NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Secretary's Journal of Executive Board
Informal Session 66/6, 10:00 a.m., March 16, 1966
and
Informal Session 66/7, Following EBM/66/18, March 18, 1966

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

Executive Directors	Alternate Executive Directors
J. J. Anjaria	A. K. Ghosh
U. Beelitz	H. Ungerer
M. C. Bicalho	
W. B. Dale	J. S. Hooker
K. Eklöf	O. Schelin
	M. San Miguel, Temporary
S. J. Handfield-Jones	P. M. Reid
L. Kandé	A. W. Yaméogo
S. Kiingi	P. L. Faber
	G. Teyssier
P. Lieftinck	H. M. H. A. van der Valk
A. Nikoi	
M. W. O'Donnell	A. M. de Villiers**
A. Z. Saad*	A. Mansour
S. Siglienti	C. P. Caranicas
J. M. Stevens	D. W. G. Wass*
G. Suzuki	E. Ozaki
	C. L. Chow
E. Tejera-Paris	J. González del Valle*
A. van Campenhout	H. Biron

Roman L. Horne, Secretary
A. Mountford, Assistant

* Informal Session 66/6 only
** Informal Session 66/7 only

Informal Session 66/6

Also Present

African Department: H. Merghani, Director; J. Waitzenegger, Deputy Director; Tun Wai. Asian Department: D. S. Savkar, Director; H. C. Murphy, Deputy Director; C. C. Liang. European Department: R. J. Familton. Exchange and Trade Relations Department: E. Sturc, Director; C. D. Finch, K. M. Huh. Fiscal Affairs Department: R. Goode, Director; J. Saper, Deputy Director. Legal Department: J. Gold, General Counsel; F. Hodel, P. R. Lachman, O. C. Snellingen. Middle Eastern Department: J. W. Gunter, Deputy Director; A. K. El Selehdar. Research and Statistics Department: J. J. Polak, Director; J. M. Fleming, Deputy Director; A. C. Bouter, G. S. Dorrance, H. Ezekiel, P. Høst-Madsen, R. R. Rhomberg, J. S. Smith. Secretary's Department: J. W. Lang. Treasurer's Department: C. B. Fink, R. Kroc, R. H. Miller. Western Hemisphere Department: E. W. Robichek, Deputy Director; P. J. Brand, U. Sacchetti, C. F. Schwartz. Central Banking Service: R. Tenconi. Information Office: J. H. Reid, Chief Information Officer; N. K. Humphreys, J. M. Zegers. Special Representative to UN: G. Williams. Personal Assistant to the Managing Director: A. L. Coleby. Technical Assistants to Executive Directors: G. M. Gill, W. K. Griffiths, J. S. H. Hunter, L. Plum, E. J. Schmidbauer, E. Stoffers, T. Tanaka, J. R. Vallet.

Informal Session 66/7

Also Present

Administration Department: P. Thorson, Director. African Department: H. Merghani, Director; J. Waitzenegger, Deputy Director. Asian Department: H. C. Murphy, Deputy Director; J. Ahrensdorf, C. G. Chang, S. Kanesathasan, B. H. Kay, C. C. Liang, Tun Thin, H. C. W. Yang. European Department: W. A. Beveridge, R. J. Familton, J. J. Hauvonen, B. S. Karlstroem. Exchange and Trade Relations Department: E. Sturc, Director; J. H. C. de Looper, C. D. Finch, K. M. Huh, A. B. Jacobs, S. Makdisi, S. Mookerjee, R. N. Selby, K. Siber, J. Swidrowski. Fiscal Affairs Department: R. Goode, Director; S. Cnossen, C. H. Tretner. The IMF

Informal Session 66/7 (Continued)

Institute: F. C. Dirks. Participant: B. K. Choo. Legal Department: J. Gold, General Counsel; A. S. Gerstein, Deputy General Counsel; H. Aufricht, J. G. Evans, F. Hodel, P. R. Lachman. Middle Eastern Department: J. W. Gunter, Deputy Director; A. S. Gerakis, M. M. Hassanein, A. S. Ray, A. K. El Selehdar, A. S. Shaalan. Research and Statistics Department: J. J. Polak, Director; O. L. Altman, Deputy Director; A. C. Bouter, G. S. Dorrance, H. Ezekiel, P. Høst-Madsen, R. R. Rhomberg, J. C. Sánchiz, J. S. Smith. Secretary's Department: W. L. Hebbard, Deputy Secretary; J. W. Lang. Treasurer's Department: C. B. Fink, D. L. Lechliter, R. H. Miller. Western Hemisphere Department: E. W. Robichek, Deputy Director; P. J. Brand, U. Sacchetti, C. F. Schwartz. Information Office: N. K. Humphreys, J. M. Zegers. Personal Assistant to the Managing Director: A. L. Coleby. Technical Assistants to Executive Directors: G. M. Gill, W. K. Griffiths, J. S. H. Hunter, R. G. Nayak, L. Plum, E. J. Schmidbauer, T. Tanaka, J. R. Vallet.

1. THE NEED FOR RESERVES AND CREATION OF ADDITIONAL RESERVES THROUGH THE INTERNATIONAL MONETARY FUND

The Executive Board resumed discussion, in informal session, of a staff paper on the need for reserves (SM/66/9, 1/14/66), which had previously been discussed at Informal Sessions 66/4 and 66/5, and also took up a staff paper on the creation of additional reserves through the International Monetary Fund (SM/66/30, 3/3/66). The Executive Board also had before it a staff paper on trends in payments imbalances, 1952-64 (DM/66/13, 3/11/66).

The Director of the Research and Statistics Department said that the paper on the need for reserves suggested three possible explanations for the fact that over the postwar period reserves had increased considerably less rapidly than trade, and that nevertheless this had apparently not led to an inadequacy of reserves. The three explanations were redistribution, mostly of the U.S. reserves, the increased availability of credit facilities, and the possibility that payments imbalances might in fact have become smaller in proportion to trade. The information on the third hypothesis, which was now available in the paper on trends in payments imbalances, did not support that hypothesis. By all reasonable measures, and several different possible measures were discussed in the staff paper, the evidence was that payments imbalances had been growing at about the same rate, approximately 6 per cent per year, as trade had increased.

Mr. Anjaria said he would confine his remarks to the creation of reserves through the International Monetary Fund. He thanked the Chairman and the staff for the outline of two possible schemes which could be considered for the creation of reserves under the auspices of the Fund. He was glad to have a Fund paper which stated clearly the starting point and the basic assumptions relating to the Fund's approach to this important problem, and which went on to develop in some detail the lines along which the desired results could be achieved. He thought this was the point where the discussion on this subject should have started. With the possible alternatives of reserve creation through the Fund thus lucidly set out, clearly, if there were other ideas on the subject then the onus for proving the superiority of those ideas would lie with those who favored the other ideas.

Mr. Anjaria considered it important that there were two alternative schemes for reserve creation through the Fund; one was mainly a development of existing practices and techniques, and the other, though not very different in effect, involved the setting up of a subsidiary or an affiliate. He welcomed the statement in the introductory portion of the first scheme regarding the basic approach to the whole problem, which clearly showed the necessity of starting from the assumption that reserve creation and the taking of decisions relating to reserve creation and the management of any new scheme, were the concern of all Fund members, and should therefore take place under the auspices of the Fund. Concerning the balance between conditional and unconditional liquidity, he thought there was a common agreement that the proportions of the two would have to be decided upon before considering in detail the creation of unconditional liquidity. But that did not detract from the importance of creating unconditional liquidity under the auspices of the Fund. Indeed, this matter impinged on the functioning and the further development of the Fund, and it was important to emphasize the interrelations between both aspects, namely, conditional and unconditional liquidity, and the danger of deciding on either in isolation from the other. Similarly, the Managing Director's introductory statement in the staff paper rightly emphasized that the creation of liquidity must be related to certain policy objectives. While he recognized that the mere fact of the creation of international liquidity would not ensure the implementation of those policies, it was worth reiterating that the effort to enlarge liquidity and to manage it more purposefully was related to the basic objectives described in the Articles of Agreement of the Fund.

On the two proposals, Mr. Anjaria felt that it was perhaps too early to express a clear view on whether the first or the second scheme was to be preferred. The first scheme had certain obvious advantages, in that it was a continuation and an evolutionary development of the present practices and policies of the Fund. The second scheme, though more flexible in the long run, raised questions of new legislation by members, and also questions relating to possible changes in the Articles of Agreement. In any case, it was quite clear that a start could be made with the first scheme if the Fund reached a consensus on that subject, and then to move toward the second scheme in due course.

With regard to the first scheme, Mr. Anjaria said it clearly indicated the process by which the additional resources needed by the Fund would have to be built up, the obligations and responsibilities of the members participating in the scheme, and the lines along which the special reserve facilities could be used, both by countries which had outstanding drawings and those which had not used the credit facilities of the Fund. He had some doubts on Part G of the first scheme, which dealt with decision making. It was too early at this stage to go into the implications of the rather elaborate formula which was suggested, but his first reaction was that the Fund Articles of Agreement probably contained sufficient indication as to the procedure to be followed for taking all the relevant decisions. If a change had to be made, it would require detailed study. Apart from this, he agreed with the approach suggested in the first scheme, as it would meet the needs of both the industrialized countries and the less developed countries.

Turning to the second scheme, Mr. Anjaria said he saw no major difficulty with it, and it might well be thought of in due course, after a beginning was made along the lines of the first scheme. However, he had doubts on some points of detail in the second scheme. For example, he did not understand, in the description of the method of allocation of additional units in connection with the scheme of reserve creation, why there should be a provision which would make it possible to defer or to withdraw the allocation of additional units in case some members so desired (SM/66/30, p.5, 3/3/66). Similarly, he had difficulties with the provision that all transfers would be made at par against the U.S. dollar, or against the currency of the transferee, "if it is convertible, at a rate to be determined" (ibid., p.6). He did not understand, if the currency was convertible, why there should arise any question of the determination of the rate, or why the U.S. dollar in particular was mentioned.

Mr. Anjaria said that with respect to both schemes, it would be useful to have a clearer spelling out of the principles which would govern the purchase and repurchase of currencies, and especially as to how the lines of credit mentioned in the first scheme would be utilized. He hoped the two schemes would be the starting point of a fruitful and productive discussion on the important subject of creating international liquidity and strengthening the international payments system.

