William McChesney Martin, Jr., Papers

Box 20/Folder 7

Series V, Subseries A

Group of Ten Ministers & Govs., 1966

Group of Ten Ministers and Governors
Delaware Suite - Sheraton Park Hotel
Sunday, September 25, 1966

Chairman Martin

LIST OF DOCUMENTS

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MINISTERS AND GOVERNORS OF THE GROUP OF TEN
MEETING OF SEPTEMBER 25, 1966

Netherlands	M. W. Holtrop (Acting Chairman)	Governor, De Nederlandsche Bank
	Emile van Lennep	Chairman, WP-3
Belgium	Hubert Ansiaux	Governor, Belgian National Bank
	Robert Henrion	Minister of Finance
Canada	Mitchell Sharp	Minister of Finance
	Louis Rasminsky	Governor, Bank of Canada
France	Michel Debre	Minister of Finance and Economic Affairs
	Bernard Clappier	Deputy Governor, Bank of France
Federal Republic of Germany	Karl Blessing	President, Deutsche Bundesbank
	Wolfram Langer	Under Secretary, Economics Ministry
	Otmar Emminger	Chairman, G-10 Deputies
Italy	Guido Carli	Governor, Bank of Italy
	Gaetano Stammati	Director General of Treasury Ministry
Japan	Takeo Fukuda	Minister of Finance
	Makota Usami	Governor, Bank of Japan
Sweden	Per Asbrink	Governor, Bank of Sweden
	Krister Wickman	Under Secretary, Finance Ministry
United Kingdom	James Callaghan	Chancellor of the Exchequer
	Leslie O'Brien	Governor, Bank of England
United States	Henry H. Fowler	Secretary of the Treasury
	Wm. McC. Martin	Chairman, Board of Governors, Federal Reserve System
Switzerland	Alexandre Hay	Vice President, Swiss National Bank
Bank for International Settlements	Gabriel Ferras	General Manager
OECD	Thorkil Kristensen	Secretary General

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Do not release before 5.00 p. m., Frankfurt time, August 25, 1966

GROUP OF TEN

COMMUNIQUÉ OF MINISTERS AND GOVERNORS

AND

REPORT OF DEPUTIES

"... on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed..."

July 1966

Communiqué

of the

Ministerial Meeting of the Group of Ten

on July 25th and 26th 1966 in The Hague

1. *The Ministers and Central Bank Governors of the ten countries participating in the General Arrangements to Borrow met in The Hague on 25th and 26th July under the chairmanship of Mr. Anne Vondeling, Minister of Finance of the Netherlands. Mr. Pierre-Paul Schweitzer, Managing Director of the International Monetary Fund, took part in the meeting, which was also attended by the Secretary-General of the O.E.C.D., the General Manager of the B.I.S., and the Minister of Finance of Switzerland.*

2. *The Ministers and Governors considered a report of Working Party 3 of the O.E.C.D. on possible improvements in the balance-of-payments adjustment process. They expressed their appreciation of the O.E.C.D.'s work on this report. Recognising that the smooth functioning of the international monetary system, as well as the general confidence in its stability, depend very much on progress toward the elimination of imbalances, they agreed that improvements in the adjustment process were needed and possible. They expressed the hope that Working Party 3 would continue to work for improvements in this field on the lines indicated in its report.*

3. *The Ministers and Governors also discussed a comprehensive report by their Deputies on other possible improvements in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed. This report also contains several suggestions for improving the existing system otherwise than through reserve creation. These suggestions should be given further study by the appropriate bodies. The report will be published in the next few weeks.*

4. *As regards international liquidity, the Ministers and Governors were in full agreement that there is at present no general shortage of reserves. On the other hand, it was thought unlikely that the existing sources of reserves would provide an adequate basis for world trade and payments in the longer run. Large U.S. deficits are not a satisfactory source of future reserve increases for the rest of the world nor are they acceptable to the United States. Moreover, gold alone is not likely to supply sufficient additions to monetary reserves in the future. Consequently, it was agreed that, at some point in the future, existing types of reserves may have to be supplemented by the deliberate creation of additional reserve assets.*

5. *As to the way in which such a future contingency could be met, the Deputies, in their report to the Ministerial Group, have achieved a consensus on a number of basic principles and elements of any such contingency planning, although they have not reached agreement on all points or presented a fully developed plan.*

Among the agreed basic principles, the Ministers and Governors particularly stressed the following:

- *Deliberate reserve creation, when decided upon, should be neither geared nor directed to the financing of balance-of-payments deficits of individual countries, but should take place on the basis of a collective judgment of the reserve needs of the world as a whole.*

- *All countries have a legitimate interest in the adequacy of international reserves. However, a group of major countries with a key role in the functioning of the international monetary system has a particular responsibility for the financial backing for any newly created reserve assets. Consequently, there is agreement that deliberately created reserve assets, as and when needed, should be distributed to all members of the Fund on the basis of I.M.F. quotas or of similar objective criteria. The major countries should be ready to provide adequate financial backing through the extension of special lines of credit to the Fund or through commitments to accept and hold such reserve assets.*

6. *A. There should be a clear distinction between the establishment of any contingency plan and the activation of that plan which would involve the first actual creation of reserves. The prerequisites for such an activation should be laid down. They should include the attainment of a better balance-of-payments equilibrium between members and the likelihood of a better working of the adjustment process in the future.*

   B. Organisational arrangements for decisions on the activation of any contingency plan and for subsequent decisions on reserve creation may vary according to the type of scheme adopted. Whatever scheme is adopted, it is essential that the organisational arrangements for such decisions should reflect two principles, namely, (I) the interest of all countries in the smooth working of the international monetary system and (II) the particular responsibilities of a limited group of major countries with a key role in the functioning of the international monetary system and which in fact must provide a substantial part of the financial strength behind any new asset. This could best be achieved by a procedure whereby proposals for reserve creation would be considered both by the limited group and by the Fund. The requisite majorities and voting procedures would have to give due recognition to the two principles set out above and this recognition would be a necessary condition for any decisions on reserve creation.

   C. One Delegation did not agree with the views set out in subparagraphs A and B.

7. *The Ministers and Governors instructed their Deputies to continue their studies on a number of unresolved questions. However they also thought it appropriate to look now for a wider framework in which to consider the questions that affect the world economy as a whole. With this in view, the Ministers and Governors, after consulting with the Managing Director of the Fund, recommended a series of joint meetings in which the Deputies would take part together with the Executive Directors of the Fund. The Ministers and Governors of the Group of Ten would expect a report from their Deputies not later than the middle of 1967. One Delegation did not join in making this aforementioned recommendation.*

REPORT TO MINISTERS AND GOVERNORS
BY THE GROUP OF DEPUTIES

7th July 1966

GROUP OF TEN July 8, 1966

Letter of Transmittal

To the Ministers and Governors:

In their communiqué of 28th September, 1965, the Ministers and Governors of the Group of Ten instructed their Deputies to determine and report to them "what basis of agreement can be reached on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed, so as to permit adequate provision for the reserve needs of the world economy."

On behalf of the Deputies, I transmit herewith the report which we were instructed to make.

In preparing the report, we have maintained close relations with the International Monetary Fund, and with the Organisation for Economic Co-operation and Development and the Bank for International Settlements. Representatives of the Managing Director of the I. M. F. and of the other two institutions have taken part in our discussions and have made valuable contributions to the work of the Group. Our discussions have also benefited from the presence of representatives of the Swiss National Bank.

Otmar Emminger
Chairman, Group of Deputies

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I. Introduction

1. This report is presented in response to the requests of Ministers and Governors in their communiqué of 28th September, 1965. That communiqué read, in part, as follows:

"5. The Ministers and Governors noted in particular that the deficit in the U.S. balance of payments which had for years been the major source of additional reserves for the rest of the world is being corrected and that the United States has expressed its determination to maintain equilibrium in its balance of payments. They welcomed this development in the United States international payments position which in itself contributes to the smooth functioning of the international monetary system. At the same time, they concluded that it is important to undertake, as soon as possible, contingency planning so as to ensure that the future reserve needs of the world are adequately met.

6. The Ministers and Governors recalled the mandate given to their Deputies in October, 1963, to 'undertake a thorough examination of the outlook for the functioning of the international monetary system and of its probable future needs for liquidity'. They noted that their Deputies had submitted to them an interim report on these problems in July, 1964, and had arranged for a detailed examination of various proposals for the creation of reserve assets by a Special Study Group. The report of this Group, which has now been published, will facilitate, through its exposition of the elements necessary for the evaluation of various proposals for reserve creation, the acceleration of the work of contingency planning.

7. Therefore, as the first phase of contingency planning, the Ministers and Governors gave instructions to their Deputies to resume on an intensified basis the discussions which were the subject of the Annex to the Ministerial Statement of August, 1964. The Deputies should determine and report to Ministers what basis of agreement can be reached on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed, so as to permit adequate provision for the reserve needs of the world economy. The Deputies should report to the Ministers in the spring of 1966 on the progress of their deliberations and the scope of agreement that they have found. During the course of their discussions, it would be desirable for the Deputies to continue to have the active participation of representatives of the Managing Director of the International Monetary Fund, and also of the Organisation for Economic Co-operation and Development, and the Bank for International Settlements. The Swiss National Bank will also be invited to continue to send its representative to the meetings of the Group.

8. The Ministers and Governors recognized that the functioning of the international monetary system would be improved if major and persistent international imbalances would be avoided. They recalled that, in their statement of August, 1964, the Ministers and Governors had invited Working Party 3 of the Organisation for Economic Co-operation and Development to make a thorough study of the measures and instruments best suited for achieving this purpose compatibly with the pursuit of essential internal objectives. They expressed the hope that Working Party 3 would be in a position to make their views known at about the same time as the Deputies of the Group of Ten report to the Ministers and Governors.

9. The Ministers and Governors recognize that, as soon as a basis for agreement on essential points has been reached, it will be necessary to proceed from this first phase to a broader consideration of the questions that affect the world economy as a whole. They have agreed that it would be very useful to seek ways by which the efforts of the Executive Board of the Fund and those of the Deputies of the Group of Ten can be directed toward a consensus as to desirable lines of action, and they have instructed their Deputies to work out during the coming year, in close consultation with the Managing Director of the Fund, procedures to achieve this aim, with a view to preparing for the final enactment of any new arrangements at an appropriate forum for international discussions."

2. Our discussions represent a sequel to those which resulted in our Report to the Ministers and Governors of July, 1964, and in the Report of the Study Group on the Creation of Reserve Assets. In our Annex to the Ministerial Statement of 1st August, 1964, we set out the major elements of the present international monetary system and the way in which it functions. We noted, among other things, that the monetary system is in constant evolution and that it has shown great capacity for adapting itself to changing circumstances. We also noted the increasingly close co-operation between central banks and the development of short-term credit facilities as significant features supporting the system. This capacity for adaptation has permitted it both to withstand successfully intermittent periods of considerable strain and to accommodate unprecedented growth.

3. Nevertheless, as indicated in our earlier report, the system is confronted with certain actual or potential problems. These can be grouped

under three main headings: *(1)* insufficient effectiveness of the adjustment process, *(2)* the risk of instability resulting from shifts between reserve assets, *(3)* the probable inadequacy of gold and reserve currencies as a source of new reserves in the future.

4. As to the *first* problem, our report of August 1964 stressed that the smooth functioning of the international monetary system depends on the avoidance of major and persistent imbalances. It would be impossible, and inappropriate, to attempt to eliminate imbalances entirely; reserve movements up and down can serve to cushion the effects of divergencies in national economic developments which are inevitable and often desirable. But, large and prolonged imbalances often have undesirable repercussions on the economies of the partner countries. Moreover, such imbalances can foster doubts about the stability of exchange rates and the effectiveness of government policies and ultimately threaten confidence in the payments system as a whole. The speed and efficiency of adjustment policies in correcting payments imbalances also influence the need for international reserves. In view of the importance of this problem, Working Party 3 of the O. E. C. D. was invited by the Ministers and Governors of the Group of Ten to examine possible improvements in the adjustment process and to report at about the same time as the present report is submitted.

5. As to the *second* problem, a system in which gold and foreign exchange reserves exist side by side and can be freely exchanged into one another entails certain risks of instability; in particular, shifts may occur from one currency into another or from currencies into gold. Not all such shifts are destabilising; but where they are due to, or give rise to, confidence movements out of reserve currencies they can put strains on the system. We have considered various suggestions for dealing with such strains. These suggestions are outlined in chapter II of our report.

6. As to the *third* problem, our report of 1964, which stressed the importance of maintaining the established price of gold, indicated that the growth in the stock of monetary gold has not been, and is not expected to be, adequate to meet the reserve needs of the international monetary system. In the past, official needs for reserves beyond those served by gold have been met in the main by increases in official holdings of reserve currencies, especially U. S. dollars. For a variety of reasons, further substantial increases of dollar reserves are unlikely to occur and in our view it would indeed be undesirable that the increase in the external short-term indebtedness of the U. S. should continue as in the recent past. Paragraph 7 of our mandate therefore specifically instructed us to determine what basis of agreement could be reached on arrangements for the future creation of reserve assets as and when needed. We have accordingly studied ways in which the responsibility for meeting overall reserve needs could be more widely shared and in which those needs could be met in a more deliberate and systematic way than hitherto, rather than being left to the outcome of individual countries' balance-of-payments deficits.

