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THE QUEST FOR AN INTERNATIONAL MONEY

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In recent weeks and months, I have had the feeling that those of us engaged in the central banking business have been living under that old Chinese curse which translates roughly as "may you have an interesting life"! Most recently, and this last weekend in particular, the word "interesting" seems to me a masterpiece of understatement in describing the sense of excitement, frustration, and accomplishment accompanying our quest for ways and means of deliberately creating, for the first time, an international money. One remembers small sidelights to the larger issues; for instance, some demonstrators in Stockholm, the general theme of whose placards seemed to be "SDR's go home"! There were, quite understandably, bad moments as well as good but the Ministers and Central Bank Governors ended up in such a way as to make even more meaningful today the topic "The Quest for an International Money".

Not long ago, I was fortunate enough to see the musical show, "Man of La Mancha" in which the song titled "The Quest", otherwise known as "The Impossible Dream," is central to the theme of the play concerned with Don Quixote's search for a seemingly unattainable goal. During the past several years in our almost monthly meetings in Europe in which we have been searching for a new international money to supplement gold and dollars, there has often been much of the same feeling of unreality and impossibility of achievement. But even more often there has been the feeling of working closely with our counterparts from other countries in seeking to achieve a real and constructive result.

The result of this search appeared, first, in the resolution adopted unanimously by the Governors of the International Monetary Fund at their meeting in Rio de Janeiro last September--a resolution with the rather cumbersome title, "Establishment of a Facility Based on Special Drawing Rights in the Fund and Modifications in the Rules and Practices of the Fund". It appeared in more full dress in the Proposed Amendment to the Articles of Agreement of the IMF, drawn up in accordance with the Rio Resolution and endorsed in last week's Stockholm Communique of the Ministerial Meeting of the Group of Ten. By now it stands as a very real milestone in the evolution of the international monetary system. Instead of taking a major step backward in the evolution of that system, which is what a change in the price of gold would represent, the 107 countries comprising the International Monetary Fund, with perhaps one exception, have moved forward into the final stage in putting into place a mechanism enabling the deliberate creation for the first time of an international money, which will assure the continuity of the present price of gold as the anchor stone for all national currencies. That is to say, because additions to SDR's will in the future take the place of those additions to reserves which might have in earlier years been provided by gold, we are no longer dependent on gold as a source of monetary reserves. On this score I think it particularly significant that the Governors of the Central Banks of the active gold pool contributing countries, at their historic mid-March meeting in Washington, noted that "as the existing supply of gold is sufficient in view of the prospective establishment of the facility for Special Drawing Rights they no longer feel it necessary to buy gold from the market".

Resolutions and Communiques, especially those with long and involved titles, seldom sound very exhilarating. But I can assure you that the Rio and Stockholm documents represent decisions of enormous significance not only to everyone in this room but to the financial and industrial communities throughout the world. The operative parts of these decisions, so far as our search for an international money is concerned, were in the Rio call upon the IMF Executive Directors to propose Amendments to the IMF Articles for the establishment in the Fund of a new facility to meet the need, as and when it arises, for a supplement to existing reserve assets, and in the Stockholm authorization to the IMF Executive Directors of nine leading countries enabling them, in cooperation with the Executive Directors of other countries, to complete shortly the final draft of the proposed Amendment.

In all the turmoil of recent developments, what do the abstruse sounding words of the Rio resolution and the Proposed Amendment endorsed in the Stockholm communique portend for the functioning of the international monetary system?

First of all, and related directly to my topic today, I am in the fortunate position of being able to report positive results from our quest for an international money. As President Johnson said on Sunday night, in calling the attention of the American people to the outcome of the monetary conference in Stockholm, "the major industrial countries took a big step toward creating a new international monetary asset that will strengthen the international monetary system."

In what way will this represent a strengthening of the system? Here I think it is necessary both to look backward at the why of our search for an international money and to look forward to the relationship of the product of that search to the future functioning of the system.