Mr. Siglienti said he had no reaction at this stage to the staff paper on the creation of additional reserves through the Fund; he thought it should be considered as one of the proposals which were now under discussion. At this stage, the Italian authorities were interested in a number of questions which would only be answered when there was a greater spelling out of some of the provisions of the paper, for example with respect to the decision-making process, and the rules of transferability. He would accordingly restrict his comments to the staff paper on the need for reserves (SM/66/9, 1/14/66); he had not been present at the previous informal discussion of this paper (Informal Sessions 66/4 and 66/5, 2/16/66).

Mr. Siglienti said he had doubts about using the monetary statistics approach to the need for liquidity. There were dangers in projecting the future from the past, and he recalled that the 1958 Fund study on liquidity had practically rejected this mathematical approach. This exercise was not useless, however, and it could be an element of the discussion, together with the other elements, provided its limitations were kept in mind. As the Director of the Research and Statistics Department had indicated at the previous meeting, "It was important not to put too precise an interpretation on these estimates; they merely implied that, if by means of reserve policy, which was not the only policy available, one wanted to reproduce the same balance between expansionary and contractionary forces in the world as had prevailed in the reference period, this could most likely be achieved by reserve creation in the order of magnitude indicated." He would emphasize that reserve policy was not the only policy available. This raised the central issue of the discussion, which, as Mr. Handfield-Jones had put it was the link between the level of reserves and expansiveness of policies. The 1958 liquidity study had practically rejected a strong link between the level of reserves and expansive policies, and had drawn attention to the role of management of domestic liquidity and the fact that governments always passed a judgment before managing liquidity in the way that was suggested by reserve movements. He agreed with Mr. Handfield-Jones' theory of a neutral zone: of course, the usefulness of this exercise was a reverse function of the size of this neutral zone. However, he was ready to accept the staff approach, as a sort of laboratory experiment. But he would feel safer if for the time being this kind of monetary Frankenstein's monster were kept in the test tube. If the paper was published or given wider circulation among officials, or if it was incorporated in the next Annual Report, the Fund should be very cautious, and perhaps put more emphasis on the reservations and caveats already contained in the staff paper. He thought it was dangerous to arrive at a final figure. Because of the character of the study, one could not have expected the staff appraisal to take into account all the factors influencing the need for liquidity (for example, military conflicts or earthquakes, or even national policies), but he thought more consideration should have been given to factors which affected the need for liquidity directly and moreover lay within the responsibility and the expertise of the Fund. These included other methods to restore balance of payments equilibrium, namely, the adjustment process, exchange rate policy, and controls or other direct balance of payments measures. A closer consideration of these factors would have made it possible to decide whether the period from 1952 to 1964, or any portion of that period was satisfactory from the point of view of the functioning of the monetary system, and also whether similar conditions were likely to prevail in future years. Although economists did not agree on appraising the reference period, the view was held by some economists that in the earlier part of this period there was an excess of controls, (the implication being that there was too little liquidity to allow an earlier dismantlement of these controls). On the other hand, other economists held the view that the system had evolved toward a system of an exchange rates which was more rigid than was desirable or was even contemplated by the Fund Agreement; (this would imply that less liquidity would have been necessary if rates were more flexible). Also, there had been much discussion of how the adjustment process had worked, and there was agreement that the surplus countries had accepted adjustment up to a certain point, until it conflicted with domestic objectives of stability, but that now the adjustment process was insufficient. If one held all these views, one would come to the pessimistic conclusion that new liquidity should be created because countries had given up relying on the other methods of coping with disequilibria.

Mr. Siglienti agreed that the system of fixed par values should continue. At the same time, there were certain countries for which the Fund itself was recommending a flexible exchange rate policy, and these countries would need much less reserves if they followed the Fund's recommendations closely. More than anything else he thought there was room for improvement in the adjustment process. In any case, it was not possible to decide on the future needs of a system without passing a judgment on the efficiency of the system.

Mr. Siglienti was interested by what the staff paper described as the striking homogeneity in the reserve movements of many countries, both developed and less developed, around 40 to 50 per cent of imports. However, like Mr. van Campenhout, he would be cautious about drawing implications from this fact. Statistical differences were important, and many countries had reserve measurements which differed from those in IFS, and their policies were based on their own measurements. Like Mr. van Campenhout, he doubted whether there was a close proportional relationship between world trade and the level of reserves. For example, the staff paper indicated that countries which did not have excessive reserves in the early fifties had on the whole increased their reserves in proportion to the expansion of their imports between the mid-fifties and the mid-sixties; however, the list of countries with initial high reserves included some, such as Argentina and Brazil, whose reserves he thought had been low in the early fifties. The criteria by which the staff defined the countries with initial high reserves were not clear.

Mr. Siglienti noted the distinction between reserve policy and balance of payments policy in the staff paper, and said he doubted whether these policies were distinct, except for countries which had a very low level of reserves and therefore made an increase in their reserves one of the main objectives of economic policy. For countries with a comfortable level of reserves, what really counted was the balance of payments policy, which was based on broader considerations than the level of reserves. The level of reserves could influence balance of payments policy in various ways. However, he agreed that in most countries the balance of payments policy was directed toward equilibrium, and that countries tended to err on the side of surplus, and that therefore some allowance should be made in providing liquidity to finance those surpluses. There was merit in this approach, but he still contributed to the theory that the form of financing deficits was what made countries more or less reluctant to run deficits. For example, Italy had accepted a deficit to the extent that it was possible to cover it by borrowing by the private banks, but when it began to affect gross reserves, Italy had taken action to restore equilibrium. The United States was an example of a country accepting a deficit willingly as an objective of its economic policy, and he agreed with the description in the staff paper of the role of the United States and the changes in that role, but again he felt that the change had to do with the form of financing of the deficit. Probably the two were linked; while the United States was performing a function which was accepted by the international community, the international community had been willing to hold dollars and the United States was able to finance its deficit by increasing its liabilities. When this function ceased to be justifiable, the United States was no longer able to use that form of financing. In terms of the problem of the creation of new reserves, this suggested that new reserve means should be such that countries would not be too reluctant to lose them, while of course they should not be made too attractive. He thought Fund positions had proved to have this quality. Countries had not resisted losing creditor positions with the Fund. (Perhaps sometimes they had resisted acquiring them!)

Although many Executive Directors seemed to prefer the period from 1952 to 1964 as the reference period, Mr. Siglienti thought it would be very difficult to agree on an appraisal of this period, or on whether it should be reproduced in the future. It would probably be easier to agree on a shorter period, say 1961 to 1963, although it would be difficult to adjust for the anomalies in that period which the staff paper described. For example, as regards the French surpluses, he thought the adjustment should have taken place in the opposite direction than suggested by the staff.

Mr. Siglienti agreed with Mr. Dale that the Fund should try to find out more about the reserve policies followed by individual countries, although he was somewhat skeptical about the possible results. He agreed also with those who had emphasized the importance of conditional liquidity and of the adjustment process, particularly as this latter had also been mentioned by some Executive Directors elected by developing countries. He thought that responsibility for adjustment lay with both deficit and surplus countries, and surplus countries should not be asked to place more priority on external objectives, to the detriment of internal objectives, than were the deficit countries. He agreed with Mr. Suzuki about the role of private credit in financing world trade: this aspect had not been dealt with adequately by the staff paper.

Mr. Handfield-Jones said that in the memorandum circulated to Executive Directors before the previous discussion on the Need for Reserves (EBD/66/23, 2/11/66), he had suggested that countries might well prove to be relatively unaffected by reserve changes within a range or neutral zone, and that only when reserves fell outside that range did they trigger markedly expansive or restrictive effects. In trying to give some empirical content to this idea, he had examined the interesting data presented in Table 3 of the staff paper, and he thought these data were consistent with a view that the range of the neutral zone might well be from 30 per cent to 50 per cent of imports. Indeed it was striking how many countries there were whose reserve experience in the period of reference was consistent with this range. He was more confident in making this judgment as regards the developed countries, many of which had stayed within the range consistently over the whole period, while some which had moved out of the range had tended to move back into the range. There were some interesting and significant exceptions to this pattern, however. The United Kingdom, one or two Scandinavian countries, and Yugoslavia, consistently maintained lower reserves, which suggested that these countries were not disposed to follow highly restrictive policies at the reserve levels which would trigger off such restrictive policies in other countries. On the other side, Switzerland and Portugal were much above the 30 to 50 per cent range, and these countries had perhaps tended to be somewhat more conservative in their financial policies.

Mr. Handfield-Jones said the other significant exception was the United States. At the beginning of the period, the U.S. reserves position was obviously much too high, and indeed the United States had followed expansive policies without concern to its balance of payments position. More recently, it had of course found itself moving toward a range of policies which reflected a greater concern with its reserve position, even though the U.S. reserve assets were still, at the end of 1964, at 82 per cent of its imports. Various hypotheses could be advanced to explain this, for example, the fact that the United States' imports were small in proportion to its over-all economic activity. However, he thought an important explanation was the fact that the reserve assets of the United States had to serve two purposes; not only did they have to serve the purposes which reserves served in other countries, but also they had to provide some backing for the U.S. liabilities held by other countries. Of course, this backing was not to be thought of as a 100 per cent backing: no banking system could sensibly operate on other than a fractional reserves basis.

Mr. Handfield-Jones said that over the period as a whole, the decline in the U.S. reserves as a ratio of imports was one of the most significant developments. There had been a general convergence by countries over the 15 years, from both low and high extreme positions, toward the average, but the most important element in this convergence had been the change in the position of the United States. He would attach a great deal of weight to this, in the explanation of why total international reserves had risen less rapidly than world trade during this period. Indeed, the whole of this difference was explained by the change in the U.S. position. He had calculated the reserve/import ratio for the world, excluding the United States, which showed that reserves for the world other than the United States had been remarkably stable in relationship to imports, and had fluctuated only in response to cyclical fluctuations in world trade as a whole. The ratio started at 34 per cent in 1951 and 35 per cent in 1952, in which years world trade had been unusually high as a result of the Korean War. It rose in 1953 to 41 per cent, and 42 per cent in 1954, then declined, during the expansion of world trade in the mid-fifties, to 39 per cent in 1955, and 36 per cent in 1956, before dropping to the unusually low level in 1957 of 32 per cent, reflecting the effects of the Suez crisis. The ratio then recovered, and for the next five or six years it was in the range of 39 to 40 per cent, and had only dropped to a level of about 36 per cent in 1965 during the period of renewed rapid expansion of world trade. The average for the period as a whole was 38 per cent, which was very close to the middle of the range of 30 per cent to 50 per cent that he had suggested might be a reasonable measure of the neutral reserve range.