7. In so doing, we were able to start from agreed basic ideas, which had in part already found expression in our 1964 report and in the 1965 report of the Study Group on the Creation of Reserve Assets. Briefly stated, these ideas are the following:

(a) There is at present no general shortage of international reserves.

(b) It is, however, likely that a need for larger international liquidity will develop in time, which might call for the creation of new or additional international reserve assets.

(c) There is no single, unique manner in which the growing requirements for liquidity have to be met.

(d) In the past the need for international liquidity has been met by improving credit facilities, as well as by additions to reserves. In the future, credit facilities can no doubt continue to play a constructive role, but their use can be only a partial and temporary substitute for reserves which are at the full disposition of the country holding them.

(e) We have been exploring arrangements whereby new reserve assets could be created not in connection with balance-of-payments deficits of individual countries, but by deliberate decision on the basis of global reserve needs.

(f) We have been aware that the problem of ensuring a proper supply of international reserves is of interest and concern to all countries of the international community. We have, therefore, from the beginning taken account of the needs of all countries. In doing so, we have treated reserve creation as a problem distinct from the provision of capital for developing countries.

8. We are conscious that deliberate creation of new reserve assets represents a bold venture. The possibilities are numerous, the pitfalls are substantial and the consequences weighty. One member indeed expressed the view that, in the present imbalance of world payments, it would be inadvisable to formulate a complete and detailed plan which could be adopted in case a shortage of reserves should occur; this member, therefore, felt unable to participate in the discussion of the technical aspects of reserve creation. Most of us feel nonetheless that it would be prudent to embark on full-scale contingency planning now. Failure to anticipate future needs, especially when new territory has to be explored and the length of time required to set in motion new arrangements is inevitably great, could place strains on the payments system.

9. In their Mandate, Ministers and Governors have indicated (paragraph 9) that as soon as a basis for agreement on essential points has been reached among the Ten, it will be necessary to proceed from the first phase of discussions in the Group of Ten to a broader consideration of the questions that affect the world economy as a whole.

II. Possible improvements in the present system

10. In response to our mandate, we review in this chapter possible areas of agreement with respect to improvements in the international monetary system, other than future reserve asset creation. The question of reserve asset creation will be dealt with in subsequent chapters. We agreed that promising areas for improvement of the present system lay in the field of the adjustment process and of multilateral surveillance. Furthermore, we examined possibilities for improvement regarding certain aspects of reserve policies and I.M.F. practices and procedures in relation to quasi-automatic drawing rights. Finally, recognising the growing role of short-term credit facilities in the functioning of the system, we agreed to keep such facilities under review for their potential further contribution. The possibility of special long-term loans of reserves was also considered.

11. On balance, it was generally agreed that improvements in these areas might be potentially useful and that they deserved further study. By contributing to the smoother working of the system they might, furthermore, in some respects lessen the demand for additional reserves. Nevertheless, they cannot be regarded as an alternative to new reserve asset creation or take precedence over contingency planning. Nor of course should contingency planning for reserve creation be regarded as a substitute for, or take precedence over, progress in improving other aspects of the existing system.

1. Improvements in the adjustment process

12. We have not sought to anticipate any of the findings of Working Party 3 in its broad study of the adjustment problem. We do, however, wish to highlight the importance of the adjustment process and of the need for improvements in adjustment policies by both deficit and surplus countries in order to assure the smooth functioning of the international monetary system. Insufficient adjustment efforts by deficit countries may put an undesirable burden on the real resources and monetary stability of other countries and thereby contribute to inflationary tendencies in the world. On the other hand, the absence of appropriate efforts by surplus countries towards reaching equilibrium may result in a large-scale accumulation of reserves by these countries, leading to deflationary and restrictive international policies elsewhere.

13. Persistence of such disequilibria could clearly endanger the soundness of the international monetary system. This is particularly true of large and prolonged deficits of reserve currency countries which may give rise to uncertainty and doubts as to the stability of the system as a whole. On the other hand, a harsh and abrupt adjustment process could endanger the objectives we all share for the growth and stability of the world economy. We have recognised that the supply of international reserves has a bearing on the functioning of the adjustment process. Indeed, in assessing the need for reserves, this relationship is highly relevant.

2. Strengthening of multilateral surveillance

14. In their Statement of 1st August, 1964, the Ministers and Governors decided to institute a procedure for multilateral surveillance of the ways and means of financing external surpluses and deficits of Group of Ten countries, comprehending the various elements of international liquidity, both official and private, that are available or used for this purpose. This decision was based on recognition of the fact that the way in which balance-of-payments deficits and surpluses are financed has implications for countries other than those directly concerned. It also took account of the fact that a significant development of the system during the last few years has been the emergence of a wide range of bilateral and multilateral credit facilities, intended mainly to cope with speculative movements and sudden pressures.

15. This procedure for multilateral surveillance came into operation late in 1964. Since then it has been in constant evolution and has proved itself to be useful, in addition to the consultations that take place within the I.M.F., in judging international monetary trends, both in individual countries and from a more general point of view. Its starting point is the statistical information which participants provide every month confidentially to the B.I.S. on their external monetary positions. This information is regularly reviewed both at the B.I.S. and in Working Party 3 of the O.E.C.D., and it gives participants a clearer and more up-to-date view of events in this field than they had in the past. At the same time, it helps them in forming a collective judgment on developments in individual countries of the Group, as regards both the methods used to finance external surpluses and deficits and the trend of their overall balance-of-payments positions. As such, it should strengthen the self-discipline of countries participating in it. Furthermore, and because of the importance in international monetary affairs of the participating countries taken as a group, multilateral surveillance has proved useful in understanding and assessing the working of the monetary system as a whole.

16. We are in agreement that the processes of international consultation, including particularly those of multilateral surveillance, will have an increasingly important role to play in future international monetary co-operation. We suggest that their functioning should be strengthened, and it is widely felt that multilateral surveillance has a useful function to perform by providing for the periodical review of policies with regard to traditional reserve assets. Furthermore, a future decision to proceed with the deliberate creation of new reserve assets would call for collective judgments and decisions, arrived at in the appropriate bodies specified in the contingency plan, as to global reserve needs. Such judgments would be facilitated by the experience gained with the existing multilateral surveillance procedures. It was also suggested that, should a new reserve asset be introduced, the fears sometimes expressed regarding its possible impact on holdings of existing reserve assets could be allayed by agreeing, at least during a transitional period, on some understandings concerning reserve policies within the framework of multilateral surveillance.

3. Lessening possible strains on the international monetary system

17. The foreign exchange element in reserves, which within the Group of Ten consists mainly of dollar holdings, has grown considerably in the course of the last decade and represents an appreciable part of total official reserves. While it has been recognised that the contribution of dollar holdings to the growth of reserves is unlikely to continue as in the past, it has been felt that a sudden and massive contraction would impair the stability of the international monetary system. Such strains on the system could result from, or take the form of, sudden and

appreciable increases in countries' gold ratios, or movements of funds from low gold ratio to high gold ratio countries. Various proposals were put before us with a view to minimising such strains, in full recognition that they would not deal with all the fundamental causes underlying such strains.

(a) Harmonisation of reserve policies

18. One proposal put forward would involve a very gradual approach, within the framework of strengthened multilateral surveillance, towards harmonising members' practices relating to the composition of their reserves, in particular as regards the gold element. According to this proposal, high gold ratio countries would settle deficits mainly in gold and accumulate surpluses mainly in other reserve assets, whereas low gold ratio countries would do the opposite. In this way, members would make an effort to narrow down the existing discrepancies between their gold ratios by bringing each individual ratio, progressively and by stages, towards a band established around the average ratio of the Group. In view of the use of its currency as a reserve asset by other countries, participation of the U.S. in a harmonisation scheme would call for further study.

19. This proposal has not found general acceptance in the Group. Some members, while concurring in the objectives of this proposal, consider that its administration would raise practical difficulties and that it would interfere unduly with the freedom of choice of monetary authorities as regards the composition of their reserves. Several members pointed out, however, that in the longer run some understanding with regard to the composition of reserves would become necessary in any case in order to adjust reserve policies to the declining share of gold in total reserves which will inevitably come about.

(b) Other possible arrangements

20. A second proposal, by another member, envisages that a new reserve asset might be used not only in order to satisfy additional reserve needs but also to prevent the existing stock of reserves from shrinking. According to this proposal, there should be full freedom to convert any part of existing reserve currency balances into the new asset through a Trust Account, which would issue supplementary reserve units in return for them. The facility should not, however, become a means of financing deficits of the reserve centres themselves. Several members of our Group expressed doubts about this proposal.

21. It was widely felt that progress towards the aims which have prompted the proposals under (*a*) and (*b*) above and which most members of the Group would share, could be achieved by periodical review of reserve policies within the framework of strengthened multilateral surveillance.

4. Improvement of the quality of existing reserve positions in the Fund

22. As a consequence of the increase in the operations of the International Monetary Fund, net creditor positions in the Fund of member countries whose currencies are drawn from the Fund, either under quotas or under the G.A.B., have been rapidly increasing over the past few years. "Reserve Positions in the Fund", which include these creditor positions and gold tranche drawing rights, amounted at the end of 1965 to about \$ 5$^1/_2$ billion, of which \$ 4$^1/_2$ billion, or 84 per cent, were held by members of the Group of Ten.

23. As was already noted in the Annex to the Ministerial Statement of 1st August, 1964, and elaborated in the Report of the Study Group on the Creation of Reserve Assets, gold tranche positions, which represent quasi-automatic drawing rights on the Fund, have many of the qualities of a reserve asset. They have also been included in the statistics of reserves as presented by the Fund and the Deputies. They do not, however, have all the characteristics that several members would think desirable in order for them to be counted as owned reserves together with gold and reserve currencies. It was therefore suggested to us that their nature and characteristics should be improved so as to make them acceptable to all countries as fully-fledged reserve assets. It was felt by some members that this would facilitate not only the inclusion of Fund reserve positions in countries' official reserves, but also their development as an instrument for deliberate reserve creation should the need arise.

24. It was suggested to the Group that gold tranche positions could be improved by changes in their juridical status (namely their liquidity and unconditionality) and in their presentation in the accounts of the Fund (so as to reflect the international unit of account implicit in the Articles of Agreement), as well as by measures to facilitate their use (e. g. in the field of service charges, conditions of convertibility into national currencies, transferability and repurchase obligations). It was further suggested that the "super gold tranche" (i. e. that part of the gold tranche position which comes into being through the Fund's net use of a member's currency for other members' drawings) should carry a reasonable remuneration.

25. While full automaticity, changes in accounting procedures and transferability of Fund reserve positions might raise problems (e. g. requiring a change in the Fund's Articles, or interfering with the Fund's established policies on the selection of currencies to be drawn), and doubts were expressed as to the feasibility or desirability of some of these proposals, the Group was of the opinion that it was worthwhile to pursue them and it was suggested that the Fund should examine them further.

5. Short-term credit facilities between monetary authorities

26. As the international monetary system evolves and the volume of freely transferable private funds increases, there will be a continuing need for official short-term credit facilities to help provide stability to the payments system. The principal existing network of reciprocal credit (or "swap") arrangements extends between the U.S. authorities and the monetary authorities of a number of other countries. These facilities have been utilised from time to time, in both directions, in response to short-term variations in payments flows between the United States and other countries and on some occasions have been called into play in response to swings in payments not involving the United States. A further refinement and extension of existing facilities are possible. Such a development might take the form of one or more additional swap networks. The most recent development in this field has been the arrangements, announced in June, 1966, between the Bank of England, other central banks, and the B.I.S.

27. Whatever form they take, it is important that such credits be of a short-term nature and that they be used only when it appears likely that the flows to be offset are of a temporary and reversible character; information on the availability and use of such credit should continue to be fully and regularly communicated to other participants and discussed within the framework of multilateral surveillance, under the agreed procedures described in paragraph 15.

6. Long-term loans of reserves

28. The Annex prepared by the Deputies in 1964 noted that, while countries are ordinarily expected to overcome balance-of-payments difficulties within a reasonably short period of time, there may be exceptional cases where longer-term lending for monetary purposes on an ad hoc basis, by members of the Group of Ten, might be in the general interest. Although in the two years since the 1964 Report no such loans have been made, occasions may arise when the interests of the international community would be served by a loan of reserves from countries which have built up substantial reserves to a country whose reserves are not large enough to handle within a short period of time the various demands that might be made upon them. It was agreed that, while there was no need for immediate action, it might be useful to examine further the problems involved in such long-term loans.

III. Deliberate reserve creation

A. General principles

1. The need for reserves

29. Provision for adequate growth of monetary reserves is of major importance to the monetary system and to the world economy. Reserves can be and are supplemented by short-term credit facilities arranged by monetary authorities, and by short- or medium-term credit facilities through the International Monetary Fund; any future assessment of reserve needs will have to take into account the availability of such credit facilities. But these facilities, important as they are, cannot be a complete substitute for owned reserves. Countries will wish to hold a significant stock of unconditional liquid assets on which they are able to count unquestionably and under all circumstances. Such a stock of reserves is generally thought indispensable, not only to allow time, in case of an adverse balance of payments, for corrective measures to have their full effect, or until foreign credits can be negotiated, but also as a basis for keeping trade and payments free from restrictions and for maintaining international confidence in the currency in general. Very often countries are able to obtain foreign credit only if they have a reasonable amount of reserves.

