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EB/CQuota/69/9

December 8, 1969

To: Members of the Committee of the Whole on Review of Quotas

From: The Secretary

Subject: Gold Payments in Connection with Quota Increases Arising from Fifth General Review of Quotas - Operational Aspects

The attached memorandum on the operational aspects of mitigating the secondary impact of gold payments made in connection with increases of quotas under the Fifth General Review of Quotas is issued in accordance with the statement made by the Acting Chairman at Committee Meeting 69/5 (12/3/69). The memorandum has been prepared for consideration at the next meeting of the Committee.

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INTERNATIONAL MONETARY FUND

Treasurer's Department

Gold Payments in Connection with Quota Increases Arising from Fifth General Review of Quotas--Operational Aspects

Prepared by the Treasurer's Department

(In consultation with the Legal Department and Research Department)

Approved by Walter O. Habermeier

December 5, 1969

1. In SM/69/153 (October 15, 1969) a technique was suggested by which the Fund could mitigate the impact of gold losses on members' reserves which would arise from some members having to purchase gold from another member in order to make their gold subscriptions to the Fund in connection with quota increases under the Fifth General Review of Quotas. At the Meeting of Members of the Committee of the Whole on Review of Quotas on Wednesday, November 19, 1969, a number of Executive Directors requested the staff to describe in greater detail the operative mechanism of mitigating the secondary gold impact as outlined in SM/69/153.

2. The basic technique suggested in SM/69/153 was that "The Fund could agree up to a maximum of, say, $500 million ... to replenish against gold the currency of a country providing gold to another member for the purpose of paying its gold subscription, provided the Fund had a need for the currency being replenished."

3. Scope of mitigation

It will be necessary to establish which members are likely to purchase gold, and for what amounts, to make their gold payments to the Fund in order to determine the amount up to which the Fund would replenish members' currencies through sales of gold.

a. Based on the potential adjusted quotas shown in the table attached to EB/CQuota/69/4 (November 20, 1969), total gold subscriptions, at 25 per cent of the increase, would be $1,885 million. If it is assumed that those members which purchased gold in connection with quota increases under the Fourth Quinquennial Review would also do so on this occasion, then the maximum secondary gold loss from members would be about $700 million.[1/] However,

1/ This figure assumes that the twelve members which joined the Fund since February 26, 1965, would buy the gold for their subscription payments.

it cannot necessarily be assumed that all members which were involved in the triangular operations which amounted to $147.94 million as described in paragraph 19 of the Report of the Executive Directors to the Board of Governors, Increases in Quotas of Members--Fourth Quinquennial Review (February 26, 1965) and SM/69/153, would, in fact, again buy their gold from other members at this time.1/

b. It can be argued, that the assumption under a. above might not be valid because a redistribution of gold holdings has occurred since 1965/66 and some members which purchased from other members the gold needed to pay to the Fund might use all or part of their own gold holdings on this occasion.

For example, on a comparison between members' gold holdings as of September 1964 and September 1969 and the proportion of gold held in relation to total reserves (gold, foreign exchange and reserve position in the Fund), 21 members show a rise in gold holdings both absolutely and relatively to total reserves. These members bought gold needed for purposes of making gold subscriptions to the Fund on the occasion of the Fourth Quinquennial Review. If all these members would use their own gold on this occasion, the demands on other members might be reduced by up to about $195-200 million. Of those members who showed a fall in their gold holdings in absolute and relative terms by an amount greater than their gold subscriptions to the Fund between September 1964 and September 1969, only six members used their own gold in making their gold subscription payments to the Fund on the occasion of the Fourth Quinquennial Review of Quotas. If all these members, and also those who paid their own gold last time but whose gold holdings have fallen below their potential gold subscription, would buy gold on this occasion, an additional demand of about $90 million might be involved.

c. A number of other factors might also tend to reduce somewhat the likely maximum of secondary gold losses. First, as was pointed out in EB/CQuota/69/4, it is possible that some members might not take the full amount of the increase in their quotas as listed in that paper. Consequently, the amount of gold paid to the Fund would be reduced; it would not necessarily follow that the secondary gold loss would be reduced to the same extent, or at all. This would depend on whether the members involved would have paid from their own gold holdings or would have bought gold from other members.

Secondly, any mitigation of the primary burden of gold losses through the application of Article III, Section 4(a) would reduce the amount of gold that members would need to purchase in order to finance their quota increases, and this could also affect the amount of gold that members might have purchased from other members in connection with gold payments to the Fund. The Fund will not know in advance which members would be affected if the provisions of Article III, Section 4(a) were to be applied and by how much gold

1/ The Fund replenished its holdings of Deutsche mark and Belgian francs through sales of gold of $147.94 million in connection with the special drawings made by Burundi, Pakistan, United Arab Republic, the United Kingdom and Yugoslavia.

payments would be reduced, or whether it would reduce the secondary gold losses. The amount of the gold subscription involved will depend on the way in which Article III, Section 4(a) would be applied.1/ Since most of the members which might come under Article III, Section 4(a) are unlikely to hold sufficient gold for payment of the gold subscription, it would not be unreasonable to assume some appropriate reduction in the total of secondary gold losses.

In light of the above considerations, it would not seem unreasonable that the Fund would replenish up to a ceiling of $500 million its currency holdings through sales of gold and thereby substantially, if not fully, mitigate the losses of gold which resulted from members buying gold from other members to pay the gold subscriptions on their quota increases.