Mr. Handfield-Jones said this marked stability in the pattern of reserve holdings for the world, excluding the United States, could hardly be coincidental. It was reasonable to postulate that it resulted from a remarkably stable propensity to hold reserves, together with the fact that the world outside the United States had been able to satisfy its propensity to hold reserves out of the growth in international liquidity as a whole and residually by running a surplus with the United States. Like Mr. Wass, he thought the U.S. deficit could be regarded as something determined at least in part by the liquidity preference of the rest of the world.

Mr. Handfield-Jones said the staff paper on trends in payments imbalances (DM/66/13, 3/11/66) gave additional corroboratory evidence that the propensity of the world outside of the United States to hold reserves had been stable in relation to the growth of world trade. The paper confirmed that the growth of imbalances had grown at much the same rate as world trade, and this would therefore be consistent with the view that over the reference period the need for reserves had been a more or less constant function of the growth in world trade as a whole. The implications of this for the future were rather startling. If one assumed that world trade would continue to grow at a rate of 6 per cent, and that the world's need for reserves would continue to grow in line with world trade, and that the reserve position of the United States would not be permitted to continue falling in ratio to imports, then the need for reserves would grow at a rate of 6 per cent. This implied a figure of $4 billion, rather than the $2 billion or $2.5 billion suggested by the staff. The fact that the staff approach came out with a lower figure was partly because it gave too little attention to the contribution made by the U.S. deficit over the last decade or more as a factor enabling a lower growth of reserves in relation to world trade, which could hardly continue. He also had some difficulty with the short-period analysis in the staff paper, which attempted to draw inferences as to the future growth of reserves from an examination of the growth of reserves in relatively satisfactory periods. The difficulty with this approach was that the linkage in the short run was extremely loose, and there could be periods in which the world economy was performing very well but reserves were changing in ways which were unsustainable for the long term. Alternatively, it would be possible for reserves to be growing in the short term, although the world economy was performing badly. Of course, this figure of $4 billion, resulting from the empirical projections, was entirely bizarre; Mr. Siglienti had suggested that the test tube might produce a specter which should be kept in the laboratory and not let outside, and this would also apply to a 6 per cent growth rate of reserves.

Mr. Handfield-Jones said one therefore had to conclude that conditions in the future were likely to be significantly different from the conditions of the reference period. In the first place, there was ground to question a 6 per cent growth of world trade. Also, more fundamentally, he questioned whether the stability of the trend to hold reserves would continue in the future. It seemed possible that capital movements had grown in the reference period in a relatively destabilizing way; they might well have contributed substantially to the widening of imbalances recorded in the staff paper on trends in payments imbalances, 1952-64 (ibid.). He asked the staff to analyze whether the growth in trade imbalances had been as rapid, and thus what the growth in nontrade imbalances might have been over this period. If nontrade imbalances had grown, this might have been a temporary development, because it was difficult to believe that international capital flows could not make a larger contribution to balance of payments equilibrium than in the last ten years. Also, the adjustment process might be expected to improve, and conditional credit might make a growing contribution to the financing of imbalances. Conditional credits had played a growing role in the recent past.

On the basis of these considerations, Mr. Handfield-Jones said the need for reserves was likely to grow at something in the range of 2 to 4 per cent rather than 6 per cent. He had doubts about what the staff paper suggested might be the contribution of existing types of reserve assets. For example, one did not know how much gold would become available for official holdings, if in fact the doubts held in some quarters about the future evolution of the international monetary system were entirely removed. Also, one did not yet know what could be counted upon in terms of the contribution of foreign exchange holdings. The staff apparently doubted whether there would be a growth in foreign holdings of U.S. dollars in the future, and it felt that if there was such a growth the contribution would be entirely offset by the need for the United States to hold an equivalent amount of reserve assets. Certainly, to the extent that the United States succeeded in maintaining balance in its over-all payments position, then any increase in the holdings of dollars by other countries would be matched by an increase in the holdings of gold and other foreign exchange assets by the United States. However, this increase could play a dual role, and make some contribution not only to providing appropriate backing for the additional reserve liaibilities, but also to satisfying some of the United States' own need for growing reserves. It was important, before discussing what precise quantity of new assets might be needed, to know with greater detail what the U.S. requirements might be in the longer term. Obviously, much would depend upon confidence, and it might well be the case that priority should be given to ensuring that the system was controlled, rather than to insisting that the right amount of reserves was created.

Mr. Handfield-Jones considered that the Executive Board had made progress, in the present discussion, with the exploration of the needs of the international monetary system. However, it should be recognized that this only amounted to a reconnaissance, rather than an operational attempt at estimating the quantities of a decision what had to be taken in the immediate future.

Mr. Tejera-Paris welcomed the paper submitted by the management on the creation of additional reserves through the Fund. Discussion of this subject was timely, and represented considerable progress in the studies on liquidity along the lines suggested by a number of Governors at the 1965 Annual Meeting. Of the various technical papers prepared by the staff on the liquidity issue, this one appeared to be of more practical interest, and he commended the staff for its clarity and simplicity. In the two previous informal discussions on liquidity by the Executive Directors, he had abstained from expressing his views, for several reasons. First, in the discussion on alternative ways of distribution of deliberately created reserves, he had felt that the basic position of the countries which had elected him was clearly stated at both the 1964 and 1965 Annual Meetings, in the sense that distribution of new reserves should be accomplished through the Fund and should benefit all member countries. Second, the study on the need for reserves was basically an exploratory approach, which could hardly be expected to lead to practical results; the minutes of Informal Sessions 66/4 and 66/5 showed the paradoxical conclusion that almost everyone had welcomed the imaginative techniques of appraisal used by the staff, but almost no one accepted the quantitative results.

Mr. Tejera-Paris said full consideration of different deliberate ways to create new liquidity was the most urgent issue at this stage, precisely because the future role of the Fund in the international payments system was at stake. He felt that the determination of the need for reserves and therefore of the amount of new reserve assets to be created would eventually depend on pragmatic rather than technical considerations. As to the distribution of the new reserve assets, the acceptance of the Fund as a central institution of the system automatically answered the question.

Turning to the schemes outlined in the staff paper, Mr. Tejera-Paris fully agreed with the advantages of the approach suggested by the Managing Director's introductory memorandum, in the sense that the first of the two schemes could be implemented without reforming the Articles of Agreement, and could operate along well-known and familiar techniques, whereas the second would be more flexible in the longer run and could be perfected and refined without undue haste. The effects of both schemes would be similar, and, which was more important, in either case the Fund would improve its standing within the international monetary system. This was the basic premise which he had sustained all along, as his aim had always been to strengthen full international cooperation as an essential condition of future world trade and development.

The special reserve facility appealed to Mr. Tejera-Paris as a reasonable and appropriate proposal. From the point of view of reserve creation and distribution, this scheme simply provided for the extension and liberalization of the present drawing policies of the Fund. An additional drawing facility of the gold-tranche type would not affect the conditional facilities of member countries, and would be accomplished without prejudice to the compensatory financing facility. In both respects the special reserve proposal would extend the creation of quasi-automatic liquidity in proportion to the relative importance of each member country within the quota structure of the Fund. On the other hand, from the point of view of the provision of resources to the Fund, the suggested scheme would virtually broaden and make more universal the present restrictive provisions of the General Arrangements to Borrow, which was also a timely and appropriate reform in the present policies. Moreover, one could expect that the Fund would continue to succeed in bringing about the use in drawings of currencies of more and more member countries.

Depending on the size of the special reserve facility proposed in the first scheme, the Fund would basically continue to provide conditional rather than unconditional liquidity. Mr. Tejera-Paris' personal preference would be to bring about a relatively higher increase in unconditional liquidity, without detriment of course to conditionality itself. In fact, he was aware that expansion of conditional liquidity was in the long run more useful to countries facing balance of payments problems than an increase of owned reserves. What remained to be accomplished was to introduce more objective and equitable criteria in applying conditionality in specific cases. He was sure this could be done within the present structure of the Fund through periodical and, if necessary, critical reviews by the Executive Board of the actual application of policies on conditionality.

With regard to the second scheme, Mr. Tejera-Paris fully supported the proposal of reserve creation through international reserve Fund units. This idea had been explored in other international forums, and had received sympathetic support from developing countries. He considered that the establishment of a Fund affiliate with universal membership was the correct approach for that purpose. The simple and clear provisions outlined in the staff paper would satisfy the requirements of a truly international solution to the present controversy on reserve creation. He had read with particular interest the suggested provisions on transferability; the second provision would set up a limit to the acceptance of transfers by member countries, and, therefore, would meet one of the major objections to different proposals and plans which appeared to imply an open-ended arrangement.

Mr. Tejera-Paris noted that in both of the proposed schemes the decision-making process would rest in the Executive Board of the Fund. Executive Directors were all aware of the fact that divergent opinions on special majorities and the rule of unanimity had hampered progress even in the consideration of proposals outside the Fund. He could never understand the rationale behind the opposition of those who objected to placing the decision-making process in the hands of the Fund's Executive Board, since it was obvious that the industrialized countries could always, and without effort, control the basic decisions on creation and distribution of new reserve assets. The suggestion, very often voiced, that developing countries might distort the process of making policy decisions on international liquidity to satisfy their own interest always appeared to him to be without basis, not only because of the limitations in the voting power but also because developing countries would hardly have the intention of dictating the course of action in issues which were clearly more decisive for industrial countries. On the other hand, he noted that in both proposals the decision-making process would be subject to a special majority, including a number of member countries with the largest quotas in the Fund. Again, he could not understand why the staff was suggesting this type of restriction, when the decisions in the Executive Board could be carried out by the simple weight of voting power. He frankly did not see why the Executive Board should have to consider the need for a sort of "security council" in the international economic community.

Mr. Tejera-Paris welcomed this opportunity to express his frank and candid views about what he considered the essential issue in the liquidity debate. He did not have to insist that the Governors of the Latin American countries had been consistent in their opinion that all matters concerning the international monetary system must be discussed in the Fund, as it provided the best international forum for this purpose. As he saw it, this was the first opportunity in which, even at the level of informal discussions or seminars, the Executive Directors were dealing with something which pertained directly to the Fund, and therefore the Executive Directors should not shy away from the responsibility of discussing these issues.