30. It is the global need for reserves with which we have been concerned. We use the word "global" in two senses: first, to take account of the interest in this problem not only of the Group of Ten, but also of other countries; second, to direct attention not to the reserve needs of specific countries in particular deficit situations, but to the provision of adequate monetary reserves for the system as a whole.

31. Although factors such as regional integration, improvements in the adjustment process, and equilibrating capital flows could, over a long period, lead to an economy of reserves, we expect that the global needs of the world will increase over time, for the following reasons:

(I) The secular growth of world trade and payments is likely to be accompanied, on average, by larger swings in payments imbalances (at least in absolute amounts).

(II) Partly for this reason, but also for more general reasons, most countries will try to achieve an increase in their reserves over time, whereas no country appears to be willing to accept a secular decline in reserves; the United States, which has been an exception to this latter statement, can no longer be expected to take this position.

32. We turn now to the prospects for the future supply of reserves. Gold going into monetary stocks has become a shrinking proportional addition to total reserves. Over the decade to 1964, the annual increase in official world gold stocks has averaged about $ 600 million, which provided about one third of the average annual increase in official reserves. In 1965, it shrank to $ 250 million. For a number of years, the United States has provided a large part of reserve additions to the rest of the world in the form of gold and dollars. But, as noted in paragraph 6, a continuance of large U. S. deficits must be ruled out as a source of future reserves for the rest of the world.

33. On the basis of these considerations, we have come to the conclusion that the supply of reserves from traditional sources – gold and reserve currencies – is unlikely to keep pace with legitimate demands, at any rate in the long run. Supplementary means are therefore likely to be needed in order to provide for an adequate secular growth in world reserves. One of us, however, in view of the uncertainty that inevitably exists concerning the future evolution both of global needs and of the overall supply of reserves, was prepared to accept the notion of a shortage of reserves sometime in the future only as a legitimate working hypothesis.

34. As regards determining the optimum rate of growth of reserves, we recognise that there is no satisfactory quantitative formula at hand. No direct proportionality between the need for reserves and the growth in the volume of world trade and payments can be established, especially in the short run. Nor, for a variety of reasons, would a projection of the tendencies

noted in the recent past provide an accurate guide to the desirable rate of growth in reserves in the future. On the one hand, the postwar growth in reserves of countries other than the United States and United Kingdom represented partly a reconstitution from what were unusually low levels; moreover, during recent years, the growth of reserves in some parts of the world has been felt by a number of countries to have been more than adequate, an impression supported by the inflationary tendencies that have prevailed. On the other hand, the decline in the United States reserves, which made possible much of the reconstitution of reserves elsewhere, has largely run its course. No firm conclusions, then, can be drawn from examining this past experience. Nevertheless some of our members consider it significant that over the recent past the growth of reserves, even for Group of Ten countries excluding the United States, has lagged far behind the expansion of international trade.

35. Nor will it be easy to evolve qualitative criteria for a collective judgment on the need for additional reserves in the future. Nevertheless, despite the difficulties involved, some of us think it important to pursue the investigations into this subject with the aim of arriving at a generally agreed set of principles. The problem of evaluating the reserve needs for a certain period ahead is, in many respects, similar to that of evaluating the need for conditional liquidity at five-year intervals on the occasion of the quinquennial review of members' quotas in the I.M.F., as provided for in the Articles of Agreement of the Fund. Some other members questioned whether it will be possible to arrive at a common judgment regarding such criteria, as member countries may differ considerably in the relative weight that they would attach to various factors. They consider that an analysis of the decisions taken will in the course of time provide precedents, derived from the test of actual experience, from which criteria can be developed.

36. We have not, at the present stage, gone into this question in more detail. We wish, however, to stress that, even without more elaborate calculation and estimates and in spite of the difficulties and uncertainties involved in any evaluation of the need for reserves, it may safely be said that the additions to the stock of world reserves to be expected from gold alone will in all likelihood be insufficient to meet global requirements over time. As we noted in paragraph 32, the annual increase in gold reserves has averaged about $ 600 million over the decade to 1964, a figure which is less than 1 per cent of total world reserves of $ 70 billion. Thus, a global shortage of reserves calling for deliberate reserve creation is a contingency with which we must reckon, even if it is at present uncertain when it will arise.

2. The aims of deliberate reserve creation

37. As has already been said in chapter I, we are agreed that deliberate reserve creation should be neither geared nor directed to the financing of balance-of-payments deficits of individual countries but rather that it should provide for the global needs of the system. This implies distribution of additional reserve assets to all participating countries in accordance with an agreed general formula. The direct purpose would be to permit countries to achieve adequate secular growth in reserves, without relying on deficits of individual countries, in particular the reserve centres. This in turn will facilitate the achievement of wider aims.

38. One of these wider aims, in our view, is the maintenance of overall monetary stability in the world. A general shortfall in the supply of reserve assets may lead to widespread deflationary tendencies, damaging controls on trade and payments and unstable exchange rates. On the other hand, an excessive supply of reserve assets may weaken the constraints on domestic economic policies and thereby contribute both to inflationary pressures and to persistent payments imbalances. The supply of reserves should therefore be such as to promote a proper functioning of the adjustment process.

39. Another aim is the maintenance of confidence in the international monetary system in general, and in particular in the capacity of the monetary authorities to maintain control over the provision of reserves. This implies, on the one hand, that they should be seen to be able to prevent a serious shortage of reserves from developing; on the other hand, there must be

adequate safeguards to prevent risk or apprehension that such a new instrument might be misused. It was widely felt in our Group that the drawing-up of a convincing scheme, combined with improved adjustment processes, might lead to less hoarding of gold and thus reduce the quantity of new reserve assets needed.

40. We are agreed that deliberate reserve creation is not intended to effect permanent transfers of real resources from some countries to others. We are furthermore agreed that, since we are dealing essentially with the problem of secular additions to world reserves, it follows that the deliberate provision of reserve assets should not be adjusted to short-term fluctuations in the international level of demand. Indeed, by its very nature it cannot be used as an instrument for short-term "demand management" on an international scale. Variations in the global supply of reserves, at least when they do not originate in large deficit and surplus positions, do not usually have effects on the international level of demand in the short run.

3. Creating reserves on the basis of a trend

41. In view of the foregoing, we consider it advisable that decisions on the amount of reserves to be deliberately created should be taken for periods of some years ahead. Such decisions, even though subject to possible revision within certain limits, (e. g., in situations when actual additions to monetary gold differ widely from those anticipated at the time the decision was taken) would help to strengthen general confidence in the system and would in particular allow the gold and exchange markets to operate on the basis of more certain expectations.

4. Role of the I. M. F.

42. Most members believe that reserve creation should be carried out within the International Monetary Fund or in close association with it. The Fund already undertakes a number of functions in support of, and it has come to play an increasingly large role in, the world's monetary system. Its most important present function is the provision, under adequate safeguards, of short- or medium-term facilities for countries in balance-of-payments difficulties. The role of the Fund in any future reserve creation scheme could have two main aspects: one relates to the creation and/or use of new reserve assets, the other to the process of decision-making, to both of which we shall return later in this Report. If the Fund were to undertake important new responsibilities in connection with the deliberate creation of reserves, this function should be kept distinct from its traditional function as a source of conditional credit.

5. Allocation of newly created reserves

43. As stated in paragraph 37, there is general agreement that distribution of additional reserve assets should take place in accordance with an agreed general formula. Most members consider that allocations of newly created reserve assets should be determined on the basis, either of I.M.F. quotas, or of I.M.F. quotas plus G.A.B. commitments, or of a formula similar to the one on which present I.M.F. quotas are based.

6. Contingency planning

44. We are in agreement that there is no global shortage of reserves at the present time and that no immediate action to create reserves is called for. In our discussion of how to proceed in the future we have therefore drawn a distinction between planning for the contingency that most of us visualise and activating, at a later stage, any systematic procedure for deliberate reserve creation.

45. Most members consider that, while the precise moment for the activation of reserve creation is not clearly discernible at present, it would be prudent to establish a contingency plan now. A contingency plan, of course, implies not only basic agreement on the various elements involved, but also a possible combination of those elements into a plan that would establish the broad lines of appropriate institutional arrangements for eventual parliamentary ratification*). In support of the view that it is essential to proceed with the development of a contingency plan in the sense set forth above, several reasons have been advanced.

(a) The prospective imbalance between the aggregate world demand for reserves and the supply requires that assurance be given

*) A brief description of the main schemes put before us is given in Annex I to this report.

to the world that the monetary authorities are determined not to let a potential shortage of reserves disrupt the world economy in general and the international monetary system in particular. Such planning, when successfully completed, should discourage speculation and hoarding of gold by dispelling uncertainty as to this disparity between demand for and supply of reserves.

(b) Even after full agreement on a contingency plan, the process of legislative approval by a sufficient number of countries to make the plan effective could easily require a year or two.

(c) The absence of a coherent and well-prepared contingency plan might force resort to hasty and ill-considered measures.

46. One member, while not excluding the possibility that there might be an insufficiency of reserves in the long run, considers that contingency planning, in the sense of trying to reach agreement on all the major elements of a scheme, would at the present time be inadvisable and even risky.

(a) In the view of this member the Group does not, at the present time, have sufficient experience of collective decisions in international monetary matters to enable it safely to manage a scheme for the deliberate creation of reserves. Before taking such a step, it would be necessary to ascertain what the practical possibilities of collective management in this field are. From that point of view, improvements in the multilateral surveillance system and in the adjustment process would be obvious prerequisites.

(b) This member considers that, if contingency planning were undertaken too long in advance, in circumstances which might prove quite different from those prevailing at the time when a definite need emerged, there would be a great risk that the mechanism provided would turn out to be ill-adapted or unsatisfactory in actual use.

(c) Furthermore, this member considers that the drafting of an international agreement for the deliberate creation of reserves would, in present circumstances, give rise to an irresistible temptation to activate the agreement prematurely. He feels that the prevailing tendencies in both reserve currency countries and developing countries make it unlikely that the activation of an agreed scheme could in practice be deferred until a real need for additional reserves arose.

(d) This member considers that the present difficulties of the international monetary system are due not to the likelihood of a shortage of reserves in the near future but to the persistent imbalances of the reserve currency countries. If the problem of creating new reserve assets were given precedence over other, more necessary, reforms, the authorities in those countries would find it harder actively to pursue their current efforts to eliminate their balance-of-payments deficits; in particular, their action in this field would be hampered by the presumed availability of new financing facilities. Far from helping to reinforce confidence, then, contingency planning at this stage might further delay necessary adjustments and thus aggravate the insecurity and instability of international payments.

This member therefore believes that contingency planning, in the sense accepted by the majority of the Deputies, is premature and that it could even prove inopportune if decided on in circumstances widely different from those taken into account by the Ministers and Governors in September 1965 when they contemplated a prompt redressment of the U.S. balance of payments. This member nevertheless considers that the Group of Ten should keep the problem of global needs under constant review, and that it should continue to analyse the possible solutions and to specify the various elements that would need to be taken into consideration if and when it should become necessary to set up a reserve creation mechanism.

7. Activation

47. All those members who think it desirable now to undertake contingency planning agree that it is essential to distinguish very clearly between the working out of a contingency plan and the activation of that plan. It is their belief that a decision to activate can only be taken on the basis of a general assessment of the situation

and that it will be necessary to establish in advance a definite procedure for taking such decisions. An established procedure for reserve creation would, in any case, be necessary before the requisite legislative action could be taken in most countries.

48. It is agreed that activation should not take place unless it was decided, on the basis of a collective judgment, that a clear need for reserves would arise in the near future. In making this judgment, the availability of other elements of liquidity, as well as the aims of deliberate reserve creation set out in paragraphs 37–40 would be taken into account. Moreover, we are agreed that the circumstances in which a decision to activate a contingency plan could appropriately be taken should include:

the attainment of a better balance-of-payments equilibrium between members;

the likelihood of a better working of the adjustment process in the future.

49. The process of reaching this collective judgment on activation would have three main elements:

first, the regular and periodic evaluation of the factors bearing upon the basic long-term need for reserve growth;

second, the formulation of a proposal on the timing and amount of new reserve creation; and

third, decisions taken in appropriate forums and under specified voting procedures.

The same elements are relevant to subsequent decisions on reserve creation. We shall return to this matter of decision-making later in our report.

50. There was not unanimous agreement on the necessity to set out now a full-scale contingency plan. Those members, representing all but one of us, who consider it prudent to do this, proceeded to study the practical means by which reserves could be deliberately created. The member who considers that such contingency planning is premature refrained from participating in the discussion and drafting of the remaining paragraphs of this chapter.

B. Elements to be considered in contingency planning

1. Nature and form of new reserve assets

51. Any new reserve asset would be held only by monetary authorities and would, therefore, not be an instrument for direct official intervention in the exchange market. It is generally assumed that the existing system of market intervention, whereby a country's foreign exchange deficit is normally covered by the central bank selling U.S. dollars in the market, would in any case be preserved. The normal use of a new reserve asset, whatever form it might take, would therefore consist in transferring it to another country in exchange, directly or indirectly, for dollars.

52. The two basic forms of reserve asset that we have considered are drawing rights and reserve units. Whichever of these forms the asset might take, it would always essentially represent the right to obtain currencies from other participants through an automatic giving and receiving of credit. Although drawing rights and reserve units have distinctive attributes, as noted below, it was recognised that at the margin their characteristics tend to merge. If drawing rights were made directly transferable (which would not be possible under the present procedures of the Fund) they would be rather similar to units. And units that involved guided transferability by an agent would be rather close to drawing rights. Nevertheless most members see significant differences in the manner of transferring reserve units and drawing rights and especially in the attitudes of monetary authorities and of the general public toward the two types of assets.