Looking first at the "why the search" question, the answer is relatively simple--it is because as we look to the years and decades ahead it is clear there will not be enough of the existing kinds of reserve assets to go around. An expanding world economy requires an expanding supply of reserves, that is, an increasing supply of the kinds of money that monetary authorities use to settle claims reflecting deficits or surpluses in their overall balance of payments. The world needs the assurance that the traditional reserve assets, gold and reserve currencies, can and will be supplemented by a new reserve asset added at a controlled rate sufficient to meet future requirements. Events in the London gold market leading to the setting up of a two-market system for gold--with monetary gold in a closed circuit and gold outside given a commodity status--illustrated dramatically how the absence of such assurance can lead to a breakout of speculative fever. With gold coming into increasing use as a commodity, and with hoarding demand stimulated by the belief that gold would soon become so scarce its price would have to rise, there was an enormous drain of gold from monetary reserves into an array of private uses. That is why another alternate reserve asset, universally acceptable, had clearly become necessary--though caution would be required in any new arrangements to assure that there would not be more of the new asset created than the justifiable need of world payments could absorb. Just as there is the risk of over-issue of domestic currency in the case of any single national economy, so there is a risk on the international scene that the supply of international reserves could expand too rapidly. But there is the opposite and equally serious risk, and certainly the most relevant one as we look ahead, that reserves will expand too slowly. All countries clearly want increases in their reserves over time. Yet unless the total supply of reserves increases, any one country can increase its reserves only by bidding them away from another. Hence there is the danger, pointed out by so many observers of the international financial scene, that countries would struggle against each other for increasing shares of a relatively constant total of reserves, with the highly undesirable result that restrictive external policies and deflationary domestic policies would reduce growth of world trade and the world economy.

To make this a little clearer, let me give you some rough figures. During the past decade, the increase in world reserves has averaged close to $2 billion a year. If one excludes the United States, which has experienced a substantial decline in reserves, reserve growth of the rest of the world has averaged nearer to $3 billion a year. But analysis of trends in the principal components of that reserve growth point to the likelihood of future difficulties.

Taking newly mined gold first, there has been very little addition to international reserves from this source in recent years--perhaps 200 to 300 million dollars a year. And, beginning in 1966, there was actually a net drain from monetary reserves into nonmonetary uses--reflecting increased industrial uses associated with space exploration, jewelry, etc., and, especially in the last few months, heavy speculative demand. So gold alone does not seem to provide the answer to the need for growth in international reserves as we look ahead. The decisions of the Central Bank Governors at Washington in mid-March further underscore the diminishing role and contribution of gold.

What about dollars--or about some other currency performing this function? Again, there are clear indications that growth in foreign official balances alone, or even in combination with new gold, could not be expected to meet these prospective needs. For substantial growth of dollar holdings abroad requires continued overly large deficits in the U. S. balance of payments to provide such an outflow. Yet, such deficits are clearly undesirable, for they can only serve to weaken the strength of the dollar and lead more and more to an unwillingness of foreign monetary authorities to accept, or at least to hold, such dollars in their reserves. The why of our search, therefore, is the strong evidence that the supply of reserves from traditional sources--mainly gold and dollars--would not meet growing needs.

As for any other national currency filling the breach, apart from the special role of sterling, all major countries have made clear their unwillingness and inability to accept the burdens of a reserve currency country. Thus it has been only prudent to look elsewhere, and that prudent look--sometimes called "contingency planning" for reserve asset creation--led directly to the Rio agreement last fall, to the subsequent painstaking work by the IMF Executive Directors to implement it, and to the Stockholm decisions last weekend.

Against this background of a brief look at the "why" of our search for an international money, the crucial question to be answered is whether the new asset incorporated in the SDR facility meets the demonstrable need for a new reserve asset to accommodate a secular growth in reserves. An unequivocal affirmative answer can be given to this question.