Mr. Lieftinck recalled that at a previous discussion on the need for reserves he had questioned the validity of assuming that the need for reserves was the same as the need for liquidity: the staff paper dealt with the question of the need for unconditional liquidity, without regard for the contribution which could be made by additional conditional liquidity. The staff paper on the creation of additional reserves through the International Monetary Fund stated that "There can be no question about the value of conditional liquidity in the sense that it makes reserves available to countries on the basis of the steps they take to achieve needed adjustment in their payments position" (SM/66/30,p.1, 3/3/66). Later it said that "The needs of an expanding world economy will thus require increases in both of these types of liquidity in an appropriate mixture" (ibid.). That was exactly the point which he had tried to make at the previous discussion, by pointing out that perhaps a useful approach in determining an appropriate mixture of unconditional and conditional liquidity increases would be to analyze further the causes of imbalances, and to distinguish between imbalances in the trade and services account and imbalances in the capital account. The Director of the Research and Statistics Department, however, apparently felt one should not make a distinction between the causes of imbalances. Mr. Lieftinck was not very convinced by this, and felt it would be useful to determine what part of the need for additional liquidity could be met by conditional liquidity, and what part by unconditional reserves. The staff paper referred to an "appropriate mixture," and perhaps the staff believed one should first determine the total amount of additional liquidity required, and then the mixture should be determined by a process of bargaining. That would not satisfy Mr. Lieftinck.

Mr. Lieftinck said the staff paper on trends in payments imbalances, 1952-64 (DM/66/13, 3/11/66), threw additional light on imbalances in the recent past, but it was more confusing than clarifying. In the staff paper on the need for reserves, imbalances were measured by taking the sum of payments deficits of countries having such deficits, but the new staff paper added both deficits and surpluses, which in Mr. Lieftinck's opinion exaggerated the problem, because surpluses were not an exact reflection of deficits but were increased by the amount of at least part of the additional reserves created during the period. Therefore, this approach distorted the real problem of the temporary balance of payments deficits. Mr. Lieftinck said he had asked at the previous discussion what the picture of imbalances would look like of one eliminated the U.S. balance of payments deficit. The need for reserves paper had stated, "If, however, the figures for the United States are eliminated the trend increase measured for all other countries combined is considerably lower" (SM/66/9, p.16, 1/14/66). It was remarkable, therefore, that the staff paper on trends in payments imbalances came to the conclusion that if one eliminated the U.S. balance of payments deficit, this would not make a substantial difference. Of course, it would not be logical just to eliminate the U.S. balance of payments deficits without making any corrections. The correction made in the staff paper was to allocate the U.S. deficits among the other developed countries; this was arbitrary, and of course would lead to a similar outcome. Mr. Lieftinck thought that if the U.S. deficit had not occurred, the reserves of the other developed countries would have been smaller, but he doubted whether it would have affected their payments imbalances very much. He thought the staff's analysis was so hypothetical and arbitrary that he was not convinced by the outcome.

Mr. Lieftinck thought it was hazardous to extrapolate the relations between reserves, world trade, and imbalances in the balance of payments positions of countries, which had been found in the past. There had been temporary conditions in the past, which could not be expected to dominate the situation in the future.

Turning to the paper on the creation of additional reserves through the International Monetary Fund (SM/66/30, 3/3/66), Mr. Lieftinck welcomed the paper and said that now the Fund was on the level of making a contribution of its own to the international discussion in this field. Earlier papers had given some indication of what the Fund could do, but now for the first time two possible solutions of the problem had been presented, which could be compared with other possible solutions. Officially, the Executive Directors knew very little about the other proposals, and it would be useful if the staff prepared an analysis of the various proposals dealing with their differences and relative advantages.

Mr. Lieftinck said the first scheme could be considered conservatively evolutionary; the second was also evolutionary, but it contained many more new elements, and it would require revision of the Articles of Agreement, and perhaps a new statute for the IRF. With respect to the first scheme, he noted that "Declarations of intent or undertakings to repurchase will not be called for in connection with the use of the special reserve facility. However, members will still be expected to make no more than a temporary use of the Fund's resources, and to repurchase as their reserve positions improve whether or not the automatic repurchase provisions of the Articles bring this about" (ibid., Att., p.3). This was not clear, and it seemed contradictory; there was of course a difference between an undertaking and an expectation, but he wondered what would happen if the expectation were not fulfilled. It would be difficult to declare a country ineligible for improper use of the Fund's resources. There would be a great risk that this repurchase provision would increase, and making more general, permanent debtor positions with the Fund, and the revolving character of the Fund's resources would be undermined. This in turn raised the question whether the provision would safequard the Fund's liquidity. There was an inconsistency between creating unconditional reserves which members would be free to use for whatever purposes they liked, and at the same time expecting members to repurchase and not make an improper use of the Fund's resources. For instance, if a country used the special reserve facility in order to cover an internal budgetary deficit, would it be easy for the Fund to say this was an improper use of the Fund's resources? He had the impression that already, under present practices, there had been cases where the balance of payments justification for a drawing was rather weak.

Mr. Lieftinck noted that under the first scheme, "members will become entitled to participate in any increase in the special reserve facility allocated to them if they grant to the Fund a line of credit equal to the increase" (ibid.). He thought this assumed that a sufficient number of countries having convertible currencies usable by the Fund would participate in the scheme. If some of the larger countries did not participate in the scheme, the Fund would be faced by a considerable liquidity problem. The first scheme would in effect require that members with convertible currencies would supply the Fund with adequate liquidity, on a permanent basis, to assist members who would draw on the Fund under this provision.

Mr. Lieftinck said the second scheme clearly stated, unlike the first scheme, that "members will reduce their holdings of units only if they are satisfied that this is to meet an over-all balance of payments need" (ibid., p.6). This meant that the transfer of Fund units would only take place in order to meet over-all balance of payments needs. He wondered if this should be stipulated in the rules which governed the IRF, and how this could be controlled. It might be better to reserve the possiblity of conditional drawings for over-all balance of payments needs, and the use of Fund units for specific balance of payments needs. He asked what the relation would be between this provision and the General Arrangements to Borrow. He noted that "Each member will undertake to accept transfers of units from the IRF or from other members in accordance with the rules established by the IRF, but a member will not be bound to accept transfers to the extent that its holdings of units would exceed, say, three times the cumulative amounts of units allocated to it since the beginning of the scheme or if the proportion of its reserves held in forms other than units would fall below a specified minimum. Units in excess of these limits can be transferred without regard to balance of payments needs" (ibid.). He asked what was the reason for this provision.

Mr. Lieftinck said there was some indication that the staff had in mind some proportionality with respect to the holding of these Fund units and other reserves. This problem had been discussed intensively in other quarters, and seemed to be one of the main difficulties for some members, which felt there should be a clear link between the newly created unit and gold, with respect to both holdings and transfers of reserves. These countries considered that such a link was the only way to make countries realize that a liberal use of these units would affect their gold holdings; thus it would be the most important safeguard in preventing the creation of additional units from becoming an inflationary factor and weakening the adjustment process. He asked whether the staff had some such link in mind when it drafted paragraph E (ii) of the second scheme, and whether the provision in the second scheme would satisfy those members which considered a gold link essential. He asked if there was a connection between this provision and the proposals actively under discussion among a group of members. He wondered how the staff itself felt about such a link with gold.

Mr. O'Donnell welcomed the discussion and the staff papers. He also welcomed the fact that the staff paper had been conveyed to the Group of Ten; it would be very unsatisfactory if the Ten agreed on an exclusive arrangement for reserve creation and later asked the Fund to ratify such a scheme, even if it had something added to it which the excluded countries would be expected to be satisfied with. The two schemes described in the staff paper had the great merit of not suggesting an exclusive arrangement that would make distinctions between members of the Fund.

Mr. O'Donnell asked what would be the practical significance of the claims which the IRF would have against its members. It was commonly argued that in any system of reserve creation, participants must accept obligations as well as privileges, yet in some of the schemes it seemed that the obligations would be largely theoretical.

Mr. Dale said that Executive Directors would recognize the limitations under which he was operating, and he hoped they would be somewhat tolerant if there was relatively little he could contribute to the present discussion. As to the need for reserves, and the previous informal discussions, he had the feeling that some Executive Directors had so much difficulty with the staff's numerical and statistical analysis that they would almost prefer the quantitative decisions in this field to be made without the benefit of statistical analysis: he thought it would be better to make the decision on the basis of this type of analysis, after making all the qualifications and judgments which would be necessary.

Mr. Dale agreed with Mr. Handfield-Jones that at least implicitly the U.S. authorities had a dual approach to the adequacy of U.S. reserve assets. During the past year or so, the U.S. authorities had reached the conclusion that, as far ahead as one could see at any rate, the relationship between U.S. reserve assets and reserve liabilities should not be permitted to deteriorate further. As these two quantities were roughly equal at the present time, this meant that any significant increase in the holding of dollars by other countries would have to be offset by an increase in U.S. assets. Mr. Handfield-Jones had made some interesting comments on how the underlying statistics ought to be regarded in connection with decisions about how much new liquidity should be created. It was useful that Mr. Handfield-Jones had indicated the possibility of a 6 per cent annual increase in the need for reserves, although he agreed that the kind of factors which Mr. Handfield-Jones had indicated might be thought to reduce the possible increase should be looked at very carefully.

Mr. Dale welcomed the staff paper on the creation of additional reserves through the International Monetary Fund, and like Mr. Lieftinck, he hoped the time would come when a comparative analysis between the Fund's approach and other proposals could be made. He felt some personal sympathy with the first scheme, which was similar to some suggestions which he had made at a previous informal discussion. Concerning the details of the first scheme, he thought there might be a slight anomaly in practice in connection with the access to the facilities by members making a conditional use of the Fund's resources, on the one hand, and the floating character of the facility on the other hand. He understood that at the time when reserve assets of this type were created, a member which had an outstanding credit tranche drawing would in effect receive conditional liquidity rather than unconditional liquidity. If a member did not have an outstanding credit tranche drawing, it would receive unconditional liquidity, and later, in making use of the Fund it would have a choice between using the unconditional liquidity or conditional liquidity first. This made it possible that there might be the anomaly of country A making a drawing the day before the creation of the new liquidity, and therefore receiving only conditional liquidity, whereas country B, making a similar drawing the day after the new liquidity was created, would be in a different position.

Mr. Dale said he had no particular reaction at this stage to the second scheme, but he noted that the two schemes could be placed in force either sequentially or simultaneously. Concerning Mr. Lieftinck's comments on the question of the linkage to gold, both in stocks and in transactions, which some countries wished, Mr. Dale noted that some other countries had strong contrary views on this subject; they felt that as one of the objects of the exercise was to relieve what might otherwise be a shortage of gold, there were persuasive reasons why there should not be a tight and well-established link to gold.

Mr. Kiingi said that at the 1965 Annual Meeting, strong representations were made in favor of creating any required additional liquidity within the framework of the Fund. Emphasis was placed on the need for such liquidity to be administered by the Fund. The developing countries maintained that the liquidity issue was of as much interest and relevance to them as it was to the developed countries. For example, appreciation or depreciation of the value of a reserve currency might directly affect developing countries whose reserves were kept in that currency. More important, the developing countries were as interested in the objectives of the Fund--employment, growth and stability--as were the developed countries.