53. Deliberately created *drawing rights* would be used in a similar way to gold tranche drawing rights under I.M.F. procedures and would presumably be subject to policies similar to those that govern the selection of currencies to be drawn from the Fund. Currencies drawn would be provided by lines of credit from member countries and, as these lines of credit were used,

the country providing its currency would accumulate additional drawing rights. The similarity of the proposed new drawing rights to existing claims on the Fund is a feature that recommends them to those members that stress the desirability of building on the familiar drawing techniques of the Fund.

54. *Reserve units* would, at least in normal circumstances, be directly transferable between participants in exchange for their currencies, which in turn would ordinarily be converted into dollars for use in the exchange market. Such reserve units would, it was thought, be more in line with the reserve assets traditionally held by monetary authorities and would be more readily seen by them, by the markets and by the public at large as a supplement to gold. In the longer run, when countries might be holding a substantial part of their total reserves in the form of new reserve assets, units might be more suitable than drawing rights. As to the technical way in which the unit accounts might be established, two possibilities were mentioned: one is deposits, and the other an overdraft facility, in the books of an agent. Advantages were claimed for each.

55. Preferences for units or for drawing rights, or for some combination of the two, tend to be associated not only with their particular attributes but also with members' views about other features of contingency planning, especially the scope and nature of participation by countries in reserve creation.

2. Participation

56. We have considered the size and composition of the group of countries which is to participate in a scheme for the deliberate creation of new reserve assets. Participation has three aspects: participation in drawing up the scheme and in subsequent decision-making, participation in the distribution of reserve assets, and participation in the obligation to accept and hold (and, in the event of liquidation, to redeem) reserve assets. Any arrangements made must conform to two important realities: first, that the aim of deliberate reserve creation is to meet the reserve needs of the world as a whole; and, second, that a particular responsibility for the successful working of any scheme must in practice rest on the major countries with a key role in the functioning of the international monetary system.

57. For reasons given in paragraph 54, most of us consider that a reserve unit should be brought into existence. Indeed several members consider that the deliberate creation of supplementary reserves should, for the main industrial countries, take the form exclusively of units.

58. A number of arguments have been but forward in favour of limiting participation in a reserve unit scheme. Not all of these arguments are accepted by all those of us who find a limited group reserve unit scheme acceptable.

59. A first argument was that a reserve unit scheme would consist of a network of mutual financial obligations; but that, as there would be no formal provisions for ensuring that countries which made use of their allocations of units should reconstitute them within a given period of time, these obligations could only be undertaken by a coherent group of countries. Participants in such a scheme must be willing and able to share the burden of temporary payments disequilibria and of restoring equilibrium within the framework of co-ordinated adjustment policies. Such a framework already exists between the members of the Group of Ten and we have proposed that it should be strengthened.

60. A second argument was that full acceptance of such reserve units requires that they be backed by major trading and financial countries which, in the event of liquidation or withdrawal, would be able to convert them into other usable assets. More generally, confidence in deliberately created reserve units would be likely to be the better maintained the more the units were limited to a coherent group of countries and the more they were backed only by major trading and financial countries.

61. A third argument was that countries, especially those which traditionally hold their reserves largely in gold, would find a reserve unit more convincing as a supplement to gold if it were created by a limited group of countries which together hold a substantial amount of gold.

62. Those of us who favour the creation of reserve units by a limited group have not, however, suggested that the group should necessarily be

restricted to the present Group of Ten. In their view, participation should be based on agreed qualifications, so that the group could be an open-ended one. At the same time, they consider that the group should not be too large and that its membership should not be changed frequently.

63. Furthermore, all of us, including those who favour a limited group reserve unit scheme, recognise that a legitimate need for reserves can arise for all countries and that, therefore, any reserve creation scheme should also include arrangements for countries outside the limited group.

64. Those who favour the unit approach for a limited group consider that the reserve needs of non-group countries could be met either by creating special drawing rights for them in the I.M.F. or by distributing units to them. In the case of drawing rights, group countries would extend lines of credit to the Fund in their own currencies, to finance these facilities. Thus the group members, as well as financing the reserve unit scheme among themselves, would also provide the necessary supplementary finance for the facilities placed at non-group countries' disposal. It was suggested that the Fund should make a proportionate use of these lines of credit, so that the group countries would share the financing burden pro rata to the size of their individual lines of credit. Some members held that claims on the Fund arising out of the use of these facilities by non-group countries should not have the character of primary liquidity. If units rather than drawing rights were distributed to non-group countries, group countries would undertake to accept units from non-group countries. The latter would not necessarily undertake acceptance obligations. The choice between the two alternatives would be left over for the second stage of discussions, when the views of non-group countries would be available.

65. Another view on participation, that was put to us and supported by some members and by the Managing Director of the Fund, is that there is no clear basis for distinguishing a priori between those countries that might, and those that might not, be in a position to accept the obligations of a reserve-creating scheme. Many countries, in different stages of development and throughout the world, have shown a willingness and capability to meet a major requirement underlying these obligations, namely, to achieve over time a balance between external deficits and surpluses; and indeed they have added to their reserves. All countries should therefore, according to this view, fully participate in the decisions to create reserve assets and in their distribution, and fully share in the responsibility of being obliged to accept them.

66. Those who take this view favour the creation of new reserve assets jointly by and for all Fund members on a uniform basis. It was proposed to us that special reserve drawing rights should be created in the Fund, financed by special lines of credit to be provided by all Fund members. Another proposal put before us, based on this view, provides for the creation of reserve units for all Fund members, each of them undertaking the corresponding obligation to accept transfers of units under procedures and rules to be established. It is recognised that in such schemes, too, the main burden of financing would rest with a relatively limited number of countries whose currencies would be mainly requested by the users of the scheme.

67. One member favours a solution which would provide (a) reserve units for a limited group of countries, together with facilities for all other Fund members financed by the limited group, and (b) special drawing rights for all Fund members on a uniform basis, financed by lines of credit extended to the Fund by each member. This proposal is designed to combine the advantages of a universal approach and an approach involving different arrangements for different groups of countries. The point was made that the total amount of new reserve assets to be created under this dual or combined approach would not necessarily be different from that which would be created under any alternative system.

3. Provisions for acceptability and use

68. Any new reserve asset would, of course, enjoy a high degree of acceptability for each individual member of the scheme owing to the obligations of the other participating countries to accept it. However, since the world will be unaccustomed to it, there is general agreement that such a new asset would have to have certain additional features to enhance its acceptability. Three general categories of provisions to accomplish this objective were discussed: a gold

value guarantee, interest and provisions on holding and use.

(a) Gold value guarantee

69. There was a consensus that new reserve assets should, as a step towards assuring their full acceptability, have a gold value guarantee. It was assumed that if the assets took the form of drawing rights created under the Fund's Articles of Agreement, they would be covered by the Fund's maintenance of value guarantee. There was a consensus that in other cases a gold value guarantee of the kind that attaches to claims under the G. A. B. would be appropriate.

(b) Interest

70. We consider that interest should be paid on new reserve assets, mainly in order to encourage the holding of them as a supplement to gold and reserve currencies. A number of suggestions were made as to a rate that would satisfy this objective, while not being so high as to compete with that obtainable on reserve currency holdings. We did not think it necessary at this stage to reach an agreed view on these matters.

(c) Holding and use

71. Proposals under this heading have the general objective of enhancing the willingness of monetary authorities to accept the new assets. Some of them are also intended to serve other purposes, such as promoting the working of the adjustment process. (We return to this aspect in paragraph 81 below.) Primary attention was given to two basic techniques. One was a holding limit under which a participant would not be required to hold more of the new assets than an agreed multiple of his cumulative allocation. The other was to link the use of assets to the use of gold or total reserves. Under a drawing right scheme a participant's obligation to accept and hold the reserve asset would be limited by the size of the credit line which he would have to provide to the Fund. The discussion of the above-mentioned techniques, therefore, concerns mainly schemes which are based on units and not on drawing rights.

72. It was suggested that a holding limit technique would make it possible for individual participants to avoid acquiring a disproportionate share of the units. While no participant would be required to hold them beyond his limit, the obligation to accept them would continue. Various suggestions as to the size of the holding limit were put forward.

73. Those who favour holding limits recognise that, in any reserve unit scheme with such limits and in which the obligation to accept units would continue beyond the limits, it would be necessary to have agreed provisions as to what happens beyond the limits. Under one suggestion, a participant acquiring units in excess of his holding limit could continue to hold such units, or, at his option, transfer them to an agent, who would redistribute them among other participants in exchange for their currencies, on the basis of appropriate criteria. While transfers within the holding limits could take place freely and directly without the intervention of an agent, the proponents of holding limits were of the view that the use of an agent to redistribute units held in excess of holding limits would not be a significant interference with their transferability. Another proposal was that excess holdings of units be converted under an agreed formula into gold provided by participants who are below their limits. In both proposals, it is envisaged that, as experience was gained in the use of units, holding limits might over time be less needed or even discarded.

74. One member who favours a holding limit considers that this by itself would not suffice to ensure orderly transfers of units and to avoid making the acceptance obligations unduly burdensome. He therefore suggested that there should be an understanding among participants according to which transfers would tend towards an equitable distribution of units, among countries not in balance-of-payments difficulties, broadly in proportion to other forms of reserves.

75. The second major technique of providing for the acceptability of units would be a transfer ratio linking the use of the reserve unit to gold. In the scheme put before us each transfer of units would be accompanied by an equivalent transfer of gold. The participant receiving the units could, if he wished, waive his right to receive gold.

76. Another proposal, which would make partial use of a transfer ratio, would not require it to be

employed except by an individual participant who had become a net debtor of the system to an extent that reduced his holding of units to some "lower holding limit" expressed as a percentage of his cumulative allocation of units. Below that limit any transfer of units would have to be associated with a transfer of gold or other reserve assets in a ratio which might be either fixed or progressive.

77. Another suggestion would be to require that the use of units be linked not to gold alone but to gold plus other reserves. Some other possibilities were also put forward, including the suggestion that participating countries hold units broadly in uniform proportion to the total of other reserves.

78. It was recognised that the use of newly created units might have special implications for reserve centres, arising out of the probability that countries using units would normally want to acquire dollars for operations in exchange markets. Such countries would find it more convenient to sell units to the United States than elsewhere, but the dollars so acquired could pass to other countries that might wish to convert them into gold. Various suggestions were made for dealing with this problem. Under a system of holding limits, it was suggested that a country providing gold convertibility should have the option to transfer units to other participants directly against delivery of its own currency. Under a gold transfer ratio system, such a country should have the option to convert its currency into gold and units at the transfer ratio. It was agreed, as a general principle, that reserve units should not be used solely to change the composition of a member's reserves.

79. Proponents of a holding limit suggested that this method of assuring the acceptability of reserve assets was the one most consistent with the objective of creating an independent reserve asset. In their view, linking the use of new assets to other assets and especially to gold would have the following disadvantages: it would compromise their standing as an independent and full supplement to gold; it would also make for difficulties in the circulation outside the limited group if that were desired; countries would have a disincentive to use units when in deficit, but would tend to use dollars instead, and this could mean that the reserve centre, although in equilibrium itself, would be faced with conversions of dollars into gold by surplus countries on a larger scale than would occur if deficit countries were more willing to use units. Furthermore, in this view, if a gold transfer ratio were established, it would become more difficult to convince the public that the world's monetary authorities had been able to break their dependence on new gold supplies for increases in reserves; in addition, countries outside the group would be inclined to increase the proportion of gold in their reserves, while countries inside the group that maintain low gold ratios would have to acquire additional gold in order to be in a position to make desired use of reserve units. For these reasons, there could be an increase in demand for gold, which would tend to converge on the reserve centre.

80. Those who favour a gold transfer ratio consider that it would have the following advantages: it would allow direct transfers of units between participants without any guidance by an agent; it would bring units nearer to an equal footing with gold than would holding limits; and it would make units more acceptable to monetary authorities, and more convincing to the market, as a supplement to monetary gold. In their view the unit system would thereby demonstrate beyond doubt that the monetary authorities had been able to break their dependence on new gold supplies for increases in reserves. Thus, one of the main factors that has contributed to gold hoarding and that has given rise to doubts about the long-run stability of the established price of gold would disappear and demand for gold could be expected to lessen. Moreover, there are in their view no grounds for expecting that a gold transfer ratio would in other respects lead to additional demand for gold. Countries outside the group, seeing that group countries had broken their dependence on gold, would have little reason to increase the proportion of gold in their reserves. As regards countries inside the group with low gold reserves, it was pointed out that they were in any case not likely to be faced with a problem for some years and that the problem could be met when it arose by channelling new gold supplies to these countries or by relatively modest gold reshuffles. The proponents of a gold transfer

ratio are of course aware that over the longer run the gold element in the ratio would have to be lowered, since the relative share of gold in world reserves would decline. In order to safeguard the United States' gold stock, they envisage that dollars presented to the United States for conversion could be converted either into gold (as at present) or fractionally (up to the transfer ratio) also into units. Proponents of a gold transfer ratio also consider that it would tend to strengthen balance-of-payments discipline for deficit countries.

