

INTERNATIONAL MONETARY FUND

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W. L. Hebbard, Secretary

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Also Present

African Department: M. Touré, Director; C. L. Merwin, Deputy Director.
Asian Department: D. S. Savkar, Director; C. C. Liang. Central Banking
Service: R. A. Young, Consultant. European Department: L. A. Whittome,
Director. Exchange and Trade Relations Department: E. Sturc, Director;
C. D. Finch, Deputy Director. Fiscal Affairs Department: J. Saper,
Deputy Director. 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; M. Fleming, Deputy Director; H. Ezekiel, F. Hirsch, R. R. Rhomberg.
Secretary's Department: A. Mountford. Treasurer's Department: W. O.
Habermeyer, Deputy Treasurer; R. Kroc, Deputy Treasurer. Western Hemisphere
Department: J. Del Canto, Director, C. E. Sansón. Information Office:
J. Reid, Chief Information Officer; J. L. Zegers. 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, E. Schmidbauer, E. Stoffers, W. Stoop.

1. INTERNATIONAL LIQUIDITY - REPORT ON MEETING OF GROUP OF TEN DEPUTIES,
AND USE AND TRANSFER

The Economic Counsellor made the following report to the Executive Board on a meeting of the Deputies of the Group of Ten in Paris on May 18-19, 1967.

This one and a half day meeting of the Group of Ten, which was attended for the Fund by Mr. Gold, Mr. Sallé, and myself, discussed a number of major outstanding issues. While the meeting produced some narrowing down of differences on some of these issues, none of them can be said to have been fully resolved.

The meeting had before it as documentation three papers prepared by the Fund staff: "The Choice Between Merged and Separate Resources for a New Reserve Facility" (SM/67/58), "Deliberate Reserve Creation--Problems Related to Use and Transfer" (SM/67/56), and "Voting Provisions in Reserve Asset Schemes: Illustrative Examples" (SM/67/62), and the Informal Record of the Executive Board Informal Session 67/16 on Liquidity of May 10, 1967. The group expressed its agreement with the suggestion made by the Managing Director that the reciprocal exchange of records with the Executive Directors be continued; the record of this Paris meeting will be made available to Executive Directors as soon as it can be prepared. During the meeting the U.S. delegation submitted two papers, namely, an "Outline of a Drawing Unit Reserve Asset (Dura) Plan" and a "Revision of the Fund Illustrative Reserve Unit Scheme."

On decision making the group had before it two proposals, that of the EEC countries for an 85 per cent majority plus at least half of the major creditors, and the U.S. proposal for a band between 75 per cent and 90 per cent. The Chairman, after stressing the need for a clear and relatively simple solution to the decision-making issue, inquired whether such a solution might not lie in a plain 85 per cent rule. The discussion that followed did not produce a convergence on a specific voting rule but a number of speakers laid stress on the similarity of the objectives of the two voting formulae referred to, in the sense that both were based on a high qualified majority supplemented by a procedure (the second vote in the U.S. proposal and the unit vote in the EEC proposal) to ensure that sufficient creditor strength was represented.

In connection with the presentation of the Fund staff paper on voting arrangements (SM/67/62), the Fund representative pointed out that perhaps not enough attention had been paid, in the discussion of voting percentages, to the question of how the votes were to be

made up. For example, the question was touched upon, but not pursued, whether the 85 per cent majority which the EEC favored was to be based on votes that contained an allowance for creditor positions, or whether the 85 per cent was intended to reflect only basic votes and quota (or cumulative distribution) votes, so that the introduction of an allowance for creditor positions could be considered as an alternative to unit voting.

Although activation conditions were also mentioned on the agenda they were not discussed.

Considerable time was spent on the question of opting out. The Deputies appeared to move toward agreement on three essential propositions with respect to opting out, namely, (a) that it was no substitute for a good decision-making process, (b) that it would provide little, if any, protection to the dissenting country, but (c) that it could not be fully avoided since no country would be willing to give an unlimited commitment. The Chairman concluded from this discussion that the solution with respect to opting out would probably have to be very close to that proposed in the Fund staff scheme, namely, no opting out for an initial amount that would be specified in the Articles of Agreement and accepted by parliaments when they ratified the Articles, with provision for opting out beyond this amount.

On the rules for transfer and use the EEC countries put forward a two paragraph proposal, as follows:

A country that wishes to utilize its automatic drawing rights shall be free to do so by direct transfer--within the framework of any general principles of guidance that may be laid down by the agent--provided it is in a net creditor position in the system and finds a country in net debtor position which is willing to accept drawing rights (even if the drawing country has no balance of payments need). In such a case the country uses earned reserves, and its drawing contributes to a better equilibrium and to a voluntary reconstitution of the debtor country's position.