It was with these broad considerations in mind that Mr. Kiingi thanked the management and staff for their efforts in formulating schemes which could form the basis for expansion of liquidity within the framework of this institution. The two schemes proved beyond reasonable doubt that the Fund could and was prepared to create the right machinery for increasing or decreasing, and for administering, international liquidity. The two proposals were attractive, simple to administer, and yet could be effective. They had built-in safeguards to ensure that excessive liquidity was not suffered, but at the same time there would be adequate liquidity to meet international requirements. Since the increase was to be related to quotas, it followed automatically that the relationship with gold to which members attached great importance--and rightly so--would be maintained. The two schemes appeared to take cognizance of the importance of economic discipline--while appreciating the need to expand liquidity to meet the expanding volume of international trade which could not be met by the normal increase in gold output. The fact that the first scheme could be implemented without amendment of the Articles, and that the second scheme could if necessary come into effect with relatively little amendment of the Articles, was a decided advantage.

Mr. Kiingi welcomed the fact that the advantages enjoyed under the compensatory financing decisions on drawings and quota increases would be maintained. Subject to more detailed study to clarify a few minor points, he supported the schemes, with a preference for the first. Among the points which might require clarification was paragraph G of Scheme I. He felt that there was already machinery within the Fund to take care of that problem. He had no quarrel with paragraph F of Scheme I, as this did not vary from the provisions under which the Fund was presently operating. He assumed that these schemes, if agreed, would be applied to meet a need for increasing liquidity and not before.

Mr. Saad said that paragraph G of the first scheme, which dealt with the decision-making process, was capable of conflicting interpretations: as Mr. Tejera-Paris had indicated, it could be taken as describing a kind of security council. He would agree with Mr. Tejera-Paris that there was no reason to discuss this aspect of the scheme at this stage; agreement could come later. What puzzled him was the fact that paragraph G began by saying that "Decisions relating to the creation, contraction, or termination of the special reserve facility will be taken by the Executive Directors" (ibid., p.3). He presumed this meant the scheme itself, not the particular cases of countries which wanted to use the special exchange facility. However, the paragraph then went on to say that "The decision will be adopted by a majority of the votes cast..." (ibid.). He was not sure what decision this applied to, but he thought it was the general decision to create, contract, or terminate the special reserve facility. Apparently, the decision would be taken by the Executive Directors and adopted by a majority of the votes cast, but it would only become effective "for any member agreeing to grant a line of credit" (ibid., p.4). He asked the staff to explain this provision. The paragraph then continued "...when members having two-thirds of the total quotas have so agreed, and provided that this proportion includes a special majority of certain specified members. This could be, for example, 9 of the members having the 12 largest quotas..." (ibid.). This was a very peculiar example, as this might result in eliminating any developing or neutral country which might not concur with the Group of Ten and which might happen to be among the 12 countries having the largest quotas. He did not know to what extent this decision would be a matter for the Executive Board, or to what extent it would be submitted to the 9 or 12 countries, but in any case he regretted that the management or staff should even have mentioned this aspect of the business. It was enough to have the present scheme of weighted voting in the Fund. The Articles of Agreement required even more than this, for an increase in quotas, but it did not require specific members. He said the answers to these questions would determine his attitude to the first scheme as a whole. Mr. Saad wondered whether the reference to "members" in paragraph G meant the Governors or the Executive Directors. He recalled that, although he did not like the arrangement, a two-thirds majority had been required for the increase in quotas under the Fourth Quinquennial Review of Quotas. He had not objected to that arrangement because the matter was unimportant. However, he believed that new kinds of voting majorities could not be created without an amendment to the Articles of Agreement. Mr. Saad wondered whether the management and staff had given any thought to the possibility of another general increase in quotas. He thanked the Chairman for putting any schemes at all before the Executive Board for discussion: that had called for much courage, and more courage would be required on the part of the Executive Directors if they were to reach a decision. He also thanked the Chairman for making it clear that the staff paper had been circulated to the Group of Ten; he believed the staff's papers were public property and should be given to anyone who asked for them.

Mr. Beelitz said he would be interested to have a more detailed explanation of what was meant by an "appropriate mixture" of conditional and unconditional liquidity. He also had questions about the techniques which were intended to be proposed for the provision of reserves. Like Mr. Lieftinck, he thought paragraph F on repurchases in the first scheme was very vague and needed more explanation. He hoped the staff would elaborate on these questions. As regards Mr. Saad's intervention about the decision-making process, he thought the countries which were prepared to extend lines of credit had a special responsibility and should also have a special influence over the decisions.

Mr. Siglienti said the staff paper on the creation of additional reserves through the International Monetary Fund proved that it would be possible to reproduce, within the Fund, any scheme that could be decided upon outside the Fund. This was a factor in favor of having the solution in the Fund. He thought the varied discussion in the Board had focussed immediately on two of the most thorny problems of creating new liquidity, namely, the decision-making process and the link with other reserve assets, particularly gold. This proved that the same problems were bound to crop up in the Fund, as had already been raised elsewhere; he was not optimistic about the possiblity of making much progress until solutions to these two main problems were agreed upon.

Mr. van Campenhout said the staff paper was timely, and he welcomed it. It was short, went straight to the point, and as a whole it was clear; it described systems which, technically speaking, would apparently work. He would raise some points of clarification directly with the staff. Of course, he reserved his position on both proposals at this stage.

Mr. Handfield-Jones said the staff paper on the creation of additional reserves through the International Monetary Fund was an imaginative and helpful contribution to the continuing discussion. The two proposals were elaborated with technical skill, and displayed an evident search for a consensus. They contained a number of features which coincided with Canadian views on the way in which the international monetary system should be improved, and the most important of these was its recognition that all countries needed increasing liquidity in a growing world economy. He would emphasize, however, that the Canadian position on the precise form in which these general needs could best be met was not firmly crystallized; for this reason especially, he had found the staff paper helpful. Like others, his authorities had been drawn to unit schemes like that set out in Part II, because they had the advantage of more clearly demonstrating that they were contributing to the controlableness of the system, and because they could perhaps be managed more precisely. Unconditional credit schemes had some special difficulty in the relationships which they would have to conditional credits. However, he recognized the force of the Chairman's comment that it might be more convenient to begin in a familiar way by means of the first scheme, which was based on drawing facilities in the Fund of a gold tranche character. He also welcomed the Chairman's comments on conditional liquidity and on the need for a wide range of policies in the adjustment process. He was not clear if under the first scheme, additional unconditional drawing rights would be created in absolute amounts or in amounts which were proportionate to quotas. If the latter were the case, the effect would be to increase the gearing of quota increases in the future. This would raise the question of the "appropriate proportion" again, and he asked the staff to clarify that point.

Mr. San Miguel congratulated the staff for its excellent paper on the creation of additional reserves through the International Monetary Fund. This document contained the basic elements for a substantive approach to the problems affecting international liquidity. It did so, in the first place, because it considered the direct participation of all the countries encompassed by the international monetary system in accordance with the spirit of Bretton Woods, and second, because it discussed schemes which would supplement rather than replace the present international monetary system.

Regarding the first scheme, to provide greater credit facilities, Mr. San Miguel said the criteria applied for the conditional use must be objective, to ensure access by all countries, without subjective connotations. The process of adjusting imbalances should contain a reasonable degree of flexibility, within a closer international cooperation and coordination of national policies. The second scheme was predicated on the fundamental principle that all members of the Fund would qualify to be members of the International Reserve Fund. Furthermore, concerning the amount and distribution of the reserves to be created, he thought it would be necessary to consider the requirements of the developing countries, both in view of the prospective shortage of international liquidity, and with the fundamental objectives of attaining high employment, growth, stability, and greater progress toward rational order in international economic relations. All countries which wished to share in both the benefits and the obligations, should qualify for participation in the creation of reserve fund units. In connection with the decision-making process, he had doubts about the proposal relating to the special majority of certain specified members. This limitation constituted a serious restriction of the normal decision making of the Executive Board.

Mr. Teyssier said he had read with great interest the paper on the creation of reserves through the International Monetary Fund. The technical questions he would have raised had already been asked by other speakers.

Mr. Suzuki said he appreciated the staff paper on the creation of additional reserves through the International Monetary Fund. As Mr. Lieftinck had suggested, a comparative study would be very useful, but if that was not possible, it might be possible to prepare a supplementary paper which indicated the thoughts of others on particular aspects of the schemes.

Mr. Bicalho said he agreed with Messrs. Saad, Tejera-Paris, and Mr. San Miguel about the decision making. He was concerned about the proposal to give special power to some members: the Fund should be very careful about making distinctions between members beyond what was provided in the Articles of Agreement.

Mr. Eklöf said he had some questions about the liquidity characteristics of the first scheme. He was not sure that the Fund, with the first scheme added to it, would be in a stronger liquidity position than it was at present. Even with the present system, special arrangements had been necessary in recent years to give the Fund additional resources. His interpretation of the decision-making provisions in paragraph G was that they were not really motivated by any wish to set up a security council, but were a necessary precaution to safeguard the liquidity of the new system. It would prevent additional drawing rights from coming into effect before the important prospective creditors were ready to take part in the system.

Mr. Eklöf said the use of any new reserve asset might be governed by restrictive rules, and paragraphs F of the first scheme and E of the second scheme gave several examples of these restrictions. These rules might be very valuable, or indeed necessary, for the working of the mechanism; personally, he doubted, for example, that it was advisable to water down the repurchase provisions as suggested. But they would also make the new asset more different from the existing first class reserve assets. They would detract from their value for the individual holder, although on balance they might be considered desirable. However, he asked whether restrictive rules of this kind could be made less necessary, or their efficiency increased, by a conscious use of appropriate interest rates on unit holdings and counterclaims in the second scheme, or on credits extended and used in the first system.

The Director of the Research and Statistics Department, and the General Counsel, responded to a number of points raised by Executive Directors.

Concerning the discussion on the need for reserves, the Director of the Research and Statistics Department first noted that Mr. Siglienti had mentioned Mr. Handfield-Jones' idea of a neutral zone or broad area within which countries were probably not very concerned about movements in their reserves. It was generally realized that there was such a neutral zone, and that to some extent, a country's present level of reserves tended to be regarded as adequate. However, he was not convinced that this really took the essence out of the exercise. The neutral zone presumably rose over time with the expansion of a country's transactions. Also, the "level of reserves" approach was only one approach to the problem, and the staff had increasingly become convinced that the approach to the need for reserves described in Section 4 of the need for reserves paper, namely, the need to increase reserves independently of the present level of the reserves, was at least as important. Insofar as countries tended to err on the safe side of balance of payments equilibrium, increases in reserves were needed even though the level of reserves was in the "neutrality zone."

