ahead was the question of decision making. The other problems, such as

reconstitution and transferability, were much less serious. He thought that the problem, which seemed to be trying to emerge at times during the discussion, over the distinction between money and credit was not a real one and it would not be very fruitful to pursue it.

Mr. Handfield-Jones thanked the Economic Counsellor for the clarification he had provided. Mr. Handfield-Jones agreed that it would be useful to give further consideration to the question of the need for a balance of payments test in the case of transfers. The sort of situation the Economic Counsellor had described where a group of dollar area countries transferred all their new assets to the United States, and in turn those assets were transferred by guidance to other countries which did not wish to hold them, was clearly unsatisfactory. The question was whether this sort of problem should be resolved by putting limits on the initial freedom of transfer or whether it should be dealt with by applying guidance criteria.

The Economic Counsellor replied to a question from Mr. Ozaki about why the term "cede" had been used instead of "transfer" in the first paragraph on page 7 of SM/67/56. The staff had the impression from the Munich Communiqué that the term "transfer" had perhaps to some extent been misunderstood. The sort of transfer envisaged was not, of course, similar to the hand-to-hand transfer of bank-notes. Nor was it like the transfer which took place in a check clearing system. It was more like a "giro" system under which the owner of an account would tell the institution to make a transfer to the owner of another account. The drafters of the Munich Communiqué had apparently been troubled by the word "transfer" and, in one connection, had used the term "cessibilité." This implied ceding or getting rid of the asset in a more general sense than transfer, but in trying to translate "cessibilité" into English, the staff had not been able to find any work other than "transferability."

Mr. Madan had rather mixed feelings about the achievements made at the Third Joint Meeting. He thought the explanations given on the Munich Communiqué did suggest that it contained some positive elements, but he was still not at all clear about many aspects of the Monetary Committee's Report. Like previous speakers, however, he did think that a general consensus had emerged on the need for some form of unconditional reserve asset. Although there was no clear agreement on the urgency of the need, it was accepted that there should be a contingency plan for dealing with that need when it arose. In that regard, he had one comment on Mr. vom Hofe's statement in which he had ruled out a number of situations in which the need for reserves was related to the individual motivations of

member countries. Mr. Madan did not think it was possible to rule out all consideration of individual needs. How would a global need be identified if the situations of individual countries could not be taken into account? Moreover, a genuine global need was bound, from time to time, to be reflected in the needs of individual countries even though these might require various measures other than, or in addition to, the supply of additional reserves. If the supply of reserves proved to be insufficient for a growing volume of world trade, this was bound to result in deficits for particular countries. He hoped, therefore, that awareness of the need for other action, such as improvements in the adjustment process, would not result in the argument Mr. vom Hofe had been making being taken to extremes.

Mr. Madan felt that there had been a certain meeting of minds at the Third Joint Meeting in regard to various technical issues which, from the record of the previous discussions, appeared to have been acting as stumbling blocks in the way of agreement on a scheme of reserve creation. On the question of whether transfers should be free or guided, it had been recognized that freedom could not be altogether free and that guidance should not be altogether arbitrary and was not necessarily inconsistent with freedom. There had been a broad measure of agreement that guidance should be a matter of certain general principles or objectives and that, provided it was exercised consistently with these principles, it was possible to have a great deal of freedom. The real problem came at the point where freedom and guidance became inconsistent with one another. At that point the question that arose was the form that guidance should take. Mr. Madan thought that it should be a matter of collective judgment and decision within the framework of the Fund and one based on the consultative and cooperative machinery that already existed. In his view, there was already a basis for reaching an understanding on this aspect. If freedom and guidance should happen to conflict, guidance would be more likely to be consistent with the objective of improving the adjustment process because it would be the result of collective thinking regarding the situation of the particular members concerned and the requirements of the membership as a whole. The staff paper (SM/67/56) had indicated that this could be reflected in certain general rules of behavior so that guidance would not be imposed from outside, but rather evolve from a generally accepted standard of behavior which would, of course, involve a certain element of proportionality.

Turning to the question of reconstitution, Mr. Madan thought a greater understanding had been achieved of the differences between reserve creation and the Fund's normal lending process. He was hopeful that it would now be possible to find a solution to that

particular problem. On the question of decision making, however, no progress seemed to have been made. He agreed with Mr. González del Valle, Mr. Faber and Mr. Kafka that unit voting would not be an acceptable feature of any decision-making process. He considered that the logical procedure was to adopt the same voting majority as was required for amending the Fund's Articles of Agreement. In his view, an 80 per cent majority was a sufficient safeguard. It was not necessary to increase the voting majority for activation and subsequent reserve creation to 85 per cent, even if this proportion came to be adopted for entry into force. If individual members were unhappy about a proposal, it would not be difficult for them to muster the necessary 20 per cent of the votes to oppose it.

In concluding, Mr. Madan hoped the Chairman would throw some further light on the future course of action and particularly on how the Board's discussions on liquidity were to be coordinated with the program for discussing the Annual Report.

Mr. vom Hofe intervened to say that he hoped Mr. Madan had not misunderstood some of his earlier remarks. He fully agreed that if there was a global need for liquidity, it would be felt by all the members of the Fund. The cases he had been describing were ones where the desire to have additional liquidity was not related to any global need for liquidity. For the special reasons which he had explained, that desire would be just as strong in those particular cases whether or not there was a global need.

W. LAWRENCE HEBBARD
Secretary