On the other hand, if a country utilizing its drawing right is in a debtor position in the system (or moves into a debtor position through its drawing), it uses a credit and therefore should be subject to certain limitations:

- (a) the principle of balance of payments need;
- (b) guidance by the agent;

- (c) the constraints which may result from the rules of reconstitution.

As a general comment a number of delegations expressed disagreement with the sharp contrast made in this text between creditors and debtors and between "earned reserves" and "use of credit," a terminology which they considered incompatible with the concept of the deliberate creation of reserves. On the substantive provisions there proved to be a wide difference of view, which ran by no means along EEC/non-EEC lines, as to the extent to which a country should, in making its transfers, enjoy two separate freedoms--(a) the freedom to transfer even without need and (b) the freedom to transfer without guidance assuming the country found a willing transferee. The two paragraphs quoted indicate a position of limited freedom, which would apply only in the case of a transfer from a "creditor" to a "debtor" and then perhaps only with the permission of the organization, this being to some the meaning to be attributed to the clause "within the framework of any general principles of guidance that may be laid down by the agent." The extended discussions seemed to make clear, as one or two Deputies stated, that it would be very difficult to foresee how wide an area of freedom on these two points, which all desired in principle, would be compatible with the good functioning of the system under circumstances that could not now be envisaged, so that it might not be possible to state in advance what categories of transactions might suitably be left free as regards observance of the rule of balance of payments need, as regards guidance, or both.

Less attention was devoted to the content of guidance. The point of view was expressed that this was a question that was more nearly technical in nature and that something roughly along the lines set out in the Fund staff paper on transfer (SM/67/56) would probably be satisfactory to the EEC countries. In the two U.S. proposals a number of additional criteria are introduced. Several speakers stressed the need for the organization to reconcile in its practical operations the three, four, or five principles which it would be instructed jointly to observe. The suggestion was also made in this connection that the guidelines should, as far as possible, not be laid down in the Articles of Agreement of the organization but reserved for later decisions by it.

It was reported to the meeting that on the question of the separation or merger of resources all EEC countries agreed that complete merger would be undesirable, but that some of these countries favored, nevertheless, some link between the resources of the present Fund and the new reserve creation mechanism. This question was not discussed further.

On the question of reconstitution, there appeared to be a broad willingness to go as far as making reconstitution one of the criteria of guidance to safeguard the liquidity of the scheme. The two U.S. papers contain a provision to this effect, which would direct drawings to countries making "large and persistent" use. One Deputy, however, judged it essential that the Articles of Agreement contain a quantitative definition of large and sustained use and referred in this connection to the concept of maximum average use given on page 18 of the recent Ossola Report (X/DEP/144).

At the end of the meeting there was a brief discussion of the procedure and agenda for the Fourth Joint Meeting. The Chairman suggested that that meeting should concentrate on the same four main items that had been on the agenda of this Deputies' Meeting, but it was also agreed that time should be available to discuss the various aspects of a liquidity scheme as they were interrelated, so that hopefully the Joint Meeting would be able to reach agreement on all major aspects, or at least most major aspects, of an "Outline" for a scheme to be submitted in Rio. The Chairman expressed a hope that this could be achieved in two or at most two and a half days, with the remainder of the third day available for a meeting of the Deputies to agree on their Report to Ministers. Some Deputies felt, however, that the Joint Meeting might well need three full days and this was agreed for planning purposes, with the Deputies to meet on a fourth day if this proved necessary.

Consideration was also given to the possible need for a meeting of the Ministers and Governors of the Ten if certain major issues could not be resolved in the Joint Meeting.

Mr. Kafka raised a procedural point. He noted that the Deputies had discussed the agenda for the next Joint Meeting and that there had been some divergence of opinion as to whether the agenda should be limited to the items that were discussed at the Deputies' Meetings or should also include discussion of a liquidity scheme. He hoped the Executive Directors would have an opportunity to express their preferences about the agenda. If one wished to get anywhere by the time of the Annual Meeting, the participants should be prepared to discuss a draft outline in joint session. Accordingly, they should be prepared to make the Fourth Joint Meeting last beyond two and a half days and even beyond three days, if necessary. If some differences still persisted after the Fourth Joint Meeting, there should perhaps be a further Joint Meeting in Rio for one or two days before the Annual Meeting. At any rate, he thought the staff should prepare outlines of schemes to be discussed by the Board and then at the Fourth Joint Meeting.