The Director of the Research and Statistics Department said Mr. Siglienti, like several previous speakers, had referred to the adjustment process, and had asked whether in extrapolating the past the staff had given up hope of improving the adjustment process; he said that what evidence there was indicated a tendency of the adjustment process to slow down in recent years. For example, as Mr. Siglienti had mentioned, the surplus countries seemed to be more concerned with other considerations than achieving balance; four countries of the Group of Ten had adjusted their exchange rates over the past 10 years, but no one could predict that this would be either desirable or possible over the next ten years. Thus, one could not assume a great improvement in the adjustment process over the next short period. What was being discussed, after all, was only the amount of reserves which might be needed for the next five years in the

Fund plan, and for an even smaller number of years in various other plans. If improvements were achieved in the adjustment process over the next five years, that would be relevant for deciding what the need for reserves would be thereafter.

Concerning the extent to which one could go by the experience of a recent period, the Director of the Research and Statistics Department noted that Mr. Siglienti thought it better to take a recent period, such as 1961 to 1963, rather than an earlier one. He felt that if one doubted the conclusions which the staff had drawn from that period, one should make a fresh appraisal of the abnormalities of that period and decide whether the allowances which the staff had made for the abnormalities were accurate, and if so how such allowances could be made better. With reference to France, he said the staff had taken the recent French consultations as a guide, in which the French Government had said that some further increase in their reserves would still be not inappropriate, in spite of the very large increases in recent years. The staff had made some small notional allowance for that. Since then, the new official French views on this subject had been described in the latest French five-year plan, which indicated that no increase in reserves was now desired for the five-year period. This was one correction which could be made.

Concerning Mr. Handfield-Jones'interesting exposition, the Director of the Research and Statistics Department said the series for the ratio of the reserves of the world outside the United States to world trade was very close to that given in the staff paper for the Group of Ten excluding the United States. He said the staff would do the various calculations suggested by Mr. Handfield-Jones. Concerning Section 5 of the staff paper in which the staff moved from the total need for reserves to the much smaller figure of the need for deliberately created reserves, Mr. Handfield-Jones had noted that if people were really convinced that the price of gold was not going to be changed, the amount of liquidity that might be contributed by gold might be quite substantial: the staff paper referred to a figure of $1 billion in that connection. As regards dollars, Mr. Dale had noted that while there might be increases in dollars held in reserves, this would be matched by increases in U.S. reserves. Therefore, this should not be allowed for separately, as an element in the reserves to be created.

Turning to Mr. Lieftinck's points, the Director of the Research and Statistics Department said the staff had always defined imbalances as referring to both surpluses and deficits; the paper on the Need for Reserves, with the exception of one chart, had been similar to the paper on trends in payments imbalances in that respect. The latter paper had analyzed the figures for surpluses and deficits separately. The difference between these figures was not systematically big in any event, because the difference was not equal to the increase in reserves, but to the increase in gold reserves. The increase in gold reserves over this period did not show any definite trend: it was high in the early 1950's and high again in the mid-fifties and early 1960's (SM/66/9, Chart 5, p.38, 1/14/66). As a consequence, the findings of the staff paper for deficits, surpluses, and imbalances as a whole, were not much affected by this factor. Some assumption had to be made in the trends in imbalances paper about how other countries' imbalances would change if the U.S. deficits were eliminated; the staff had not merely taken the U.S. imbalance and added the same amount to the imbalances of other countries, but had tried to work out a reasonable guess as to how other countries' imbalances would change if the U.S. corrected its own deficit. The staff had made a number of assumptions, namely, that the balances of payments of all countries would worsen, and that the whole of this impact would fall on the other industrial countries, which in any case accounted for the bulk of whatever statistical measures one took. Some reasonable assumption had to be made as to how this could be allocated, and the staff had found that two possible ways of allocation, according to reserves and according to trade, would produce similar results. These assumptions were "arbitrary," in the sense that if one made other reasonable assumptions somewhat different results would be obtained; but it was his conviction that such results would be only slightly different. If there was any conflict between the need for reserves paper and the trends in imbalances paper, that was because the earlier paper had made preliminary assumptions which were examined more carefully and corrected where necessary in the later paper. The study of this aspect of the need for reserves paper had been made, because another study on reserves had defended the thesis that imbalances had not increased at all over time; the staff had felt that this was too important a point not to be investigated deeply. The staff had started with the assumption that there was probably some validity to the thesis, and had now concluded, somewhat to its surprise, that there was not.

Turning to the comments made by Executive Directors on the staff paper on the creation of additional reserves through the International Monetary Fund, the Director of the Research and Statistics Department said he and the General Counsel would each answer some of the questions. They would later issue their comments, in expanded form, as a supplementary paper. In dealing with the various provisions of the two schemes, they would in fact touch on almost all the issues which had been raised in all the other liquidity plans, with the exception of the question of universality. Some of the other plans were based on a universal approach, and others, in their earlier versions, were based on limiting the reserves to a participating group of ten or fifteen countries: however, everyone now realized that the needs of the whole world would have to be taken into account, and the present versions of the nonuniversal plans envisaged control by a small group and initial distribution to that small group, then allocation to the Fund of an appropriate amount which would be used in some way to meet the needs of the other countries which were not members of the small group. The other difficult issues, namely, participation, the role of gold, control, and the link with the Fund, were the same issues which had been difficult at the time of the Ossola Report.

Concerning what was meant by an appropriate mixture of conditional and unconditional liquidity, the Director of the Research and Statistics Department made it clear that the staff did not have in mind the idea of analyzing deficits and allocating different types of reserves to specific types of deficits. It was not envisaged that the new reserves would be less usable, for any purpose, than present reserves. With regard to the limitations of conditional liquidity, he noted that the original injunction on the Fund not to use Fund resources for capital transfers beyond certain limits had in fact also lost much of its practical value, for the very good practical reason that this did not agree with countries' approach to the Fund. The "appropriate mixture" would be that which was appropriate in the light of countries' collective view as to the extent to which they wanted to make the financing of their deficits subject to a collective supervision, exercised in connection with the provision of conditional liquidity, and the extent to which they wanted to retain freedom. If countries wished to maintain roughly the present balance, quotas would have to increase in the same proportion as reserves. On the last occasion when countries had expressed their views on this subject, in connection with the Fourth Quinquennial Review of Quotas, the result had been that quotas were increased by 25 per cent for a five-year period, or about 5 per cent a year, which was similar to the increases in trade and reserves generally. The suggestion that a larger proportion should be in conditional liquidity, by having a larger increase in Fund quotas than in trade or reserves, had not encountered universal support.

Turning to the first scheme, the Director of the Research and Statistics Department said that as regards paragraph A, on creation and distribution of the special reserve facility, the staff had been asked why the amounts to be distributed were not rigidly proportionate to quotas and were only "broadly" proportionate to quotas. The question had also been asked why these amounts should be expressed in absolute amounts. He said the purpose was to ensure that the special reserve facility technique was not unnecessarily more rigid in this aspect than the proposals for reserve units. Reserve units, although it was broadly agreed that they should be distributed roughly proportionate to Fund quotas, had no necessary link with Fund quotas. It would be reasonable, similarly, to make the automatic drawing facilities in the Fund basically proportionate to quotas, but in fact it would be necessary to come up with absolute figures. Similarly, in the recent quota increase exercise, although it was based on a 25 per cent increase in quotas, the decision which was actually taken was in terms of a list of absolute figures, because of rounding and special increases.

The Director of the Research and Statistics Department agreed with Mr. Dale's description of the first scheme as a semi-floating one, i.e., unfloating at the time of distribution but floating thereafter: this of course was the "self-qualifying principle" which was inherently built into the Fund. It did not really involve an anomaly between a country which drew just before a distribution and a country which drew immediately after a distribution. A country which was well into the credit tranches at the time of the distribution would only receive conditional liquidity. A country which had not drawn, or had used no more than its gold tranche, would receive unconditional liquidity, even if it should draw soon afterwards. There was in a sense a distinction between those countries at the moment of the distribution. In any case, the difference was already a feature of the Fund; when there were quota increases, countries which paid gold but were in the credit tranches received only conditional liquidity, not additional gold tranche facilities.

With regard to the provision of resources to the Fund, the Director of the Research and Statistics Department noted that some Executive Directors had asked about the meaning of the statement that countries would be entitled to participate "if they grant to the Fund a line of credit equal to the increase." He said that was only one of several "ifs," and others were spelled out in the decision-making process. No one country by itself could put the scheme into operation. The basic structure of these lines of credit, as providing resources to the Fund, was in a sense similar to the quota provision of resources to the Fund. When quotas were increased, countries contributed to the Fund the equivalent of their quota increase, 25 per cent in gold and 75 per cent in currency, and received additional drawing rights equal to 125 per cent of their quota in the form of the gold tranche plus the four credit tranches. This procedure had on the whole seemed to provide adequate liquidity for the Fund's operations. Under the first scheme, countries would make available the additional resources in the form of a credit line of a certain amount, and would receive additional drawing rights of the same amount, rather than 125 per cent. To some extent this was offset by the fact that all the contribution was in the form of currency, and none in gold. Also, all the increased drawing rights were unconditional. Staff calculations which had been published in Staff Papers, and also in the Ossola Report, suggested that on the average this should provide adequate liquidity to the Fund to handle these additional drawing rights, provided that the resources of the Fund were merged for this purpose. The staff paper did not spell out the order in which the Fund would use, for all its transactions, its holdings of currency or of these new credit lines. Clearly, it would not use the new credit lines before its holdings of the currency in question had been reduced to 75 per cent of the member's quota, as this would be a borrowing operation. Beyond that point, the Fund would have to decide in which priority it used the two sets of reserves. This would not be a particularly important decision, as the credit lines and the Fund's holdings of currencies would be essentially similar from the Fund's point of view, and similar from the creditor member's point of view with the exception of the payment of interest. Creditor lines would pay some reasonable interest, and of course at the present time super gold tranche positions did not pay interest. Apart from that difference, which might become difficult to maintain if the scheme went into effect, it would not really matter whether the Fund drew on the one resource or the other. It would presumably have to establish some reasonable operational rule.