81. Many members consider that, in order to maintain full confidence in the operation of a system of deliberate reserve creation, there must be arrangements to prevent misuse of the new assets and to lessen the risk of long-term transfers of real resources. In their opinion it would not be enough, given the uncertainties mentioned in paragraph 34 with respect to the quantitative assessment of reserve needs, to rely solely on the safeguard that new reserves will be created in judicious amounts. They therefore believe that it will be wise to provide for some additional safeguards. The gold transfer ratio discussed in the preceding paragraph would, in the view of its proponents, be such a safeguard. Other safeguards suggested were that reserve drawing rights should be used pari passu with an acquisition of currencies from the Fund, either by means of a gold payment or by the use of other available drawing rights; that countries with drawings outstanding in their Fund credit tranches should use their allocations of new assets in the first place for repurchasing their currencies from the Fund; and that persistent debtor positions in new assets could be avoided by rules concerning the average net use to be made of the assets over a longer period.

82. Other members, while agreeing fully on the need to improve the adjustment process, believe that it would be inappropriate to attach special disciplinary provisions to the use of reserves that are designed to be unconditional. Such special provisions would in their view be inconsistent with the character of reserve assets, the loss of which in any event imposes in their opinion restraint on countries in deficit. Furthermore, they consider that the proposed conditions on the use of reserves would be asymmetrical, since they would not impose corresponding pressures on countries in surplus. Instead of attaching built-in disciplinary restraints to the use of new assets, these members would rely on reserves being created in judicious amounts and only in response to a collective judgment regarding global needs for reserves.

4. Decision-making

83. Organisational arrangements for decisions on the activation of a contingency plan and for subsequent decisions on reserve creation may vary according to the type of scheme adopted. Whichever scheme is adopted, it is essential that the organisational arrangements for such decisions should reflect the two principles outlined in paragraph 56, namely, (a) the interest of all countries in the smooth working of the international monetary system, and (b) the particular responsibilities of a limited group of major countries with a key role in the functioning of the international monetary system and which in fact must provide a substantial part of the financial strength behind any new asset.

84. Thus, there is agreement that, with any type of scheme, decisions on the timing and amount of new reserve creation should be taken on the basis of a proposal from an independent authority. A proposal could also come from participating countries, in which case it would be referred to the independent authority for his advice. This independent authority could be the Managing Director of the I.M.F. In the view of some of our members, proposals should also be referred to the Secretary-General of the O.E.C.D. and the General Manager of the B.I.S. for their advice.

85. Furthermore, a majority of members favoured a two-stage procedure whereby, whichever scheme is adopted, a proposal would first be considered and decided upon by the members of the limited group and, on being accepted by the requisite qualified majority vote, would be submitted to the appropriate body of the Fund which will decide, according to a specified voting procedure, whether it will be accepted or not. Some members believe that the requisite qualified majority vote in the limited group should be on the G.A.B. model. Others believe that if a proposal obtained the requisite weighted vote in the

limited group, but was opposed by less than a majority of the unit votes in that group, it could be referred to a vote in the Fund, where a heavy qualified majority would then be required for final approval.

86. Some members held the view that, if reserves were created and distributed on a worldwide basis through the Fund, or a Fund affiliate, the only proper forum would be the Fund itself, or its affiliate. In this view, the decision-making procedures should recognise the particular responsibilities of certain countries by providing that decisions to create reserves in the Fund, or a Fund affiliate, would become effective only with the support of some qualified majority of Fund members.

87. It has been suggested that any member dissenting from a decision to activate a contingency plan should be allowed to opt out of the rights and obligations implicit in the initial distribution of reserve assets, while retaining the possibility of taking part in the scheme later. As far as subsequent decisions on reserve creation are concerned, the view was put forward by some Deputies that a participant should not be allowed to opt out of individual decisions, while retaining his membership in the scheme.

5. Liquidation, withdrawal and amendment

88. We have not given detailed consideration to possible liquidation and withdrawal provisions. We believe that a contingency plan should contain provisions for liquidation and withdrawal, and that these should be consistent both with the long-term nature and with the monetary character of the arrangements envisaged. In order to reinforce the acceptability of new reserve assets, there should be provisions assuring holders that they would be able to realise their claims within a reasonable period, if a withdrawal or liquidation actually occured; but the withdrawal provisions should adequately safeguard the interests of the continuing members.

89. Any contingency plan should contain provisions for review and, if necessary, amendment which will balance the need for stability in the arrangements with the need to adapt them to changing circumstances.

IV. Conclusions

90. In our mandate we were asked to "determine and report to Ministers what basis of agreement can be reached on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed". In this concluding part of our report we wish to summarise the bases for agreement that we have reached on the varied aspects of the international monetary system which we have discussed.

91. We wish to stress our general agreement that the stability and smooth working of the international monetary system depend in a direct and substantial way upon the maintenance of a satisfactory equilibrium of the balances of payments of the larger countries. The restoration of such an equilibrium is important in maintaining confidence in the monetary system and in avoiding the danger of massive and possibly damaging conversions of one type of reserve asset into another. We, therefore, attach the greatest importance to the adoption of internal economic policies which are conducive to success in adjusting payments imbalances.

92. We agree that improvements in the adjustment process are needed and possible; but we realise that progress is bound to be gradual and this makes it the more necessary to keep the possibilities for improving the process under constant and active review within the appropriate bodies.

93. We are in agreement that the processes of international consultation, including those of multilateral surveillance which were instituted by Ministers and Governors following our first Report of 30th May, 1964, have proved to be of great value and should be continued and strengthened. Since these processes permit nations to learn of the effects of their policies upon others and to explain their policies to others they offer important opportunities both of advancing

knowledge and understanding of the adjustment process and of avoiding conflicts of policy respecting reserves and the balance of payments which could threaten the international monetary system. We are also agreed that efforts should be pursued within the framework of strengthened multilateral surveillance to avoid, by periodical review of reserve policies, any sudden and massive contraction of reserves.

94. We have examined some suggestions for improving the status of I.M.F. reserve positions as reserve assets and we are agreed that the Fund should be asked to examine these suggestions further.

95. We are agreed that, while global reserves are sufficient at present, the existing sources of reserves are unlikely to provide an adequate basis for world trade and payments in the longer run, because a continuance of large U.S. deficits must be ruled out as a source of future reserve increases for the rest of the world, and because gold alone is not likely to supply sufficient additions to monetary reserves.

96. Accordingly, we are agreed that at some point in the future existing types of reserves may have to be supplemented by the deliberate creation of additional reserve assets.

97. Most of us are agreed that, although the precise moment for deliberate reserve creation is not clearly discernible at present, it would be prudent to begin preparing for such a contingency now. One member did not share this view. This member refrained from participating in the discussion and drafting of all those passages of this report that relate to the technical elements of contingency planning. The reasons underlying these different attitudes towards contingency planning for reserve creation are spelled out in detail in paragraphs 45 and 46.

98. While those members who are in favour of going forward with contingency planning would not all proceed in the same way as regards all technical details, they are agreed that any contingency plan should encompass the following principles and elements:

(1) Deliberate reserve creation should be neither geared nor directed to the financing of balance-of-payments deficits of individual countries, but should take place on the basis of a collective judgment of the reserve needs of the world as a whole.

(2) Deliberate reserve creation cannot be aimed at dealing with short-run or cyclical problems of international demand management but should be geared to long-term trends in global needs for reserves.

(3) The amounts to be created should be such as to assure sufficient growth in reserves to avoid world-wide deflationary pressures, disruptive external economic policies or excessive strain on the monetary system, but not so large as to create inflationary pressures or undermine balance-of-payments discipline and the general stability of the system.

(4) Any contingency plan should rest on the principle of creating reserves for distribution to all members of the I.M.F., on the basis either of I.M.F. quotas, or of I.M.F. quotas plus G.A.B. commitments, or of a formula similar to the one on which the present I.M.F. quotas are based.

(5) The supplementary reserve assets should be unconditional in principle; nevertheless there must be arrangements to prevent misuse of the new assets and to lessen the risk of long-term transfers of real resources. It was, moreover, agreed that such assets should not be used simply to change the composition of a country's reserves; this might be achieved by some provisions regarding the holding and use of new reserve assets.

(6) The need for supplementary reserves, as ascertained by collective judgment, should be met through issues of a new reserve unit which is directly transferable between monetary authorities and/or through special reserve drawing rights in the I.M.F. Both kinds of asset would originate in an automatic giving and receiving of credit and would confer the right to obtain other participants' currencies. New reserve assets would be held only by monetary authorities and could, therefore, not be used for direct market intervention. The existing system of official intervention in the exchange market would not be changed.

(7) All countries have a legitimate interest in the adequacy of international reserves. However, the major countries with a key role in the functioning of the international monetary system have a particular responsibility regarding the financial backing for any newly created reserve assets in terms of accepting and holding such assets or of extending special lines of credit to the Fund. Therefore, the organisational arrangements for decisions on the creation and management of reserve assets should reflect both (a) the interest of all countries in the smooth working of the international monetary system, and (b) the particular responsibilities of a limited group of countries.

(8) It is essential to distinguish clearly between the working out of a contingency plan and the activation of that plan. Activation should not take place unless it was decided, on the basis of a collective judgment, that a clear need for reserves would arise in the near future. In making this judgment, the considerations in subparagraphs *(1)*—*(3)* as well as the availability of other elements of liquidity should be taken into account. Moreover, the circumstances in which a decision to activate a contingency plan could appropriately be taken should include:

- the attainment of a better balance-of-payments equilibrium between members;
- the likelihood of a better working of the adjustment process in the future.

(9) The decision on activation of a contingency plan and subsequent decisions on the creation of supplementary reserve assets would be taken on the basis of probable needs over a period of three to five years ahead, with provision for adjustment in the light of circumstances.

99. Most of us favour, as part of a contingency plan, the creation of a new reserve unit by the limited group referred to in subparagraph *(7)* of the preceding paragraph. The creation of such a reserve unit should take place in close association with the I. M. F. As regards the corresponding reserve asset creation for Fund members outside the limited group, the character of these assets and further particulars attaching to them should, regardless of whether they were units or drawing rights, be among the questions to be discussed in a wider forum at the second stage. The limited group should be willing to provide, in a manner to be agreed upon, the additional resources for the financing of these assets.

100. In the opinion of certain others of us, any additional reserves should be created in a uniform way for all Fund members, either special reserve drawing rights in the Fund or reserve units in a Fund affiliate. Financing would be provided, either by a sufficient number of countries with strong currencies or by all Fund members, through special lines of credit or acceptance obligations. In any case the main financing would be supplied by the group of countries mentioned in subparagraph *(7)* of paragraph 98.

101. A dual or combined approach was also suggested by one member. This would comprise reserve units along the general lines proposed in paragraph 99 and drawing rights for all Fund members financed by lines of credit from all Fund members.

102. As concerns the institutional arrangements and voting procedures for taking decisions, both on the activation of any contingency plan and on the amounts and timing of subsequent reserve asset creation, we have not yet reached agreement. For a discussion of these questions, we refer to paragraphs 83—87.

103. There are also other problems of particular interest to the Group on which further work remains to be done. In the field of deliberate reserve creation, this is for instance the case with regard to the provisions which should govern the use and acceptability of new reserve assets, a problem on which we have not yet reached a conclusion. Apart from future reserve creation, there is also further work to be done on some of the possible improvements in the international monetary system which we have discussed in chapter II of our report. Thus, the role of multilateral surveillance in reviewing reserve policies, and the techniques for minimising strains on the system through better adjustment policies should be given further consideration in our Group. We recommend that the Deputies continue to study these questions, together with any other questions of common interest to the Group concerning international monetary reform.

ANNEX I

Description of main schemes

1. In our work we have considered a number of proposals for the deliberate creation of reserve assets. In what follows we present a brief description of the main schemes put before us.

2. A personal proposal has been made to us by the Secretary-General of the O.E.C.D. that, as a step which should be taken immediately and without waiting for the outcome of contingency planning, the existing lines of credit to the I.M.F. under the G.A.B. should be made available to the Fund for use in exchange transactions not only with G.A.B. participants but also with other I.M.F. countries.

Scheme A

3. The main features of one proposal for contingency planning can be summarised briefly as follows: a group of countries establishes a scheme for the creation and holding of reserve units. Membership of the limited group would be open-ended. It would be open to countries that qualify for assuming the obligations attaching to participation in the G.A.B., that have currencies which are convertible and available for use in short-term international assistance operations, that assume the obligations of multilateral surveillance and that accept any agreement that may be reached on the adjustment process. In addition, members of the group would be required to provide the Fund with usable currencies by extending lines of credit to the Fund in a certain proportion to the reserve units created; this would enable the Fund to create drawing rights (or other special facilities) for non-group members. The Managing Director of the I.M.F. (or the Managing Director of the I.M.F. together with the Secretary-General of the O.E.C.D. and the General Manager of the B.I.S.) would participate in the process of decision-making by having the right to initiate proposals, or giving advice on proposals originating from members, with regard to reserve unit creation by the group.

4. A clear distinction is drawn between the agreement on contingency planning and the agreement to activate the scheme. Both decisions should be unanimous. As concerns activation a qualified majority vote under a special procedure could also be envisaged. The decision on activation would be taken in the light of circumstances, for instance, after a better balance-of-payments equilibrium within the group was attained, and after rules for improved adjustment policies had been agreed upon. At the time of the activation the group would decide to create reserves for a period of several years, with the possibility of adjusting such decisions within certain limits during that period.