Mr. Dale referred to the fact that all EEC countries had agreed that complete merger of resources would be undesirable, but that some of these countries had nevertheless favored some link between the resources of the present Fund and the new reserve creation mechanism, and he asked the staff to clarify this difference. He agreed with Mr. Kafka that the participants should be able to devote as much time as might prove necessary to a discussion at the Fourth Joint Meeting of the staff's illustrative schemes. While it was clearly necessary to discuss the four specific items that had been on the Deputies' agenda, it was also important to discuss the interrelationships between the various parts of a scheme.

The Economic Counsellor referred to Mr. Dale's question about separation of resources, and said there had been no more discussion of it than had been described in his report. The General Counsel added that, in his brief statement on this subject, the Chairman of the Deputies had given the impression that there was still some disagreement on this question among the EEC countries, and that the extent to which there should be a link was still in doubt. This matter had not been discussed further by the Deputies.

The Chairman referred to Mr. Kafka's procedural point, and said he believed everyone was now ready to discuss a draft Outline at the next Joint Meeting. The staff would produce a draft Outline as soon as possible, based on drawing rights in the Fund with separation of resources. The draft Outline would not be as complete as the illustrative schemes.

After some discussion it was agreed that the Board would take up the draft Outline on June 5, 1967.

Mr. Larre had doubts about the possibility of producing a very useful Outline at this stage. On the basis of the discussions in the Board, the Deputies, and among the EEC countries, he thought it was still quite unclear what would be put under various headings. It would not be helpful if the staff put into the Outline its own ideas on the controversial issues.

Mr. Handfield-Jones said he had thought that the next discussions would take place on the basis of revised illustrative schemes prepared by the staff, which would provide a better basis for discussion than papers prepared by individual participants. He had been looking forward to revisions of both illustrative schemes.

Mr. González del Valle said he had understood that after the Third Joint Meeting the Executive Board had decided that the staff would prepare revised versions of both illustrative schemes, but particularly of the

unit scheme. He recalled that some Executive Directors, including himself, had opposed the idea of revised illustrative schemes earlier because it was not known how the EEC proposals would develop. However, this information should have been made available by now, and he thought the staff should go ahead with preparing something that would serve as a basis for further discussions. He thought the Chairman of the Deputies was being over-optimistic if he expected real progress to be made at the next Joint Meeting without a discussion of the full structure of a scheme. The U.S. revised version of the unit scheme was useful, but it would be better to proceed along the lines of the staff proposal.

Mr. Larre had no objections to the procedure proposed by Messrs. Handfield-Jones and González del Valle. Some countries might wish to express their views on a more detailed illustrative unit scheme, and they were of course free to do so. For their own part, the members of the EEC and the Ten Deputies would continue working on their own scheme, which they would then bring to the Joint Meeting. He had thought that a later stage had been reached, when one would look for a compromise, but if the participants were still at the preliminary stages, exchanging ideas and taking positions which they knew would not lead anywhere, he was quite willing to go along.

Mr. Dale supported Messrs. Handfield-Jones and González del Valle. He thought it had been agreed that the staff would prepare revisions of both schemes. Of course, it was open to any Executive Director or Deputy to introduce other illustrative schemes. He did not like the idea of being invited to wait until certain countries made up their minds, especially as that did not seem to be advancing very quickly.

The Chairman said the staff would prepare a revised illustrative unit scheme, taking into account the discussion at the Third Joint Meeting. He shared the view that an Outline of a revised drawing rights scheme would be helpful, even if all of the participants had not made up their minds on what they wanted. He did not share Mr. Larre's fear that the staff would produce provisions that were unacceptable to many members. He agreed with Mr. Larre that various alternatives were still open, but he thought that outlining these alternatives would be helpful.

The Economic Counsellor said that a revised drawing rights scheme in the form of a draft Outline would be produced shortly. He could not say how quickly it would be produced until the staff had had the benefit of the Board's discussion of the three papers on the agenda of the present meeting. The Deputies' discussion had been useful in indicating certain areas of agreement and of disagreement which would have to be taken into account in the drafting. The areas of disagreement would have to be

narrowed down if there were to be agreement on a draft Outline. In some cases, agreement simply involved agreeing on a percentage figure for the voting majority, for example, but in other cases, the difference was more subtle and would have to be reconciled by inserting appropriate words. Someone had to put forward possible words, and this was one of the things that the staff's draft Outline would do. He said that thereafter the staff would prepare an up-dated illustrative unit scheme.