Some Executive Directors had asked whether use of the credit lines would lead to a permanent extension of credit to the Fund and the Director of the Research and Statistics Department said that in a sense this would depend on the development of the country's own reserves. Credit under the credit lines would be a part of the country's reserves; presumably, if the country's reserves continued to rise, and if the Fund's outstanding drawings did not go down, then for that period countries would continue to own claims on the Fund under the credit lines. In this respect there was a certain difference, perhaps in psychological appeal, between the credit line approach and the unit approach. No one had questioned the fact that units would be permanent additions to a country's reserves. A country's credit line, on the other hand, was very similar to a purchase of claims on the Fund as part of the country's reserves, and so long as the country's owned reserves did not go down and it never ran a deficit, then presumably its claims on the Fund would also remain as a normal part of the country's reserves. Whenever its reserves decreased, however, or the total of outstanding Fund drawings decreased, the country would be expected to reduce its claims on the Fund, and there was a special provision which would enable the Fund, on its own initiative, to repay a claim under a line of credit.

The Director of the Research and Statistics Department noted that whereas in the second scheme there was a provision that countries should not use their units except to meet a balance of payments deficit, there was no parallel specific provision in the first scheme: however, this was implicit in the Fund mechanism, and paragraph E of the first scheme said that drawings would be made in accordance with the gold tranche policy, which of course included a provision that a country should represent its balance of payments need. There was no intended difference between the two schemes in this respect.

The General Counsel responded to questions concerning paragraph F of the first scheme, which dealt with repurchases. First he explained the general intention of the idea of eliminating the need for representations of repurchase, and substituting the Fund's expectations on repurchase. The idea stemmed from some of the proposals which had been made for improving the quality of the gold tranche: in fact the proposal was intended to cover both the new facility and the existing gold tranche. Referring to the basic decision of February 13, 1952, which had established the gold tranche policy and the policy on "representations of repurchase," he said that decision indicated it was expected that members would represent that they would repurchase as the problem for which they drew was overcome. He emphasized this as the starting point of the decision. It was the basic element in the policy, but it was sometimes overlooked, and undue emphasis was sometimes placed on the second part of the policy, which was that countries would represent that to the extent they had not already repurchased by the end of three years after a drawing, they would bring about the repurchase by the end of five years. In relation to the gold tranche, this representation of repurchase, in both its elements, was legally of a somewhat weaker character than the undertakings given in connection with other drawings. For example, on a gold tranche drawing alone, there was no way in which, in the normal course of events, this representation could be made legally binding. It was a representation of intention, and not an obligation for which a member would be in violation if it failed to observe the representation. Also, the language in which this representation was couched was somewhat different from the representation in other transactions. The decision of February 13, 1952 said that members recognize that they would be requested by the Fund to repurchase within five years, if they had not done so within three years, in contrast to the representation on the other drawings which was that members would agree to repurchase within five years.

The General Counsel then described the origin of the proposal which was embodied in paragraph F of the first scheme. Although the representation of intention with respect to the repurchase of the gold tranche was not the strongest kind of legal representation that one could imagine, nevertheless, some members felt that psychologically it detracted from the reserve quality of the gold tranche. Therefore, the staff felt that it might be possible to eliminate this representation of intention, taking into account the fact that it was a representation and not an obligation and also the character of the representation. He emphasized strongly that this proposal did not and could not change the fundamental law of the Fund on the use of its resources, in the sense that the use of the Fund's resources must be temporary. It was not proposed that elimination of the representation of the intention to repurchase should enable members to make a protracted use of the Fund's resources, whatever that was understood to mean. At present, and since 1952, it had been understood to mean a use not extending beyond five years. He did not think that the proposal would represent a radical change of policy or a change of law; rather, it was a psychological or "cosmetic" change.

Concerning what would happen if a member using this facility were in fact to make a protracted use of the Fund's resources, the General Counsel said the background against which this facility would operate would presumably be some reiteration that the Fund expected members to repurchase, even in the absence of representations by those members, within the temporary period. If a member should not in fact honor its implicit intention, and respect the expectation of the Fund, one of the remedies available was the possibility of using the Fund's provisions on ineligibility. Hitherto, the Fund had been reluctant to use these provisions. However, these provisions would cover a long-term use of the Fund's resources, should the

Fund ever wish to use them. He recalled in this connection that in February 1961, when the standard language of stand-by arrangements was changed and when the "prior notice" clause which enabled the Fund to prevent the use of the Fund's resources under stand-by arrangements at the Fund's will was eliminated, several Executive Directors had indicated that perhaps the ineligibility provisions should be regarded as more usable than in the past. However, the Fund had not changed its attitudes and policies in practice, and he agreed with Mr. Lieftinck that it was unlikely that the ineligibility provisions would be used as a sanction to ensure the proper operation of the first scheme. But there was another sanction under Article V, Section 8(d), and Rule I-4(g). The requirement that a member consult with the Fund and reach agreement on reducing the Fund's holdings of its currency when a particular rate of charge was reached would apply to the first scheme. At present, this rate of charge was 4 per cent, and it was reached not later than three years after a drawing. The special facility would operate when the Fund's holdings of the drawing member's currency were already above 100 per cent of quota; therefore, not later than three years after using the new facility, the country would have to consult with the Fund and reach an agreement on the reduction of the Fund's holdings. In default of agreement or in the observance of an agreement, the charges would go up beyond 5 per cent in the regular way as prescribed in the Rules and Regulations. The staff paper did not propose any change in that system for the special facility. It would, of course, be possible legally to have a different system of charges for the facility. The requirement to consult and reach agreement on repurchase thus provided a remedy in addition to the ineligibility provisions. However, it did not apply to the gold tranche, as periodic charges were not payable in the gold tranche. In the last resort, the answer to the question about sanctions with respect to the gold tranche must simply be in terms of good faith on the part of members, and the confidence of the Fund that members would make a proper use of Fund resources with respect to the gold tranche. That was the present position, and the proposal in the first scheme would not involve any change in that connection.

With regard to what would happen if there was an abusive resort to the special facility, the General Counsel noted that the Director of the Research and Statistics Department had already indicated that the normal representation of need under Article V, Section 3(a) would have to be made by any member using the facility. The question of what legal remedy would be available in the case of a clearly improper representation already existed in connection with the gold tranche. The Fund had never had to face the issue, which in the last resort was one of bad faith on the part of the member, because of the concept of the overwhelming benefit of any doubt that members received. Legally, there was a power to challenge a request which seemed to the Fund to be an improper one.

Turning to paragraph G of the first scheme, on the decision-making process, the General Counsel said it was perhaps unfortunate that certain features of this paragraph were placed under the heading of decision making. They could more appropriately have been considered under some other heading dealing with the liquidity of the Fund. There was no intention to set up anything resembling a security council. The sole inspiration for the suggestion in paragraph G was the need to ensure an adequate liquidity for the Fund to operate the scheme. The model which the staff had taken for this proposal was a general quota increase. With a general quota increase, there was the need for a vote by the Executive Directors recommending that there should be a general quota increase, and the recommendation was adopted by the Board of Governors only if 80 per cent of the total voting power so decided. If such a decision was taken there must then be individual consents by members, and the Fund had deemed it wise, in the interests of its own liquidity, to lay down a participation clause in both the general quota increases which had taken place in the past. One had required a 75 per cent participation, and the second a 66 per cent particpation. The voting aspect of the proposal that had been made for the first scheme was less onerous because it involved a majority of the votes cast and not 80 per cent of voting power. The participation clause was also smaller than 80 per cent and would thus call for fewer parliamentary actions. If the participation clause had called for 80 per cent, it would probably have required the participation of all of the members that were referred to specifically in the examples of participation clauses in the memorandum. Incidentally, these were examples only, and the only consideration on which they had been advanced was the liquidity of the Fund.

In reply to Mr. Saad's question about the meaning of the words "effective for any member," the General Counsel said this also was clarified by reference to what happened with a general quota increase. It meant that the scheme would not come into operation for any one country until the general participation clause was satisfied. Under the present general quota increase exercise, for example, it was only when 66 per cent had signed up that any country's quota could become increased. The words "effective for any member" did not mean that any particular member's adherence to the scheme would require a special vote, nor did they mean that resort to the facility itself, once it came into operation for any particular member, would need a special voting majority in the Board. In reply to Mr. Saad, he said that the word "member," in reference to fulfilling the participation clause, did not mean the Executive Director appointed or elected by the member, but rather the duly authorized agency of the member country. It must be kept in mind that participation by any member meant that it was agreeing to grant a line of credit to the Fund under Article VII, Section 2.

The General Counsel confirmed that the first scheme would not require amendment of the Articles of Agreement. He said that the possiblity of quota increases had been considered as an alternative to the first scheme, but it was felt that there were certain advantages to the first scheme; for example, it eliminated the gold subscription, and it involved quasi-automatic drawings.

The Director of the Research and Statistics Department referred to the relative positions of the first and second schemes, and said there was no legal or technical reason why they could not be introduced at the same time. In response to Mr. O'Donnell's question about the significance of the exchange of claims described in paragraph C of the second scheme, he said the claims acquired by the IRF would be balances of the currencies of the participating countries, which would be kept by the institution for as long as the scheme was in effect. They would have a gold guarantee, but otherwise they would be simple IOU's. In some other plans, such as the Bernstein and Roosa plans, these amounts of money had been described as "contributions." That was perhaps not a fortunate description; in the comparative staff paper on different reserve unit schemes (SM/65/97, 12/2/65), it had been explained that these were only guarantee balances, to ensure the claims of the participants upon liquidation or upon reduction of the size of the scheme. In some quarters, for example in the UNCTAD report, the suggestion had been made that these amounts of dormant money could be used for some other good purposes, such as development finance. This was not proposed in the second scheme; instead it proposed, like all the schemes which had been suggested in connection with the Group of Ten's deliberations, that these sums of money be simply set aside for the duration of the plan, and never be touched, except on account of withdrawal, reduction of the amount of units outstanding, or general liquidation of the plan.

Mr. Anjaria had asked about the statement in paragraph C that by agreement between the Fund and the IRF, the allocation of units to each member on the occasion of a reserve increase could be deferred or withheld. The Director of the Research and Statistics Department said this sentence alluded to a provision which was implicit in the first scheme, namely, that it was subject to the ineligibility provisions of the Articles of Agreement. There was not an exactly similar provision in a unit scheme; it was not intended to suggest that ineligibility in the Fund would involve ineligibility to use units, but rather that in cases of disagreement between the Fund and a member, something might be considered by the IRF, not as to the use of units which had already been distributed, but as to participation in a new distribution.