As I have already indicated, the IMF Governors at Rio approved an Outline of a Facility based on Special Drawing Rights in the Fund. The introduction to that Outline stated: "The facility described in this outline is intended to meet the need as and when it arises, for a supplement to existing reserve assets." These same words reappear in the first article of the Proposed Amendment to the IMF Articles, as endorsed at Stockholm, covering the allocation of special drawing rights. Without attempting to cover all of the details as to the nature of the agreed facility for reserve asset creation, some of the key features are as follows:

First, this supplementary reserve asset takes the form of Special Drawing Rights that are set up in a separate and segregated account in the International Monetary Fund. This brief statement registers two important decisions. The accounts of the SDR facility are entirely segregated and use of SDR will be clearly distinguished from the use of other resources in the Fund, but the Special Drawing Rights will be set up as a part of the International Monetary Fund, by amendment of the Articles of the Fund.

Second, participation is offered to any member of the Fund which undertakes the obligations of the amendment. That is, this is a universal scheme that is not limited to a particular group of members of the Fund. When Special Drawing Rights are created, they will be allocated to all member countries participating in the scheme in proportion to their IMF quotas.

Third, the new reserve asset will normally be created for a basic period of five years at a time. That is, it is designed to provide for the growth in reserves over a considerable period of time, so that international decisions, which are not likely to be taken easily, would normally need to be made only at five-year intervals. The IMF itself has had a provision for quinquennial review of the adequacy of its regular resources.

Fourth, the procedures for taking a decision to create reserves are spelled out rather carefully. It is not surprising that this is the case because, as I have indicated, the decision deliberately to create international reserves is indeed something new and unique, and it is very important that it be done in a responsible manner by collective judgment, so that the world will have confidence that the new asset will be of the highest quality.

To achieve this, the plan proposes that the IMF Managing Director would normally initiate any proposal to activate the plan to bring about the actual creation of a given quantity of Special Drawing Rights. Before doing so he would consult carefully to ascertain that there is broad support among the participating countries. His proposal would need the concurrence of the Executive Directors, and then would be put to the Governors of the Fund. It would become effective only if 85 percent of the weighted votes of the participating countries were in favor of the creation.

You are probably aware that this 85 percent majority requirement was one of the crucial decisions reached in negotiation of the SDR facility. It is no secret that it was strongly urged by the members of the European Common Market, whose aggregate votes in the IMF are just over 15 percent. In other words, this provision would mean that no decision to create Special Drawing Rights could be passed if all of the Common Market countries were to participate and unanimously to oppose the proposal. The United States resisted the 85 percent proposal, advancing among other arguments the suggestion that the Common Market countries might appropriately increase their quotas in the International Monetary Fund in order to bring their weighted vote just beyond 20 percent, and retaining an 80 percent weighted majority vote for application to the new facility. When other aspects of the SDR facility developed to our satisfaction, we agreed to the 85 percent provision, recognizing that as a practical matter the new facility could not operate in the face of opposition on the part of all of the Common Market countries acting together. While French abstention from participation would mean that the 85 percent provision no longer provided the other Common Market countries with a veto, the practical need for the participation of these other countries would remain.

Fifth, and most important of all, what about the quality and usefulness of the new asset? As to the quality of the Special Drawing Right as a new asset, it will be unimpeachable. *It will consist of a firm, unequivocal and solemn obligation on the part of the participants to accept the new asset when it is presented and to pay currency in exchange*. That obligation is the fundamental assurance of the useability of the asset and is the principal factor which will ensure its value. Each participant will be obligated to accept Special Drawing Rights up to an amount equal to its cumulative allocations, plus two times its cumulative allocations: in other words, three times the initial allocations. As I mentioned earlier, allocations will be made to participants in proportion to their IMF quotas. This results in a margin between amounts created and acceptance obligations wide enough to assure that any country wishing to use its holdings of Special Drawing Rights will be able to do so without question. At the same time the existence of specified acceptance obligations assures each participant that it is not undertaking an unlimited commitment.

As to use of the new asset, one way to visualize this is to conceive of it being used in a fashion similar to the use of gold but with the IMF acting as a kind of traffic director, at times guiding the flow of Special

Drawing Rights as they are transferred from one country to another. Finally, there are rules and regulations governing the reconstitution (or restoration of holdings) by countries, in order to avoid a situation in which some countries might pay out (i.e. use) the entire amount of the SDR's that they have been allocated, and then leave them outstanding with other members indefinitely. If they did not reconstitute at least a part of the initial allocation they would be using them improperly as a means of deficit financing. The essence of this provision, as it applies for the first five years, is that countries should on the average retain over a five-year period at least 30 percent of their average allocation. There will be a review of these rules in the light of experience, but they cannot be changed for the future without an 85 percent majority.