Mr. Larre thought that some of the points were purely technical, and he was sure the Board could make headway on them at this meeting or the next one. However, other differences were more political, and he doubted whether agreement on these could be reached in the near future. He thought the author of the Outline would simply have to stress that there were many possibilities, and leave blanks in the paper. However, he was surprised that it had been suggested, before the Board had discussed the three items on the present agenda, that a draft Outline be prepared. It would be more normal to have an exhaustive substantive discussion of the three staff papers and then to have a synthesis of the discussion to form the basis of the Outline. It might also be useful to discuss the reserve unit scheme, in view of Mr. Handfield-Jones' useful contribution.

The Chairman thought that one could already have some idea about the general matters concerning drawing rights which had received general acceptance, in the light of the Joint Meetings and the last Deputies' meeting. In addition, the staff would have the benefit of whatever points the Board members would make later in the present Informal Session. Taking all these into account, the staff felt able to produce an Outline.

The discussion turned to the paper on Deliberate Reserve Creation--Problems Related to Use and Transfer (SM/67/56, 5/5/67).

The Economic Counsellor said the Deputies' discussion on this subject had showed that there was something to be said against any extreme position on these matters. His impression was that the Outline should not be rigid on these issues, as any absolute position would prove unacceptable to some participants and might prove unwise in the operation of the scheme. He thought the Outline would be more nuancé than were Sections I, A, B, and C of the staff paper.

Mr. vom Hofe said a consistent solution reconciling the different views on this subject had still not been found, despite the discussions at the Third Joint Meeting and the recent Deputies' meeting, and apparently it would have to be passed over to the Fourth Joint Meeting. His personal view was that the pragmatic answer on transfers was to have guidance where necessary and freedom where possible. On reconstitution, the staff seemed to object strongly to a repurchase mechanism, and even to doubt its feasibility. He thought the technical practicality of obligatory repurchases could not be denied.

Mr. vom Hofe noted the staff view that a member, to which representations about excessive use were made, "would have no other means to reduce its use except in the quite unlikely event that other members would seek it out to arrange voluntary transfers." However, he thought that such a member might have unused conditional drawing rights in the Fund, which could be used to reconstitute the unconditional drawing rights of the new scheme. In the extreme case where a country had used all its new assets and all of its other reserves, and most of its conditional drawing rights, he thought such a country would not be far from defaulting anyway, and reconstitution provisions would not be enforceable by mere representations. Such a country would probably be already faced with serious pressures from other quarters to restore a sufficient over-all reserve position through responsible economic policies. One should not forget that the envisaged reconstitution commitment would merely have the character of a first reminder or a signal. He agreed that in extreme cases the organization would have to cooperate with the Fund and perhaps other creditors, to bring about a rehabilitation of the debtor country by correcting its underlying weaknesses, for example, by a suitable stabilization program connected with a drawing in the higher credit tranches, with part or all of the drawing being directed to specified purposes.

Mr. van Campenhout did not agree with the statement in the staff paper that the "structure of the Fund" contained two main techniques for reconstitution, namely, the reduction by the Fund of a member's use of the Fund by selling that member's currency to other members and voluntary repurchases. While the Fund was a revolving Fund, it was clear from the Articles of Agreement that Fund operations were limited to those which were undertaken on the initiative of members. Admittedly, the policy on the selection of currencies reduced this limitation on the Fund's operations, but that policy was not intended for the reconstitution of the Fund's resources. Moreover, this policy was not the "structure" of the Fund. He thought the reference only to voluntary repurchases overlooked the compulsory reconstitution obligations which might well inspire the reconstitution system of a new scheme, particularly as it had no fixed date of repurchase but was based on movements in the traditional reserves of the country.

Mr. Larre thought that the issue of direct versus indirect transferability had been solved, and that perhaps the staff had accepted Mr. Ossola's point that all transferability was indirect, inasmuch as the new asset would be kept as a bookkeeping item by the Fund, and there could be no transfers of the new asset without going through the books of the Fund. Therefore, the real issue was between voluntary or guided transferability. He thought that in most, if not all cases, there would have to be guided transferability. This was not to say that he liked guidance, but if the

scheme were to work, and if it could not work without guidance, one had to accept this fact, and it would be very difficult to mix guidance with voluntary transfer. If guidance was the rule, voluntary transfers should be the exception and perhaps should be limited to transfers from a creditor to a debtor. As to whether the use of the reserve unit should be connected with a country's balance of payments situation, he thought that whatever assets might have to be created would be needed to settle balance of payments accounts, and he did not see why an asset should be used for any other purposes. He favored having a balance of payments need test. However, there was the separate legal question of knowing how this need would be recognized, and how it could be challenged. This question might have to be faced when the Board considered the Belgian proposals about the Fund gold tranche.