5. The asset would take the form of a reserve unit with an absolute gold value guarantee of the G.A.B. type, and would have interest attached to it. It would be directly transferable to other participants in the books of the Agent (I.M.F.). Participants would have to supply against the reserve units their own currency, of which they assure convertibility. A special feature of this scheme is that, not only for ensuring acceptability but also for other reasons (see para. 80), each transfer of reserve units would have to be accompanied, at least initially, by an equivalent transfer of gold; this obligation could be waived at the option of the country receiving reserve units. To safeguard the position of the United States against conversions of reserve units into gold via dollars, provision is made for the United States to have the option of converting dollars presented to them by members not only into gold, but fractionally (up to the transfer ratio) also into reserve units.

6. This scheme attaches particular importance to the role of multilateral surveillance as a framework for consultations on the use of the reserve

units and on reserve policies in general, and in particular on the role of traditional reserve currencies in the new reserve system.

7. The details of how non-group countries would participate would be left for later discussions in a broader framework. One possibility mentioned was that the Fund should, on the basis of the lines of credit extended to it by the group, provide unconditional drawing rights to those Fund members not participating in the scheme. Such unconditional drawing rights would carry with them some obligation to assure the temporary use of the asset and to avoid a permanent transfer of real resources from the group countries to individual non-group countries, since such transfers are not considered to be in line with the strictly monetary aims of deliberate reserve creation.

Scheme B

8. Another proposal provides for the simultaneous creation of reserve units by a limited group of countries and of special reserve drawing rights (S.R.D.R.) to be created by and distributed to all members of the Fund including those of the limited group. The constitutional decision to establish this scheme would be taken under the auspices of the Fund Board of Governors and would enter into effect after approval by a qualified majority of participants with a specified share of the allocations. Proposals for reserve creation, containing equal amounts of reserve units and S.R.D.R.'s, would be put forward, by the Managing Director of the Fund (or by members), and decisions on them would be taken under separate voting procedures by the limited group and the Executive Directors of the Fund. These decisions would become effective for the limited group, and for the Fund, when participants with a qualified majority of the shares of allocations of each reserve asset had signified that they had completed all requirements necessary to bring the decisions into effect in accordance with their law. The Managing Director of the Fund would play a co-ordinating role in consideration of reserve creation proposals by the two decision-making bodies. A participant accepting allocations of reserve units would also be required to accept drawing rights created at the same time.

9. S.R.D.R.'s would be created for each member country in the Fund in proportion to its quota and would be available at the discretion of the holder on terms of use similar to those applying to the gold tranche. All participants would be required to provide unconditional lines of credit to the Fund in their own currencies at least as large as the allocation of S.R.D.R.'s and would also agree to make these currencies fully convertible when called by the Fund. When a country's line of credit is called, that country's S.R.D.R.'s would increase by the same amount. This proposal would extend S.R.D.R.'s fully to all Fund members, without regard to whether they had Fund drawings outstanding since deliberate reserve creation should take no account of the balance-of-payments positions of individual countries. The S.R.D.R.'s used by a country would be reconstituted, either by its own payments of convertible currencies to the Fund or by drawings of its currency from the Fund by other countries exercising their special drawing rights, in accordance with policies to be established by the Fund.

10. As regards reserve units created by the limited, but open-ended, group, and allocated in proportion to participants' share of Fund quotas plus G.A.B. and similar commitments to the Fund, their transferability and acceptability would be assured by an initial holding limit for each participant, together with a gold value guarantee. Such holding limits would be defined as a multiple of three times each participant's cumulative allocation of reserve units or $^2/_3$ of the total reserve units outstanding, whichever is smaller. If units are presented to a participant beyond his holding limit, he would accept them, but could in turn transfer them to an agent who would redistribute them among other participants on the basis of appropriate criteria. To ensure that the unit will serve to supplement aggregate reserves and that its purpose will not be frustrated by destabilising shifts in the composition of reserves, any participating country

which fulfills its exchange stability obligations under the Fund Agreement by freely buying and selling gold may, at any time, at its option, present units to another participating country against payment in the presenting country's own currency, unless the receiving country would be forced thereby to exceed its holding limit.

11. Members of the limited group would also be required to allocate an appropriate proportion of reserve units created by them, or alternatively amounts of their own currencies, to the Fund which would administer these funds for the benefit of non-group members of the Fund; the use of these resources would be decided by the Fund. Such a provision of resources would be in addition to the lines of credit which members of the group would have to extend as participants in a scheme for special reserve drawing rights as outlined in paragraph 9 of this Annex.

Scheme C

12. According to this scheme (described by its authors as a sample scheme), the members of the G.A.B., plus Switzerland, would agree on an initial agreement for deliberate creation of reserve units, a proportion of which would be reserved for use by non-G.A.B. countries. The uses to which these setaside units would be put are left to be determined in the second phase of wider international negotiation. So far as the initial agreement is concerned, the management and fundamental obligations would rest with its members, together with the Managing Director of the I.M.F., whilst participation in the distribution of the reserve units would be worldwide under conditions to be agreed in an extended arrangement.

13. The initial agreement to create reserve units would become binding as a contingency plan on those who adhered to it when a specified number of G.A.B. members representing a specified percentage of total G.A.B. credit lines signified their adherence. The initial agreement would come into operation for adhering members when a specified number of them representing a specified percentage of such countries' G.A.B. credit lines decided, on the proposal of the Managing Director of the I.M.F., to activate it. Those countries that agreed to activate the scheme would become operating members of it. The same procedure would apply for subsequent decisions to create units, with the proviso that any operating member could opt out of any such decision, and of the vote on it, in advance.

14. The operating membership of the scheme would be open-ended, since there would be a review of membership every four years. At the same time the number of operating members would be limited by the fact that all operating members would undertake the following obligations: to buy units without limit against their own currencies; to buy from a withdrawing member any units held by him in excess of his cumulative allocations; to assume the obligations of multilateral surveillance and to accept any agreements that might be reached on the adjustment process and on reserve policies; and to set aside an agreed amount of any units created for use, under the extended arrangement, by countries that were not operating members.

15. Reserve units would be denominated in terms of a given weight of gold, they would be fully gold-guaranteed, they would bear a low rate of interest and they would be directly transferable between monetary authorities, including those of countries that were not operating members, and the I.M.F.

16. Units would be allocated to operating members in proportion either to their Fund quotas or to their Fund quotas plus G.A.B. commitments. The rules governing allocations to non-operating members have been left for later determination in the second phase.

17. Each operating member, whilst obliged to buy units without limit against his own currency, would have an upper and a lower holding limit. The upper holding limit would be defined in terms of a uniform multiple of his cumulative allocations. Any accumulation of units by an operating member above his upper holding limit would, at that member's option, be convertible into gold by other operating members who were

below their upper holding limits. The lower holding limit would be defined in terms of a uniform fraction of each operating member's cumulative allocation. Any transfer of units by an operating member whose holding of units was below his lower holding limit would be accompanied by the transfer of an agreed proportion of gold or other reserve assets.

18. Backing for the units in the event of liquidation or withdrawal would be ensured by a provision that all recipients of units, whether operating members or not, would undertake in such event to return to the I.M.F., as agent for the scheme, the same number of units as they had cumulatively been allocated since joining the agreement.

Scheme D

19. According to this proposal, of which there are a number of variants, special reserve drawing rights (S.R.D.R.) would be deliberately created, consisting of unconditionally available drawing rights which would be additional to the existing unconditional and conditional drawing rights of Fund members. S.R.D.R.'s would be distributed to all members of the Fund, broadly in proportion to their I.M.F. quotas. Financing and transfer of the reserves so created would be accomplished by each member providing to the Fund an unconditional line of credit in its own currency at least equal to the amount of S.R.D.R.'s allocated to it.

20. Particular S.R.D.R. proposals differ primarily in the degree to which the special drawing rights would automatically and immediately be made available to all Fund members for adding to their monetary reserves and for use in settlements. One proposal would make S.R.D.R.'s available only to countries which are not, at the time of the creation, making use of their conditional drawing rights, while providing conditional drawing rights for Fund members which are making such use. A second proposal envisages that S.R.D.R.'s would be available without policy conditions, but that they would be used pari passu with an equivalent acquisition of currencies from the Fund, obtained either by means of a gold payment or by the use of other available drawing rights. A third proposal would extend unconditional drawing rights to all Fund members independently of their position in the Fund.

21. In order to ensure adequate financial backing of such S.R.D.R.'s it would be necessary that a sufficient number of member countries with strong currencies should put up large enough credit lines in favour of the scheme. One proposal, put forward by the Managing Director of the Fund, provides therefore that, while decisions on the creation of S.R.D.R.'s would be taken by a majority of "weighted" votes, they would only become effective when members having $^2/_3$ of total quotas under the scheme have agreed to grant to the Fund a credit in their own currency, provided that this includes a special majority of certain specified members. Another variant proposes that a limited group of countries with "strong" currencies should, as a group, take separate decisions on the provision of credit lines to the Fund both at the beginning and on the occasion of any further increase in S.R.D.R.'s.

Scheme E

22. A reserve unit scheme in which all Fund members could participate could be created through a special affiliate of the Fund ("International Reserve Fund"). This scheme and the previous scheme could be combined by proceeding first with the establishment of special reserve drawing rights in the Fund, to be followed later by a reserve unit scheme.

23. On the adoption of a decision by the I.R.F. to increase reserves, all members of the I.R.F. would exchange claims with the I.R.F. in accordance with the rules of the I.R.F., unless

they decided not to participate in the particular increase. Members participating in this exchange would acquire claims on the I.R.F. expressed in I.R.F. units of gold weight, and the I.R.F. would acquire corresponding claims on the member. The exchange of claims between the I.R.F. and participants in the increases in question would be in amounts broadly proportionate to I.M.F. quotas.

24. On the occasion of any creation of units, participants that had made a net use of conditional drawing facilities of the I.M.F. would be required to reconstitute those facilities through repurchase up to an amount equal to the reserve units they then received.

25. Units and counterclaims would enjoy a gold value maintenance guarantee and would bear interest.

26. Units would be usable only to meet over-all payments deficits. Each country would undertake to accept transfers, against dollars or its own currency, up to a holding limit (e.g. three times its cumulative allocation). These provisions on transferability might be supplemented, to the extent necessary, by rules intended to distribute equitably among net creditor countries those units disposed of by other countries in order to meet payments deficits.

27. In order to ensure adequate financial backing in strong currencies, it will be necessary to have minimum participation requirements for the establishment of the I.R.F., and requirements of majority and effectiveness for the making of decision by the I.R.F., similar to those to be provided for in the case of the S.R.D.R. proposals.

ANNEX II

MEMBERS OF THE GROUP OF DEPUTIES

Chairman
O. Emminger

Vice-Chairman
A. B. Hockin

Belgium	M. d'Haeze C. de Strycker	Ministry of Finance National Bank of Belgium
Canada	A. B. Hockin R. W. Lawson	Department of Finance Bank of Canada
France	M. Pérouse B. Clappier	Ministry of Finance Bank of France
Germany	R. Gocht O. Emminger	Federal Ministry of Economic Affairs German Federal Bank
Italy	G. Rota R. Ossola	Ministry of the Treasury Bank of Italy
Japan	H. Suzuki G. Suzuki H. Mayekawa	Ministry of Finance Ministry of Finance Bank of Japan
Netherlands	Jonkheer E. van Lennep G. A. Kessler	Ministry of Finance Netherlands Bank
Sweden	K. Wickman S. F. Joge	Ministry of Finance Bank of Sweden
United Kingdom	Sir Denis Rickett Sir Maurice Parsons	H. M. Treasury Bank of England
United States	F. L. Deming J. D. Daane	Treasury Department Federal Reserve System

Observer

National Bank of Switzerland	M. Iklé J. Lademann

Representatives of international institutions

Representing the Managing Director of the I. M. F.	J. J. Polak J. P. Sallé
Organisation for Economic Co-operation and Development (O. E. C. D.)	J. Cottier
Bank for International Settlements (B. I. S.)	M. Gilbert

Secretaries

M. G. Dealtry	(B. I. S.)
A. Guetta	(I. M. F.)
H. H. Travers	(O. E. C. D.)

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SEP 22 1966

GROUP OF TEN

CONFIDENTIAL

8th August, 1966

Summary of views expressed by Ministers and Governors of the Group of Ten at their meeting at the Binnenhof, The Hague 25th & 26th July, 1966

(to be distributed to the Deputies for their own records)

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I. REPORT BY WORKING PARTY 3 OF THE ECONOMIC POLICY COMMITTEE OF THE O. E. C. D. ON THE BALANCE OF PAYMENTS ADJUSTMENT PROCESS

The MINISTERS and GOVERNORS considered the Report of Working Party 3 of the O. E. C. D. on possible improvements in the balance of payments adjustment process, after it had been introduced by Mr. KRISTENSEN, Secretary General of the O. E. C. D., and Mr. VAN LENNEP, Chairman of Working Party 3. They expressed their appreciation of the O. E. C. D.'s work on this Report. Recognizing that the smooth functioning of the international monetary system, as well as the general confidence in its stability, depend very much on progress toward the elimination of imbalances, they agreed that improvements in the adjustment process were needed and possible. They expressed the hope that Working Party 3 would continue to work for improvements in this field on the lines indicated in its Report.