These reconstitution rules, along with the procedures for decision making, required very intense negotiations up to the Rio approval of the Outline Plan. Existing reserves of gold and foreign exchange may, of course, be spent by any country without any formal requirement that they be reconstituted. In their own interest, countries will normally wish to reconstitute their reserves after a period of temporary strain. Some of us, therefore, felt that no formal reconstitution requirement was necessary.

On the other hand, the institutional reserves which have developed in the past in the International Monetary Fund in the form of claims on the Fund have been subject in part to repurchase obligations. It was urged by some European countries that there was a need to apply some plan of reconstitution to the new SDR. The resolution of this question is set forth in the Outline Plan and incorporated in the Proposed Amendment. The essential operating rule in effect allows a country to make its own decision regarding the timing of reconstitution of 70 percent of its allocation, but establishes the principle that on the average over a period of years at least 30 percent of any given country's allocation of the new asset should be held. There is also a general statement of a broader obligation to "pay due regard to the desirablility of pursuing over time a balanced relationship between their holdings of Special Drawing Rights and other reserves." It is our view that under these provisions, it is quite appropriate for countries to consider all of their holdings of Special Drawing Rights as reserves.

The United States, n turn, will be able, subject to the general test of need, to use its Special Drawing Rights to acquire dollars from any other country agreeing to such a transaction. And we will be able to acquire foreign currencies under the Fund's rules of guidance. We would expect to retain over time a rising total of the new reserve assets in our reserves. The reconstitution feature suggests that these holdings averaged over time should be at least 30 percent of our allocations. <u>While in our own opinion, we would have been prepared tp place a greater measure of responsibility on individual countries for management of their own reserves rather than apply such a specific reconstitution rule, we are satisfied that the rule that has been adopted is reasonable and can be made to work</u>. It would be our hope that over time, as experience accumulates, it will be found unnecessary to place great emphasis on reconstitution rules.

The Stockholm agreement, building on the Rio resolution and all of the subsequent work of the IMF Executive Directors, is another landmark in the search for a new reserve asset to strengthen the international monetary system in the interest of the entire free world. By the time of the meeting last weekend at Stockholm the issues in the construction of the necessary machinery to provide a new reserve asset, and in a reform of the existing machinery of the International Fund, (a report on which had also been called for in Rio), had become inextricably linked in the negotiations.

Roughly speaking, there were six issues remaining, largely technical, with respect to the SDR facility and another six issues, also largely technical, with respect to the so-called Reform of the IMF.

In the latter case, three of the most technical issues were referred back to the IMF Executive Directors for resolution. Two of the other issues involved voting majorities; for increases in quotas and for changes in uniform par values and maintenance of value. Adoption of an 85% voting requirements for quota increases--despite objections raised prior to Stockholm by Executive Directors of countries outside the Group of Ten, objections which the U. S. shared and voiced at the meeting--was part of the package advanced strongly by the EEC countries; the 85% voting requirement for uniform par values and related maintenance of value simply strengthens existing procedures protecting against any change in gold price or related consequence to Fund liquidity. The final IMF Reform question involved a suggested appeal procedure for interpretations of the Fund Agreement; this was satisfactorily resolved by a procedure within the IMF whereby a Committee of Fund Governors, or their temporary Alternates, will serve as an initial appeal board subject to reversal by an 85% vote of Fund Governors.

On the SDR itself the principal issue was that of "opting out," specifically whether a member country could become a participant in the scheme but not join in the first "activation" or creation of assets when it had been decided by an 85% majority. All countries finally agreed to grant this concession, designed to encourage French acceptance, which permits a country voting against an activation to opt out of any receipt of assets and subsequently, with majority approval, to opt back in again. Other issues were similarly settled; provisions governing Other Holders, Other Transactions, and Transactions with IMF General Account. The special considerations relating to initial activation are now essentially identical with those in the Group of Ten's Hague Communique of July 1966, namely, a collective judgment that there is a global need to supplement reserves, and the attainment of a better balance of payments equilibrium as well as the likelihood of a better working of the adjustment process in the future.