Turning to the question of reconstitution, Mr. Larre thought it very doubtful whether the liquidity of any scheme could be maintained without a strict reconstitution requirement. But in addition to the liquidity argument, he thought one should prevent a list of permanent debtors growing up. Of course, this was also linked to the liquidity argument, since a scheme might well be liquid even if it had one persistent debtor with a very small quota. It was a question of policy and of policing the new scheme. He did not consider that reconstitution was basically contrary to the so-called need for additional liquidity. It was not a question of reconstituting borrowed reserves. What might be needed in the more or less remote future was a possible increase in owned reserves. If countries went on accumulating reserves, and did not wish to hold them all in gold or dollars, they should be offered a third choice. This third choice should be reserves to be held, not to be borrowed, because it was a self-defeating proposition to say, "I will borrow some reserves, and then I will keep them for good." That would not seem to be a correct approach to the problem of additional liquidity. He recognized that, in the Fund mechanism, the cancellation of owned reserves was usually a consequence of the cancellation of a country's borrowed reserves, for example, when a country, which had previously drawn, repurchased its currency and the super gold tranche positions of creditor countries was reduced as a consequence. However, this was not always the case. For instance, in the case where the Fund borrowed money from Italy and lent this money to a debtor country, a repurchase by that debtor country would not reduce Italy's super gold tranche position. One should not mix too closely the borrowing aspect and the owned aspect. Mr. Larre thought that the reconstitution provisions should work effectively and smoothly. He thought the staff proposals were loose and weak, and were tantamount to saying that reconstitution would not be mandatory but would be required when the Fund was in dire need of liquidity. It was as if a bank told its borrowers to keep their loans until the bank had an urgent need for repayment, whereupon the debtors would have to pay back on demand. This provision could

not work well, because members might be faced with a wholesale request to repay and they would be close to a situation of default. In order to have an efficient reconstitution provision, countries should have notice that they would have to pay back on a certain date. To ensure that it worked effectively, one had to avoid the possibility that a country could pay back one day and draw again the next day, because this would not mean a reconstitution at all. Also, any bumpy situation, in which a country drew 100 per cent for two years then had to pay back all of it at once, should be avoided. This was why the French Deputies had presented a proposal which would establish the reconstitution obligations on the basis of a concept of average use. He thought that at some stage these two aspects, efficiency and smoothness, would have to be reconciled. He thought the reconstitution provision should be clearly expressed in legal language, so that there would not be any misunderstanding or difficulty when the time came to establish the repurchase policy.

Mr. Larre said he had assumed that the reconstitution operation would be like the normal operations of the Fund in the gold tranche or super gold tranche. In other words, there would be an exchange operation, and the country would have to provide its own currency, in exchange for the currency it borrowed from the organization, and this operation would be reversed at the time of the repurchase. If the Fund had been started on this road, it was for good reasons, and it had gained some experience of this method, and it was easier to extend these known operations than to introduce a quite different approach, which would not fit in well with the Fund's own practices.

Mr. Madan thought that the discussion on the relative advantages of freedom and guidance had indicated a certain convergence of views. This pointed to the need to consider more closely the rules for guidance, because it was understood that even freedom would be exercised within a broad framework of guidance. On reconstitution, he thought the tendency was to look at it in terms of requiring reconstitution where there had been excessive use or a large and sustained use. This really shifted the issue to considering what would constitute excessive use. In view of the fact that the aim of reserve creation was to supplement the conventional reserves, such as reserve currencies and gold, he thought it could be expected that the new reserve instrument would be in constant use by all the members. This had a bearing on determining what was excessive use. Apparently there would be an attempt at approximation of the holdings of reserve rights to the total reserves of the countries toward which the transfers were directed. This had been the policy underlying the Fund's operations in the selection of currencies for drawings. On the other hand, if transfers were directed toward members that were not in a strong balance of payments position, for reconstitution of reserves, there was the question of defining excessive use or large and sustained use.

Mr. Madan said that one problem which had seemed to emerge in the discussions of the Deputies was with respect to the distinction between so-called strong countries and other countries, because these categories were not hard or rigid. They could not be expected to be maintained indefinitely. In fact, the flexibility and resilience of a monetary mechanism resulted from the fact that there would be shifts from one category to the other. Therefore, the proportion which was thought of as a guideline in considering to which countries transfers might be directed could not be very different from the proportion which was thought of for countries that received transfers for reconstitution reasons. If these two proportions were very different, there would be too large a change when countries shifted from one category to another.