II. STATEMENT ON ADJUSTMENT MEASURES BY UNITED KINGDOM

Mr. CALLAGHAN outlined the recent adjustment measures taken by the United Kingdom Government with the intention of restoring the basic balance of payments equilibrium over the year 1967 as a whole. MINISTERS and GOVERNORS expressed their support of the U.K. Government measures and wished it full success.

III. DISCUSSION OF THE DEPUTIES' REPORT AND OF THE PRESS COMMUNIQUE

The MINISTERS and GOVERNORS of the Group of Ten APPROVED the Report of their Deputies and AGREED on the text of a press communique. They also AGREED to publish the Report with its Annexes. The following points were made in the course of the discussion:

Mr. EMMINGER presented the Deputies' Report to Ministers and Governors. Referring to the 1965 mandate, he described the work done by the Group of Deputies since September of that year, and outlined the findings that had been set out in the Report. Regarding improvements in the system other than reserve creation, he noted the Deputies' conclusion that the best way of reducing the strains which might be placed on the system as a result of sudden and massive shifts from one reserve medium to another was to subject member countries' reserve policies to periodic reviews in the context of strengthened multilateral surveillance. It had also been agreed to ask the I.M.F. to study the possibility of further improvements in the status of reserve positions in the Fund. As far as the deliberate creation of reserve assets was concerned, consensus had been reached on a number of basic points which were spelled out in the Conclusions to the Report. Certain questions still remained to be resolved, however, and thus required further study. These included, in particular, the form and acceptability of the asset, the conditions for its use, the participation in the distribution and decision-making processes and, finally, the decision-making rules. Agreement had been reached on the general principles relating to the latter point, but their implementation still generated differences of view that were fundamental, in that they raised the issue of actual control over the reserve creation process. It had seemed that some member countries considered a satisfactory agreement on this point as a pre-requisite for any decision of going over into a second and wider phase of discussions.

Mr. Emminger continued by drawing the attention of Ministers and Governors to the fact that the Report called for their decisions on two further, more technical points: the publication of the Report itself and the issuance of a mandate to Deputies for the continuation of their work.

Finally, Mr. Emminger pointed out that Ministers and Governors would have to decide on the basis of the Report whether to move to a "second stage" and widen the scope of participation in the discussions. He outlined the procedure recommended by Deputies for further work in the second stage. Under this procedure, the parallel work of Deputies and Executive Directors would be continued, but provision would also be made for joint meetings aimed at reaching a consensus of views. This consensus would subsequently be formulated in a joint report (or two separate reports), which would then be presented by the two bodies to their respective masters. The exact procedure would, of course, depend on the type of plan recommended. The Deputies were against drawing up too rigid a timetable for the joint meetings at this stage, preferring to leave the Managing Director of the Fund and the Chairman of the Group of Deputies to prepare these meetings through informal consultations with each other. Arrangements should be made for a full exchange of documents between the two groups.

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Mr. FOWLER stated that the absence of agreement on an number of questions was not a good reason to delay the widening of the discussions, since most of the unresolved problems were of vital concern to other nations. Full-scale discussions on liquidity were bound to begin shortly in the I.M.F; the U.S. being in the process of formulating plans for resuming progress towards balance of payments equilibrium intended to participate fully in these discussions, in the belief that further delay in the elaboration of a specific contingency plan would be imprudent. It would require a long time to establish a full contingency plan. It was important for the countries of the Group of Ten to retain their leadership in this field, however, and the knowledge and experience accumulated by the Deputies should not be allowed to be wasted in the forthcoming wider debates. It was therefore important for the Deputies to continue their activity, and for their work to be properly coordinated with any deliberations that took place in a broader forum.

Mr. Fowler believed it would be both improper and unwise for advance agreement on a rigid and precise decision-making formula - requiring the prior approval of a limited group and permitting prior veto by a clearly defined group of countries - to be exacted by the Group of Ten as a condition to the second stage, regardless of the character of the ultimate scheme for reserve creation. While the decision-making process must, and clearly would give full recognition to the particular responsibilities of a limited group, no formal or informal agreement, tying the second-stage deliberations to the acceptance of a prior veto power of a minority, perhaps a small as one or two members, would be acceptable to the U.S. or to the rest of the world.

With regard to the actual activation of a scheme Mr. Fowler felt that it would be unrealistic to make this conditional on the complete stoppage of U.S. balance of payments deficits. In his view, a distinct slow-down in the supply of reserves from traditional sources was a sufficient prerequisite to the activation of a new scheme. In that connection, Mr. Fowler stated that, despite substantial progress achieved in 1965 towards reducing the U.S. balance of payments deficit, it would not be possible to eliminate it entirely in 1966 in view of the heavy additional burdens imposed on the U.S. foreign expenditures by political and military developments in South East Asia. Although he could not venture, at this stage, any prediction as to how long that situation was to continue, he reaffirmed the declared intention of his Government to seek a further reduction in the deficit in the light of the prevailing situation.

Mr. DEBRE considered it premature to move to the second stage of the discussions. The mandate given to the Deputies in September 1965 clearly subjected this move to the reaching of agreement not only on general principles but also on their implementation. Furthermore, at a time when so many countries were struggling with an excess - rather than a shortage - of liquidity, he feared that the combined pressure of deficit countries for early activation of the scheme would be politically more difficult to withstand in the wider forum, where prudence would be mistaken for avarice. He warned that the alleged desire of developing countries to participate in the process of liquidity creation was actually the result of an illusion on their part that the availability of facilities of a monetary nature could solve their basic problems. He stressed the necessity of clearly separating development problems from the liquidity discussions.

Mr. Debré believed that the present disagreement among Deputies had more to it than had been made out; it was not merely a question of differences on procedural matters. There could be no need for the creation of additional liquidity until the U.S. balance of payments had been in equilibrium for some time. He was unable to agree with the original wording of the communiqué, which implied that gold alone could not, in any circumstances, represent a sufficient addition to monetary reserves; such a statement was based on the arbitrary assumption that the price of gold would remain unchanged. He could only agree to a less categorical formulation of the relevant paragraph.

The roots of the present difficulties were to be found in the operation of the existing system. Reserves were channelled to Central Banks as a result of the vagaries of the balance of payments of reserve currency countries. This, coupled with a deficient adjustment process, was responsible for the export of inflationary pressures from deficit to surplus countries. Such a situation could be corrected, not by moving to the second stage, but by keeping the problem of the reserve currency countries' need for liquidity distinct from the wider problem of the

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overall need for liquidity. Only when the former problem had been solved, through the cooperation of all industrial nations, would it be appropriate to tackle the problem of creating an international currency.

Mr. Debré considered that the proposed joint meetings would be most unwise unless it was made clear that no attempt would be made in them to reach conclusions but they would be confined to discussions aimed solely at the clarification of issues. Consequently, he requested that the Communiqué should state that France did not join in the recommendation concerning these meetings. Deputies should be instructed to continue their work and to report to their Ministers and Governors by September 1967. A move to the second stage without these reservations would be tantamount to the abdication of the Group of Ten countries from their responsibilities; this could have far-reaching consequences and precluded any endorsement on his part.

Mr. COLOMBO felt that the improvement of the adjustment process and the elimination of de-stabilizing factors from the system should be given priority over the creation of new reserve assets. He was gratified to see that at least the aims of the Italian proposal for harmonization of reserve policies had been generally agreed to. In view of the inevitable decline of gold in relation to total reserves, such harmonization would, in the long run, become indispensable to the stability of the system, especially if a new reserve asset were added to those already in existence.

As far as the deliberate creation of reserve assets was concerned, he did not consider this as urgent, but held it prudent to be ready in case a global shortage of reserves should arise. Since creation of reserves should not take place to finance deficits he would have preferred a more precise formulation of the conditions governing the activation of a scheme. It was unthinkable to activate a scheme before the reserve currency countries had achieved broad balance of payments equilibrium. The Italian authorities felt that the U.S. could make a substantial contribution to the stability of the system by abstaining from financing their deficit through the creation of dollars, and by having greater recourse to the drawing facilities of the I.M.F.

Many of the still unresolved questions relating to the elaboration of a contingency plan could appropriately be solved in the second stage. Mr. Colombo had serious misgivings, however, about leaving the basic question of decision making open for that stage, and would have preferred Deputies to be instructed to reach consensus on this issue before moving to the second stage. He finally agreed to the wording of paragraph 6 (b) of the communiqué, since it dealt only with the decision-making rules for activation of a plan and subsequent creation of reserves. Should countries feel that "the particular responsibility of the limited group" was not sufficiently safeguarded in the final scheme, they could always refrain from adhering to it in the first place.

It was important for the countries called upon to provide the real resources in the reserve creation process to have effective control of the process. This meant that all decisions should first be taken in a limited group, through a procedure which would not give a veto to a small minority, but would nevertheless protect substantial minorities from being overruled. A procedure analogous to that of the G. A. B. could adequately meet this requirement. Mr. Colombo expressed the hope that, in the forthcoming discussions in the wider forum, members of the Group of Ten would feel bound to support the compromises they had reached so far amongst themselves. He supported the proposal for joint meetings between the Deputies and the Executive Directors of the Fund, possibly with alternating Chairmen, but felt that the Group of Ten should preserve its individuality during the forthcoming discussions.

Mr. CALLAGHAN agreed that the countries of the Group of Ten would be running a certain risk by taking the discussions into a wider forum at this stage; if they did not do this, however, there would, on balance, be a far greater risk of other countries trying to take the initiative out of their hands. If the impression were given that the Group of Ten refused to discuss the issue with other countries, that could have serious political consequences and it might also weaken the position of the Fund. A decision at this stage as to whether or not the U.S. should be in balance was less important. The persistence of the U.S. deficit was due, to a large extent, to the fact that the country had assumed responsibilities which were to the interest of the whole free world. Thus, the existence of a U.S. deficit was no reason to arrest the process of reserve creation. The problems that remained to be settled were technical in character and could easily be solved if the political will to solve them existed. Mr. Callaghan had no strong views as to whether or not an agreement on the decision-making rules should be reached before the move to the second stage. He did not believe that in practice any minority would wish to impose its will on the Group.

Mr. SATO considered that failure to move to the next stage would create an atmosphere of uneasiness and cast doubts on the solidarity of the Group of Ten. He agreed that the move to the second stage should not be held up by the absence of consensus on the practical implementation of the agreed decision-making principles. Should the new reserve asset be created in the Fund, then he doubted it would be possible, from a legal point of view, to subject the creation of reserve assets to prior decisions in the limited group. Finally, he did not feel that members of the Group of Ten should be bound by their earlier discussions when it came to taking decisions in the wider forum.

Mr. HENRION hoped that the I.M.F. would give high priority to the study of improvements to the status of reserve positions in the Fund, as requested in paragraph 94 of the Report. As far as the next stage of the discussions was concerned, he felt that this should be confined to studies and should not aim at reaching, by 1967, a decision on a contingency plan for reserve creation. He stressed the importance of hinging the forthcoming discussions on the I.M.F., and of subjecting the enforcement of any result of these discussions to approval by the Group of Ten.

Mr. ANSIAUX agreed with other speakers that the improvement of the present system should have priority over the deliberate creation of reserve assets and that the premature creation of reserve assets could raise false hopes in developing countries. It was more important to improve the existing system than to create a new asset. There was no current shortage of liquidity; the possibility of such a shortage arising in the future was largely theoretical and could materialize only after the U.S. deficit had been eliminated for some time. At present it was impossible to see when the U. S. deficit would end and the excess liquidity to which it was giving rise was the main problem at the moment. At present, the size of both Fund quotas and claims on the Fund accumulated by certain countries was sufficient to meet contingencies. It should be a matter of course for countries to accept the use of the Fund for the financing of their deficits and the settling of their surpluses. Mr. Ansiaux did not object to a second phase of studies in a wider forum, but felt that any result of these studies should be approved by the Group of Ten before being implemented. With regard to paragraph 6 (b) of the press communiqué, he said that it was the Belgian understanding that before any decisions on reserve creation were taken there had to be a substantial majority in the Group of Ten in favour of such creation.

Mr. SHARP felt that the machinery for the creation of the new asset should be set up without delay. Only by doing this would it be possible to convince the rest of the world that the system was well under control. The Canadian authorities believed that reserve units should be distributed across the board to all Fund members; they had a distinct preference for the implementation of the second of the two schemes presented by the Managing Director of the Fund, but were open to alternative proposals. Canada would not, however, stand in the way of a general agreement on reserve creation by a limited group, on the lines of the procedure outlined in paragraph 99 of the Report, if this seemed to offer the best chance of rapid progress. As far as decision making was concerned, he agreed that it was essential for the procedure to require the concurrence of a substantial majority in the Group of Ten, as well as to recognize the interests of other countries and to safeguard the position of the Fund.

Mr. LANGER said that, once a scheme was ready, there would be great pressure (not only from countries outside the Group) for its activation.

In view of this, satisfactory guarantees against premature activation were indispensable and should be clearly spelled out in the scheme. There was also a danger that, once the need for activation arose, the scheme might prove to be ill-suited to the prevailing circumstances. For these reasons, it would not be prudent to deviate too widely from the well-tested procedures of the I. M. F.