As to where we go from here in implementing the Rio and Stockholm agreements procedurally, the next step--already under way--is for the IMF Executive Directors to complete the final draft of the proposed Amendment to the Articles of the IMF and to transmit it to the Fund's Board of Governors for approval. After this approval, which may take a month or so, the Amendment will be submitted to individual country's Parliaments and legislatures for ratification.

The Amendment to the Articles will enter into force only after it has been ratified by a weighted majority of 80% of the IMF membership which must also comprise 3/5ths of the member countries. Following this so-called "entry into force" stage of the SDR facility, further time is involved in the consultative processes leading up to a decision to activate the facility. The first activation--possibly sometime in 1969--will represent the first actual deliberate creation of the new reserve assets.

This brings me full circle in my remarks this noon. I began by stressing the historic significance of the Rio and Stockholm decisions, and I would like to make a few concluding comments on that point.

What do these decisions really mean for the United States and for the international monetary system? To me, at least, they mean two very important things. First of all, the countries which are members of the IMF are going to put into place machinery for creating a new reserve asset that can function as a full supplement to existing reserve assets. The very act of agreeing to set up such machinery is a notable historic event. It is commonly and correctly realized, as I pointed out earlier, that a desirable rate of growth of the total of world monetary reserves cannot be achieved by increases in the supply of the kind of reserve assets now in use. Without such machinery in place for creating new reserve assets as and when they are needed, therefore, the present international monetary system would have been exposed to increasing, perhaps even intolerable, strains. The blueprint of the machinery agreed on goes a long way toward preventing these strains and remedying this problem.

The second thing the SDR facility signifies is the firm commitment of the monetary authorities of major countries to continue to strengthen international monetary cooperation. This was again explicitly recognized in the Stockholm Communique. It strikingly illustrates the clear intent of all these countries to build strongly and securely on the base of our current international monetary system--including the present official price of gold. There has been no lack of gloomy prophets ready to proclaim that the framework of international financial cooperation was someday bound to break down and that the key features of the present system--the present fixed price of gold and a pattern of stable exchange rates--would someday have to be abandoned. In recent months, these prophets have been particularly vocal in inveighing against the $35 official price of gold. The manifest strength of international monetary cooperation--in Rio, in Washington last month, and most recently in Stockholm--

discredits the views of these prophets of doom and substantially reinforces the international monetary system.

I do not want to leave you with the impression that all the hard work on international financial problems is finished or that the blueprint for creating Special Drawing Rights provides a panacea for all such problems. This is patently not true. I would also like to emphasize that the creation of new reserve assets does not remove the need for continued efforts to make the balance of payments adjustment process work more smoothly. This was recognized explicitly last month in the Washington and Stockholm communiques. The SDR facility in no way alters the importance of further intensive efforts by the United States and by European surplus countries jointly to restore a reasonable pattern of payments balance in their external accounts--other than, perhaps, to make the price of failure even higher because failure to reach equilibrium now on our part could jeopardize all that has been achieved. The establishment of machinery for the orderly and deliberate creation of new reserve assets to supplement gold, reserve currencies, and IMF reserve positions is indeed a necessary condition for a continued healthy expansion of world trade and commerce. But, in my view, it would be seriously misleading to regard it as a sufficient condition.

We cannot, just because of the successful culmination of more than four years of discussion and negotiations, look forward to an era in which international financial problems are absent. On the other hand, it would also be a mistake to minimize the importance of the agreement to establish the SDR facility. Evolution occurs in small steps which, when viewed at the time, may not always seem sufficiently radical to be noteworthy. In retrospect, however, and seen in the full context of subsequent developments, some evolutionary steps can turn out to be tremendously important. I firmly believe that future historians of international financial affairs will look on the recent and prospective agreement among the IMF Governors to create international money in precisely this manner, as one of the significant milestones which mark the progress of the world economy.