Mr. Lieftinck recalled that he had once expressed the view that courageous people, who wanted to create a new reserve asset, might be so much afraid of their own courage that they came back to some kind of conditional liquidity. Considering the present state of the proposals, he could not see very much difference between the drawing rights proposal that was crystallizing and the familiar Fund gold tranche. He hoped somebody would point out the difference between drawing rights, as conceived by the staff and by the EEC countries, and the gold tranche position. As an example of the similarity, he thought it was almost agreed that there should be reconstitution, at least in the case of long and sustained drawings, and where the balance of payments position of the country had improved. In addition, there was the idea of a balance of payments need test, as in the gold tranche, although the word "current" had been dropped and accordingly the new asset could be used to finance structural capital movements. In essence, therefore, it was very similar to the gold tranche. The differences were only in details. On the question of direct or indirect transfers, he thought that if there were indirect transfers via the Fund, there was no difference, but if there were direct transfers, there should be guidance. However, this was nothing like unconditional liquidity, it was just an ordinary conditional gold tranche position.

Mr. Handfield-Jones thought that it might be easy to forget that there had always been two alternative ways in which one might respond to the circumstances which had become increasingly apparent in the international monetary system, first to increase the role of the Fund, or second, to attempt something rather different in the way of deliberate reserve creation. As regards the first option, there had been proposals for a substantial general increase in Fund quotas at the time of the Fourth Quinquennial Review of Quotas, but it had only been possible to achieve agreement on an increase in Fund quotas that simply maintained the relative size of the Fund within an enlarged international payments system. Accordingly, there had been long discussions on the second option. The discussions

had aimed at creating an asset which could stand in the company of the traditional reserve asset, and would thus be different from the existing claims upon the Fund. Other speakers had compared the proposed new asset to the Fund gold tranche. However, in the discussions of deliberate reserve creation, people had been thinking of doing things rather differently in the new regime than in the Fund. They were thinking of various changes in the Articles and in the voting procedures. To justify such changes, one would have to demonstrate that the new exercise was different from what had been done before. He thought the desirable and essential attributes of deliberately created reserve assets were different in some important respects from those of the present operations of the Fund. Mr. Handfield-Jones felt considerable disquiet at proposals that there should be a balance of payments need before voluntary transfers could take place between countries. He would also regret any reconstitution provision which was not firmly and specifically rooted in a self-evident need to safeguard the liquidity of the organization. To go even beyond these in the directions which Mr. Larre had described, and which were reflected in the Economic Counsellor's report on the Deputies' meeting, would indeed lead to a situation which would provide no basis for justifying other changes in the Fund as it now operated.

Mr. Dale was interested by Mr. Liefstinck's point about the similarity of the new drawing rights proposal and the gold tranche, and he agreed with Mr. Handfield-Jones that what had been thought of originally was something which in substance and in its psychological effect would be different from what was done in the Fund. Perhaps the differences were no less real if they were psychological. On the question of direct and indirect transfer, he agreed that perhaps the more important substantive issue was the manner in which guidance or other rules of the game were formulated, and what effect they would have on the transactions of countries within the scheme. The fact that the more important question was the substantive one did not detract from the fact that direct transfer had important psychological benefits.

Mr. Dale noted that in describing the general criterion that the organization would use for guidance, the staff paper stated that, "In particular, the organization would avoid directing transfers to countries at a time when they were in serious balance of payments difficulty,..." He thought that "serious balance of payments difficulty" was rather strong language, and it might give rise to the implication that if transfers were not being directed to a country at a given time, that country must be in a difficult situation.

Mr. Dale referred to the U.S. papers distributed to the Deputies and to the Executive Directors, and said they included an effort to articulate as fully as they could, and in as much detail as possible at this stage,

what they thought might be a reasonable position on the subject of holding and use. As regards the Drawing Unit Reserve Asset (Dura) paper, which was substantially identical in this respect to the reserve unit paper, he said that the U.S. authorities agreed that there should be an appropriate definition of "need" for financing. In this respect, he was on common ground with Mr. Larre, rather than with Mr. Handfield-Jones. He had found persuasive the arguments given by the Economic Counsellor at the last Informal Session. In addition, the United States authorities thought that one of the ideas which had been generally accepted was that the deliberately created reserves should not be used to change the composition of reserves, and he thought the need concept was related to that idea, rather than to a conditionality notion. Mr. Dale noted that the Dura paper provided for voluntary purchases along the general lines that had been suggested in Mr. Emminger's paper on holding and use. There was also a specific reference to use of the proposed assets in transactions with the Fund.