In order to ensure the smoothest possible working of the mitigation operation, it would be necessary for a member to inform the Fund that it intends to purchase gold, and in what amounts, from another member to make its gold subscription in connection with the increase in its quota. The Fund may, if it deems it appropriate, indicate to the member purchasing gold which other members would be prepared to sell gold for this purpose. Furthermore, the Fund would replenish its holdings of the currencies of those members which had sold gold to other members by the sale of gold under Article VII, Section 2(ii) up to the amount of gold that had been sold by members in connection with increases in quotas.

4. Methods of replenishment

The Fund has a bona fide case to replenish its holdings of a member's currency if there is a need, either concurrently or in the near future, to use that currency in net sales to other members. Normally, such a need could be considered to exist if the Fund's holdings are below 75 per cent of a member's quota. However, it cannot be known with respect to which members' currencies, nor the extent to which, the Fund would have a bona fide need for replenishment, at the time that members make their gold subscriptions to the Fund or at the time they purchase gold from other members in preparation for making gold subscription payments to the Fund. Thus, any replenishment arrangements made by the Fund with members for the purpose of mitigating secondary gold losses must be flexible within the maximum amount to be replenished through sales of gold by the Fund.

Certain general aspects relevant to the execution of these replenishment transactions can, however, be discussed at this time.

a. It is likely that most members wishing to purchase gold for purposes of paying their gold subscription on increased quotas would normally wish to buy that gold from their reserve center. The bulk of these transactions would very likely be concentrated on the U.S. Treasury. For the convenience of those members which hold dollars and would prefer to sell those dollars to the United States for gold, and also to obviate the

1/ An illustration has been provided in EB/CQuota/69/3 (November 13, 1969).

necessity of some other members to hold U.S. dollars obtained from sales of gold to members, it might be desirable to direct such transactions to the United States to the extent that a bona fide case for replenishment of the Fund's holdings of U.S. dollars would permit. The Fund would then replenish its holdings of U.S. dollars up to that amount. This replenishment would be kept within the limits of the net creditor position of the United States in the Fund.

It is, of course, possible that certain members may wish to buy gold for subscription payments from other reserve centers against their respective reserve currency. In such a case, the possibility might exist for that reserve center to replenish its gold stock, if it so desired, in the United States, which in turn would receive gold from the Fund within the established ceiling.

b. If the size of the net creditor position of the United States were insufficiently large to accommodate the over-all amounts of currencies that the Fund would replenish through gold sales, then the Fund could replenish the currency of the member having the largest relative net creditor position in the Fund or the currencies of those members whose absolute net creditor positions in the Fund were, say, the five largest, or which were $100 million or more, or even of all members with creditor positions, provided the members concerned were willing to engage in gold transactions with other members. Gold sales could be prorated among these members in proportion to the normal use of their currencies in drawings, i.e., roughly in proportion to their holdings of gold and foreign exchange.

It should be noted that even though part or all of the replenishment might be directed to countries other than the United States, this would not preclude the possibility that countries desiring to purchase gold in connection with quota increases acquire this gold from the United States. The United States would then buy gold from the other creditor countries whose currencies the Fund would need to replenish and the Fund would sell gold to these countries in the same amounts and on the same day in replenishment.

5. Consequences for members involved in mitigation transactions

In SM/69/153 it was stated that "The acquisition by the Fund of an additional amount of currency would lower the reserve position in the Fund of the member acquiring the gold and this might make it necessary to place temporarily more emphasis on this currency in selection of currencies for ordinary transactions."

This would be desirable from the point of view of the member and in the light of the Fund's currency policy. Though a member's gold holdings would have been restored, its net creditor position in the Fund would have been diminished and its foreign exchange holdings would have been higher (or, in the case of the United States, its official liabilities lower) than before the member had sold gold to other members. In addition, these transactions would change the distribution of reserve positions in the Fund. In order to compensate for any distortion that might have arisen, the Fund might consider excluding the use of the member's currency in repurchases (except, of course, for those repurchase obligations incurred under Article V, Section 7(b)), and might also sell that member's currency, perhaps exclusively for some period of time, in connection with other members' purchases on the basis of the Fund's policy on currencies to be drawn and to be used in repurchases. Furthermore, the distribution of the mitigation operation among a number of creditors would tend to lessen the fall of individual net creditor positions and also lessen any temporary distortions in the composition of members' reserves. In addition, depending on the volume of Fund transactions, the distortion could be evened out within a comparatively short period of time.

6. Timing of replenishment

Replenishment of the currency of the member which sold gold to other members in connection with the latters' quota increases could take place, as convenient, either against gold at the same time as the member sold gold to other members or in connection with particular drawings. If replenishment operations were timed to coincide with gold sales by members, they would have to be frequent and, possibly, for very small amounts of currencies. Replenishment on this basis would, however, avoid the possibility that the members involved would show a fall in their gold holdings. Members might well feel it advantageous to replace the gold in their reserves as quickly as possible.

Replenishment could take place with greater operational ease if it occurred in connection with regular purchases by members from the Fund. The number of transactions would be fewer and the amounts would be larger, in particular, if replenishment were linked to large drawings. If the Fund sold gold to members in order to replenish currencies at the time of ordinary transactions, a member's net creditor position in the Fund would remain unchanged; that member, however, would have experienced a fall in its gold holdings as well as a rise in its foreign exchange holdings (for the United States there would be a reduction in its official liabilities to foreigners). In addition, it is not impossible that members' net creditor positions would diminish in the interval before the Fund would replenish holdings through sales of gold because of the flow of currencies into the Fund through the discharge of repurchase obligations under Article V, Section 7(b).

On balance, therefore, it is felt that replenishment in connection with mitigating the secondary impact on members' gold reserves might normally be made on the same value date as the sale of gold by that member. In any event, it is likely that the bulk of subscription payments and the sale of the currencies acquired from replenishment of $500 million will be concentrated within a relatively short time span of a few months.