Concerning transferability, the Director of the Research and Statistics Department said paragraph E of the second scheme dealt with a number of subjects which the Group of Ten had also discussed at length. In a sense, the proposals to regulate transferability had been regarded by the Group of Ten as an alternative to a possible link of units to gold. In the various plans, three kinds of links to gold had been proposed.

First, there was the suggestion that distribution should be proportional to gold holdings, which was a feature of the French proposal, but the French had some time ago abandoned gold holdings as the sole criterion for distribution. Second, a proportionality between gold holdings and holdings of units had been proposed, even though the distribution was not proportional to gold holdings, by means of an initial reshuffle: the units would be distributed according to some such principle as Fund quotas, then immediately reshuffled against gold to result in a situation where unit holdings would be proportional to gold. This idea also had no supporters at the present time. The third version of a link to gold was that in any use of the unit, a country would be obliged to use a specified amount of gold, for example in equal parts. This version was intended to ensure that countries would not simply use up their units while retaining their other reserves, as a way of avoiding the appearance of a reduction in what was previously called their reserves and accordingly avoiding the public reaction and perhaps the adjustment which would result normally from a reduction in reserves. It was also hoped that such a gold link could be used as a substitute for rules about transferability, which might be thought to be an encumbrance on the money quality of the units and involve the existence of an agent between countries, which some countries were eager to avoid.

The Director of the Research and Statistics Department said the staff's view was that the side effects of a link to gold would be quite undesirable; the objectives which were intended to be achieved by a link to gold could not in any case be achieved without transferability rules. The link to gold on a use basis raised many difficult issues, in that it would produce packages of gold and units which would be traded against currencies at one price, as against gold by itself, which might be traded at an unrelated price; these two reserve assets would be quite independent unless there were transferability rules. The link would also require creating a special facility for the United States, so that it could choose to redeem dollars not in gold, but in gold cum units; this would undermine the present status of the dollar. It might also encourage the countries which used units, and which had low gold ratios, to hold more gold than they did at present. Yet, the gold link would fail to achieve its objective of avoiding the necessity of rules for allocation. He thought the rules did not necessarily imply the interposition of an agent to execute what in Fund terminology would be called a "currencies-to-be-drawn-policy." If the countries could agree on detailed rules, the agent could be entirely passive in administering the rules. The Fund's experience with the currencies-to-be-drawn policy suggested that it would not be technically difficult to draft such self-executing rules; however, it also suggested that it might be difficult to reach agreement on these rules. He did not think that merely paying a high enough rate of interest on the units would solve the problem as to holding under all circumstances; there would still be a risk of the units starting to float if countries became less optimistic as to their quality.

The Director of the Research and Statistics Department said the other objectives which were intended to be achieved by the gold link, namely, to ensure that countries would not capriciously get rid of units for no other reason than to improve the composition of their reserves, and to ensure that countries would in fact use their other reserves as well as units in meeting payments deficits, were covered by subparagraphs (i) and (iii) of the transferability section. Units would not be used unless a country had a balance of payments need, and a country would finance only part of its deficits by units. Moreover, apart from when they were in payments difficulties, countries would be expected to hold units in some proportion to their reserves; this was a generalized version of the holdings ratio. It was already presently applied, in terms of the ratio of positions in the Fund to countries' reserves, as a result of the Fund's currencies-to-be-drawn policy. As regards subparagraph (ii), he corrected a printing error: it was not intended that members would undertake to accept transfers of units "from the IRF," as there were no provisions by which the IRF itself would be involved in the transactions. He said subparagraph (ii), like all the schemes which did not include a gold link, provided for an acceptance limit, which was three times the original amount of units distributed to each member. This was larger than the limit in the first scheme, in which the line of credit was equal to the amount of the drawing rights, and accordingly under the first scheme members would be asked to acquire a maximum of twice the amount allocated to them. The willingness to have a higher quantity in the second scheme was related to the psychological difference, in that members would be purchasing claims, whereas under the first scheme they would seem to be extending lines of credit. Also, as the first scheme would be grafted on to the Fund, it had rather more leeway in terms of the use of individual currencies, and therefore the smaller limit was possible; under Scheme I there would also remain the possibility to borrow under Article VII outside of the lines of credit. He said the last sentence of subparagraph (ii) was intended to induce countries not to stop acquiring units once they reached their limit, but to go on acquiring them; they would be fully authorized to pass them on to other countries without the requirement of a balance of payments need in this connection. His own opinion, based on the experience of the Fund, was that subparagraph (iii) was more important than subparagraph (ii): in the Fund's operations it had been found that countries were interested in a scheme which would determine how claims were allocated among countries before the quota limits were reached.

The Director of the Research and Statistics Department said subparagraph (iv) of the transferability section dealt with the price of transfers; this was an essential ingredient of a scheme if it was not desired that the price of the unit would be determined by market forces, in the light of the acceptability of the unit to central banks. It would be necessary, in a scheme which had at least a certain degree of freedom of choice of transferee, that the unit could not be changed against each currency at par, because if there were different market rates for currencies among themselves and the unit was changeable at par against all, there would be a convergence of units on those countries whose currencies were most highly quoted. In the Fund this had been prevented by the currencies-to-be-drawn policy. Under the second scheme, there would be greater freedom of transfer, and one way to ensure consistent exchange rates was to make the transfers at par against the U.S. dollar, and at the corresponding cross rates against other currencies. The expression "at a rate to be determined" referred to the corresponding cross rates. Exchange against other currencies would have to be limited to convertible currencies; the term "if it is convertible" therefore referred to the currency of the transferee.

The General Counsel said he would like to clarify the constitutional techniques which were contemplated for the second scheme. There were references in the paper to three different possible techniques for bringing the second scheme into operation. First, there might be an amendment of the Articles of Agreement to weave the scheme into the Articles. For example, this would be necessary if there were a merger of assets for the scheme and the Fund's other operations. This would require a radical amendment of the Articles, and the staff had not chosen that particular technique. The second technique was a separate account in the Fund without a merger of assets. The account could be established in the Fund by a comparatively simple amendment of the Articles. The staff had not chosen that technique either. The staff preferred the third method, which was to have a separate affiliate outside the Fund; this would not involve amendment of the Articles. It also meant that the conditions on which the affiliate could come into existence would be a matter of choice: for example, it need not be the same as the requirement which was laid down for an amendment of the Articles of Agreement.

Mr. Lieftinck thanked the staff representatives for their replies, and said he welcomed the fact that a supplementary paper would be issued. He wished to make some observations on some of the staff's replies, which they might take into account in the preparation of that paper. For example, the Director of the Research and Statistics Department had referred to the increase in quotas under the Fourth Quinquennial Review of Quotas: Mr. Lieftinck said he understood that quota increase to be a retroactive adjustment to the growth of world trade in the past five years. Second, it was a flat 25 per cent increase, which was less than a cumulative increase of 5 per cent each year, and moreover it did not amount to a net increase of world liquidity of 25 per cent because of the gold payment.

With respect to the General Counsel's explanation that there was no difference between the proposed repurchase scheme and what existed already with respect to gold tranche positions, Mr. Lieftinck said that might be true from the legal or moral point of view; however, there was a difference, as the present gold tranche was a paid-in gold tranche, and the member country felt it had contributed resources to the Fund out of its own reserves. The extension of the gold tranche policy to two tranches, would create a use of the Fund resources which went beyond what the member had paid in, but which it would obtain by way of credit. This credit would be supported by a line of credit extended by the surplus countries, or by the convertible currency countries. This was a difference in substance.

Mr. Mansour thanked the staff representatives for answering Mr. Saad's questions: however, as regards the decision-making paragraph, they did not think that changing the label would have satisfied Mr. Saad, who was really objecting to the provision which involved a special majority of certain specified members. He doubted whether a technical explanation would dispel the apprehension that this was really creating a financial security council in the Fund. The Articles of Agreement, without being so specific, included all the necessary safeguards. He did not think it should be necessary to introduce anything that went against the spirit of the Articles of Agreement.

Mr. Handfield-Jones took up again the reply of the Director of the Research and Statistics Department to his comments on the need for reserves paper. As regards the proper treatment of U.S. dollar balances, he had suggested that it might not be appropriate to eliminate a possible growth of U.S. dollars held by other countries, in projecting a supply/demand calculation of reserves for the future. The Director of the Research and Statistics Department had replied that in accordance with the present U.S. balance of payments policy, if other countries increased their holdings of U.S. dollars by some amount, then the United States would not be satisfied unless it increased its gold stock by an equivalent amount as an offset. However, Mr. Handfield-Jones considered that this increase in the U.S. gold stock would not only serve as a backing against the liabilities, but would also satisfy the whole of the U.S. need for reserves. If one was not going to take into account the increase in other countries' holdings of U.S. dollars, then in computing the total need for growth in reserves, one should eliminate the need of the United States from the considerations. Therefore, if one was thinking in terms of a growth rate of 4 per cent, this should be applied to the present stock of reserves of the world outside the United States. This would make a significant difference to the annual increments required.

The Director of the Research and Statistics Department said Mr. Handfield-Jones' intervention illustrated clearly that one could not discuss the future need for reserves without making explicit assumptions about U.S. policy on reserves and the balance of payments. He thought it correct to assume that the United States was aiming at balance, in the liquidity sense of the definition, plus an increase of reserves of some reasonable amount.

Mr. Dale confirmed that the staff's interpretation of the U.S. policy was correct at the present time. He was not sure what the implication of Mr. Handfield-Jones' analysis would be operationally, as well as for the calculations.

Mr. Handfield-Jones agreed that in any such calculations it was essential that the position of the United States should be specially and specifically treated. His own personal view was that an important aspect of the process of increasing the precision of thinking in this field would be obtaining a more precise long-term view as to the U.S. position. However, the staff's reply did not satisfy him completely: he asked if the U.S. position was that the reserves of the United States should grow, by an amount equal to any increase in the dollar liabilities, plus a normal 4 per cent increase in its gold stock.

Mr. Dale said he could not answer Mr. Handfield-Jones' question authoritatively, but he would look into the matter further.

Mr. O'Donnell wondered why the United States should apparently be concerned with increases in absolute amounts, rather than in preserving safe ratio between its assets and the growth of its short-term external liabilities.

Mr. Dale said the principle concern of the U.S. authorities was not in terms of the absolute amount of dollar liabilities outstanding, but with the relationship between U.S. reserve assets and the outstanding liabilities.

The Chairman said that after the staff's supplementary paper was circulated, it might be useful for the Executive Board to have another discussion of the same problem. The next meeting might be on April 15, 1966, which would be before the next Group of Ten meeting, and it would therefore give the Fund's representatives at that meeting some additional guidance.

ROMAN L. HORNE
Secretary