Mr. Dale referred to the list of principles which the U.S. authorities felt would be reasonably appropriate in connection with guidance (page 5 of Dura paper), and said that perhaps the paper overdefined these. This was partly a result of an attempt to clarify what kind of criteria would be appropriate. He thought the somewhat precise statement of a series of criteria did not differ greatly from the guidance policy of the Fund, although it would put more emphasis on the importance of balance of payments surpluses or reserves increases as criteria. Where it was mentioned in VII (e)(1)(iii) that purchases of currencies might be directed toward a member that had notified the organization of its willingness to have its currency purchased by the organization, this was intended to cover the possible situation in which, if the United States were not covered by subsections (i) or (ii), it would be able to notify the organization of its willingness to take reserve assets. Referring to VII(e)(2), he said the organization ought to pay due regard to the effects of members' reserve composition policies and to shifts in these policies. In VII(e)(3), there was a provision to try to avoid an undue concentration of new assets in the holdings of a given member, as a discretionary departure from the other criteria he had mentioned. There was an acceptance limit, rather than a holding limit, in VII(e)(4), and here the U.S. authorities had moved over to the stand that the staff had previously taken. It articulated the idea that, if suitable conditions could be created, the acceptance limit should be allowed and indeed encouraged to wither away. Of course, one would have to take a pragmatic view of this. Paragraph VII(e)(6) contained a provision that if a member failed to observe the need test, the organization ought to be able to direct transfers to it. In paragraph VII(e)(7), there was a rather modest statement of what the U.S. authorities thought was the general position on reconstitution at the Third Joint Meeting. Mr. Larre had made some interesting points about

reconstitution, but those points seemed to be founded on a credit concept rather than a reserve asset concept. He felt very strongly that what would be created was a reserve asset. Mr. Dale then referred to the provision in paragraph VII(f) which would enable a member to purchase balances tendered to it of its own currency. This was a rather modest redemption feature, which was subject to two limitations, first, that the country redeeming its own currency would need to fulfill the need criterion, and second, that the country which was tendering the currency for redemption must not itself be over its acceptance limit. He believed this provision was in substance not very different from the provision in Article VIII(4) of the Articles of Agreement.

Mr. Kafka thought it was important to decide whether what was to be created was conditional reserves or unconditional reserves. If mechanical reconstitution provisions were established, one would not really be creating an unconditional reserve asset, and in that case the whole exercise might prove fruitless, because one might find oneself, after a few months, again trying to establish a new scheme. He understood the fears behind the lack of enthusiasm in favor of an unconditional reserve, but he thought there was a way of meeting that fear without giving up the establishment of an organization which could satisfy the world's need for unconditional reserves. This possibility arose provided one avoided writing anything into the constitution which would constitute a mechanical restraint, but in the policy on the amount of reserves to be created, and in the policy of administering these reserves, one would follow the lines of prudence which in any case a new organization should follow. One should not prejudice the development of the organization by writing mechanical limits into its constitution.

Mr. Larre understood the nostalgia expressed by Mr. Handfield-Jones for the reserve unit, but hoped he would be satisfied by the fact that the staff would prepare a revised unit scheme. Then there would be two schemes again to choose between. He agreed with Mr. Liefstinck's remarks, except on some minor points. First, Mr. Liefstinck had suggested that the gold tranche was conditional liquidity, but the staff had often stated that it was an unconditional asset. It had often been explained that the Fund had an extensive role in the field of unconditional liquidity, and this had been the basis for its participation in these discussions; otherwise, he did not know why the Fund should be discussing these matters, which could have been left to the Ten who had started the discussions. He agreed there was not much difference between the present proposals and the gold tranche. This was a very good thing, and the greater the uniformity between the gold tranche and the new reserve asset that could be established, the more would one know where one stood. This would be particularly good if the present gold tranche were overhauled. However,

there were important differences, because the gold tranche was based on a gold payment, but it was expected that the new reserve asset would be backed by national currencies. It seemed that some countries were ready to move from a gold tranche with gold to a gold tranche without gold. This was a big change, even if he was not sure that it was an improvement. It was enough to justify overhauling the structure of the Fund. If one wanted to extend the role of the Fund and give it more responsibility, and if one wanted all countries, creditors and debtors alike, to trust the Fund, then one would have to change the structure. As regards the concept of a balance of payments need test, Mr. Larre thought that any facility could only be used in one of two ways, either to meet a balance of payments need or to change the composition of one's reserves. He thought everybody was on record that they did not want the new facility to be used to change the composition of reserves, and he was surprised that some were reluctant to accept a need test.

Mr. Wass agreed broadly with the consensus described in the staff paper. As regards use of the new asset, he still favored freedom, even where the balance of payments need was not proven. The safeguard that there should be a willing transferee should be sufficient. Where the transferee sought guidance, he thought it would be appropriate to have a need test. He broadly agreed that guidance should be directed toward the strong countries, and that the broad objective should be to harmonize the ratio of reserve assets to total reserves for countries that were in a position to accept transfers. There should be an over-all limit on the obligation to accept, and he welcomed the incorporation of such a provision in the U.S. proposal. Like Mr. Larre, he drew a distinction between an asset which was presently available but subject to reconstitution on demand, and an asset which was only available on certain conditions. He had always thought of Fund conditionality as not applying to the gold tranche and this should apply also to the new reserve asset. Of course, if the reconstitution rules were very rigid, a situation might arise where the unconditional asset would simply not be available because the conditions could never be fulfilled. On the other hand, he accepted that the liquidity of the new scheme must be protected by some form of reconstitution requirement. At the very least, the formula propounded in the staff paper should be adopted, but he thought that going very far in the way of definition would ultimately cast doubt on the value and desirability of holding the asset. One of the objects of the whole exercise was to create something that countries would want. If the asset were surrounded with too many formal rules, it would acquire certain undesirable characteristics, and it might prove difficult to get members to accept it and retain it. He agreed with Mr. Kafka that whatever rules on reconstitution were adopted should be flexible and not defined too precisely or codified. These matters could well be left to be worked out by the Executive Board of the new organization. The founders of the Fund, for example,

had not attempted to define conditionality with regard to use of the Fund's resources in the Articles of Agreement, with the exception of the very broad wording of Article I. These provisions had been worked out by the Executive Board in a pragmatic fashion and in the light of subsequent circumstances. He hoped the problem of reconstitution could be handled in the same way.

Mr. Faber agreed with the assumption in the staff paper that the technique of an affiliate would be selected, as this seemed more sensible than a system of separate accounts. He also agreed with the assumptions about freedom or guidance of transfers. With reference to the statement that, "In providing its guidance the organization would attempt as much as possible to operate through general rules and recommendations," he thought the setting up of rules might be a helpful way of avoiding discrimination. These rules would have to be reviewed from time to time.

Mr. Faber had some difficulty with the word "implies" in the statement that "The obligation to accept...implies that a member must be prepared to reconstitute...whenever this is necessary to meet the need of other members to make use of their reserve assets." He did not think that the obligation to accept was the counterpart of use of the asset--rather it derived from membership in the organization. He did not think there was any implied commitment to reconstitute, apart from the general rule regarding the ratio of new reserves to total reserves. He agreed with the staff that it would be less complex if the organization could dispense with a second technique of reconstitution.

Concerning the provision that the organization would take excessive use as one of its criteria for transfer, Mr. Faber wondered if it would really be possible to avoid an excessive use. Most of the safeguards that were used in the Fund, such as a tranche policy or a time limit, would not be appropriate. The ratio to be maintained with total reserves would provide some form of safeguard against excessive use. In this respect he was impressed by the suggestions in paragraph VII of the U.S. authorities' Dura paper. It was clear that specific criteria were needed with regard to extensive use of the new asset, and that the size of the country involved should be taken into consideration. The use should be of such a type that it would affect adversely the liquidity of the organization, and it was clear that this was not the case with smaller countries, such as those which had elected Mr. Faber. Therefore, the rules should be flexible.

Mr. Faber thought one should avoid having a criterion for reconstitution which was based on a country's past behavior. He would not like this form of discrimination. As regards the method of transfer, he thought one

should attempt to reach an understanding along the lines of voluntary transfer, as this would lead one slowly but consistently toward the creation of unconditional assets. He also hoped the present exercise would bring about the use of a larger number of currencies in Fund drawings. He was not sure there was no difference between direct and indirect transfers, as had been suggested, as the validity of voluntary transactions between countries would be postponed until recorded on the books of the organization in the case of indirect transfers.

Mr. Faber said he was not clear about the statement that "The drawing rights could be exercised just as well without the drawing member providing the countervalue in its own currency." He understood that lines of credit would already have been extended, and that when there was use of the reserve asset which required holding in excess of acceptance limits, the transferee would have to extend an additional line of credit to the transferor or to the organization. He would have preferred this provision in the unit scheme, where there would not be specific lines of credit. He hoped the staff would clarify the statement that "direct transfer might also be the most convenient solution in some guided transactions, for example, in those instances where the transferor was guided toward his reserve center as the transferee." He thought this should also apply where particular economic ties linked the transferor and transferee.

It was agreed to resume the discussion later.

W. LAWRENCE HEBBARD
Secretary