As far as institutional issues were concerned, the control over the liquidity creation process, should clearly lie with the limited group. Within the Group itself, decisions should be carried only if supported by a clear majority. If and when the creation of additional reserves proved to be really necessary, Mr. Langer could not visualize the possibility that a majority in favour of reserve creation would, in practice, fail to materialize in the Group. As for the form of the new asset, he would favour an asset that had an unconditional character but that also had adequate built-in safeguards against the danger of its being used to cause permanent transfers of real resources. This was an important condition, in view of the fact that the Adjustment Process Report had revealed, in all countries, an apparent lack of readiness to give the achievement of balance of payments equilibrium high priority amongst their economic policy goals.

Mr. WICKMAN considered it essential to start preparing a contingency plan at the present time, in view of the need to convince the market that they would not be forced into a rise in the gold price and of the institutional delays that would occur in connection with its approval by Parliaments. He saw no foundation for the fear that to set up the machinery would also be to activate it. In any case, the amounts created in the initial period were likely to be small. It was also necessary to clarify the role of the Group of Ten in the liquidity creation process. He agreed that the creation of the new assets should be conditional on a substantial majority in the limited group. This was one of the facts of life that could not be escaped. In his opinion, the Group underestimated the outside world if it thought that the latter did not accept the fact of the Group's leadership and special position.

Mr. HOLTROP shared Mr. Colombo's views on the priorities for future work. There was no urgency to create an additional asset. Too many hopes had been raised in countries that thought of reserve creation as a means of financing their deficits. If the new system were to avoid strengthening inflationary pressures, agreement must be sought on many important points that were still open. This was a good reason for asking the Deputies to continue their work.

One of the points which deserved more study was that of the future role of gold in the monetary system; a philosophy on the fiduciary element of reserves could hardly be evolved if there were no philosophy on the role of gold. Finally, Mr. Holtrop expressed his opposition to a move to the second stage before an agreement had been reached on the decision-making rules, on the lines of the procedure outlined in paragraph 85 of the Report.

Mr. BONVIN felt that an excess of international liquidity in recent years had been responsible for existing inflationary pressures. He regarded the very principle of artificial creation of reserve assets with reservation. He agreed, however, that the supply of traditional reserve assets might, in the long run, taper off, and that it was thus necessary to plan ahead for such a contingency. It should not be forgotten, however, that the danger of premature activation was a real one. With regard to the form of the new asset, it had to be borne in mind that deliberately created assets could be nothing other than a mutual extension of credit lines. He was therefore in favour of drawing rights similar to those already in existence in the Fund. The creation of a unit-type asset would raise difficulties with respect to its coexistence with traditional assets, and would require the introduction of a limitation on the full convertibility of the U. S. dollar. He favoured a pragmatic approach that would show no marked departure from past experience: namely, cooperation within the Fund or within the framework of inter-Central Bank swap operations.

Mr. SCHWEITZER was strongly of the opinion that any scheme should be truly universal in character and that all Fund members should participate in it. There was no clear-cut distinction between countries belonging to the Group of Ten and other Fund members which could justify a paternalistic attitude towards the latter. No member of the Fund had ever stated that the object of reserve creation should be that of financing balance of payments deficits or the development process; all agreed that its purpose was to take care of global needs, and this view was clearly spelled out in the Fund's Annual Report. Mr. Schweitzer felt that the best way of meeting the principle of universality, which the Deputies had underlined in their Report, was for reserves to be created by the Fund. He had made proposals to this effect, which provided adequate safeguards for the legitimate interests of the Group of Ten countries with respect to both decision making and the use of the asset.

Mr. Schweitzer considered that the time had now come to proceed to the second stage. As for the procedure for future discussions, he agreed, in his personal capacity, with Mr. Emminger's suggestions. In order to make the joint discussions both meaningful and successful, however, it was important that the Executive Directors representing the countries of the Group of Ten be authorized henceforth to participate fully in Board discussions on the liquidity problem.

IV. DATE AND PLACE OF NEXT MEETING

It was decided that Ministers would meet again in Washington during the Annual Meeting of the Board of Governors of the Fund. It was left open for the Chairman to decide on the exact place and date of this meeting.

E

September 15, 1966

MEMORANDUM

Subject: Liquidity Resolution

The five EEC Executive Directors have now informed Mr. Schweitzer that the EEC Ministers considered the matter of a liquidity resolution at their meeting last Monday in Luxembourg. The Ministers have issued common instructions to the Executive Directors, and these instructions permit absolutely no leeway for any negotiation or compromise. The position being taken by the EEC is as follows:

(1) They would strongly prefer no resolution at all at the IMF Annual Meeting.

(2) If, however, there is a strong majority of other Executive Directors who nonetheless would still wish to put forward a resolution, the EEC Directors could agree, but only on their terms. Such a resolution would have to conform to the following:

(a) There must be reference to the Group of Ten in the operative provision, and this reference must constitute an affirmative response to the recommendation in the Hague communique that there be joint meetings. At the same time, it would not be acceptable to include any reference of any kind, regardless how indirect it might be, to any other group or body. Thus, for example, a reference to "consultations", "including with the Deputies of the GAB countries", would not be acceptable.

(b) There must be no reference to "formulating a plan" or to "making recommendations, as soon as feasible", or to any other words which would create the impression of in any way making haste toward actually reaching agreement within the near future on a plan or scheme. Indeed, it seems quite likely that they would object to an instruction for the Executive Directors to report to the Board of Governors pursuant to a resolution in time for consideration of such report at the next Annual Meeting of the Board of Governors.

Given this position, Mr. Schweitzer has concluded that it is not possible to reach agreement on a resolution which could be put forward at the Annual Meeting as the basis for proceeding with the next phase. He has explored the matter sufficiently with the Executive Directors of the EEC to be satisfied that nothing would be acceptable to them which could remotely approach the basis for a compromise among other groups of members. He urges that the idea of a resolution now be dropped promptly, since he is deeply concerned that further extended efforts to reach a compromise on a resolution would only serve to harden positions, and that this would open the possibility of demands to review in advance what he intends to say at the Annual Meeting, with the result that it would become extremely difficult for him to set the stage in his speech for the coming activities. His strategy at present is therefore to try to retain as much flexibility as he can with respect to what he can say.

Mr. Schweitzer has also commented that the issuance of a communique by the Six, as well as a statement to the press by Debre, has not made the situation any easier. His interpretation is that the EEC communique seems to harden the position expressed in the Hague communique. He further comments that the issuance of a communique by the G-10 in ten days would make the position somewhat difficult, and would tend to create a contrast between what the Ten can do and what the Fund can do. Although he would prefer no G-10 communique at all, the important point is that any such communique should avoid any new reference to reserve creation, but should perhaps restrict itself to reaffirming the Hague position.

William B. Dale
William B. Dale

cc: Deming Group

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

September 14, 1966

To: Members of the Executive Board

From: The Secretary

Subject: Statement of EEC Finance Ministers

There follows an unofficial translation of a portion of a press release issued by the Ministers of Finance of the EEC countries at the close of their recent meetings in Luxembourg. The full text will be circulated when it becomes available.

Without ignoring the divergences which appeared between them on the occasion of the work of the Group of Ten, particularly on matters of procedure, the Six confirmed their agreement on the principles which inspired the Hague Communiqué of July 26, and laid particular stress on the following points:

A) The satisfactory operation of the international monetary system requires the elimination of severe continuing disequilibria from the balance of payments. In addition certain improvements ought to be made in the system itself. The EEC countries are prepared to collaborate actively in seeking and introducing these improvements.

B) Notwithstanding the divergences on the desirability of defining forthwith a mechanism for the future creation of additional liquidity, they believe that in any event the effective introduction of such a mechanism could not be decided upon before the achievement of a better equilibrium in the balance of payments of the principal countries, in particular the disappearance of the deficits of the reserve currency countries, or before the emergence of a general agreement that a world shortage of reserves exists. Such a shortage is not visible today.

C) In the establishment of any mechanism for the creation of additional reserves and in the adoption of all the decisions which would be required by this mechanism, the main industrial countries, which include the EEC countries, have a special responsibility.

D) While all countries have a legitimate interest in a distribution of monetary reserves corresponding to the financing needs of expanding international trade, it is nevertheless clear that the economic growth of the developing countries calls for specific methods such as investment aids and various forms of technical cooperation and trade policies. It cannot be sought through the creation of additional liquidity.

F

Mr. Dale's Statement
Executive Board Meeting
Monday, September 19, 1966

Over the weekend, the U.S. authorities have very carefully considered all of the aspects of the question of a Governors' resolution on reserve creation. I should first make it clear that the U.S. Governor has not, prior to midnight yesterday, notified the Managing Director of either an addition to the agenda for the Annual Meeting, or of a resolution to be presented to the Governors.

The U.S. authorities recognize it as a fact that must be reckoned with that it is not possible, in present circumstances, for the Executive Board to reach full agreement on a resolution for presentation to the Governors. I am therefore not instructed to press today for immediate further formal discussion of language and I have no suggestions to make except that we discontinue our discussions, at least for the moment.

I am instructed to say, however, that the U.S. Governor has not been able to bring himself to give up all hope of a resolution that would attract substantially universal support from the Governors. The U.S. Governor accepts the proposition that it would not be desirable for the Fund, for the Group of Ten, or for the future development of the international monetary system to have at the Annual Meeting a contentious debate, a seriously split vote, or competing resolutions. Therefore, the U.S. Governor does not have in mind any dramatic moves that would risk such a result. I may be engaging in further informal discussion with other Executive Directors on forms of language that appear to have promise, and/or the U.S. Governor and other U.S. officials may be engaging in discussion with their colleagues from abroad before and during the Annual Meeting.

The U.S. Governor is deeply disappointed that the Executive Board has not been able to reach a commonly accepted view on a resolution. This result is not a good augury for the Fund as an institution, or for the interests of its members. He had hoped that the larger view of the financial requirements of the international monetary system as a whole would permit the differences to be bridged. However, this has not occurred, and we shall have to carry on as best we can toward meeting the needs of the future. It is the sincere hope of the U.S. authorities that the further consultations of the Executive Directors, which have been discussed, can be instituted promptly, carried out in a practical spirit of cooperation, and will prove beneficial within the near future.

G

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

Presentation of the
Twenty-First Annual Report

By the Chairman of the Executive Board and
Managing Director of the International Monetary Fund

Pierre-Paul Schweitzer

[Introductory paragraph of greetings.]

I am pleased to present to you the 1966 Annual Report of the Executive Directors of the Fund. I am sure you will agree that the Report reflects the intensive and concentrated character of the work that the Fund has pursued in the past year.

The Report records that in terms of financial operations the latest fiscal year was the most active in the Fund's history. Assistance was extended to more members than in any previous year. Sales of currencies reached a new record, exceeding the equivalent of $2,800 million, and stand-by arrangements approved during the year amounted to $575 million. Since the fiscal year ended, the Fund has actively continued its work of assisting members through financial transactions and through stand-by arrangements. In this connection, I should like to mention an important innovation in the Fund's transactions with member countries. On August 18, the Fund borrowed the equivalent of $250 million in lire from the Italian Government. This loan made possible a corresponding drawing of lire by the U.S. Government notwithstanding the low level of the Fund's holdings of lire. The transaction enabled the United States to acquire dollars from Italy against lire--a transaction of the kind which was specifically provided for in the Articles of Agreement.

Governors will be aware of the progress which has been made in increasing members' quotas in the Fund under the Resolutions which they approved in March of last year. As of today all but a few members have agreed to the increases in quotas provided for under those Resolutions, and total quotas now exceed $20.5 billion.

The Report also describes how the Fund has continued, and indeed expanded, the activities whereby, in a variety of ways, it seeks to be of assistance to its members. Programs of technical assistance have continued to help members in carrying out monetary, banking, exchange, and fiscal policies and in developing financial statistics. The Fund also has begun to provide its courses on monetary policy and analysis in Spanish as well as in French and English. Fundamental to all of these activities, there has been a continuation of that close consultation and cooperation with individual member countries which has always been the heart of the Fund's endeavors.

In May of this year the Executive Directors marked the 20th anniversary of their first meeting. As we reflect upon the past two decades of the Fund's existence, we can point to the increase in its resources, the development of its policies and facilities, and the advances that have been made toward carrying out the basic principles and objectives of the Fund as set forth in the Articles of Agreement. In any comparison of the economic and financial record of the postwar period with that of the interwar period, we cannot fail to note the unprecedented advances in economic understanding and in international cooperation. Then, looking at the latest developments, we observe that economic growth in most of the industrial countries continues at a high rate, that international trade goes on expanding, and that the exports of the primary producing countries are being supported by high and rising levels of demand in the industrial countries.

All this gives much cause for satisfaction, and it is essential to keep it in mind as a matter of perspective. But I do not intend to dwell upon the more favorable side of things, historical or current. I will instead focus on certain problems in the world economy that require the attention and efforts of all of us--in the Fund, in other international organizations, and in national governments--now and in the coming months and years. Also, I shall have something to say about two matters that have been important preoccupations of the Executive Directors and staff of the Fund during the past year--compensatory financing and international liquidity.

Looking at the industrial countries, I would draw your attention to several developments during the past year. First, the further expansion of economic activity in the United States and Canada created a situation in which, for the first time in the postwar period, virtually all industrial countries are simultaneously enjoying high levels of employment and at the same time experiencing pressures on resources. Second, changes in economic activity and in underlying demand pressures have not served to reduce the imbalances in world payments. Third, the widespread strength of demand for credit and capital, along with other factors, has led to a dramatic rise of interest rates in most industrial countries. These features of the economic scene in the industrial world point up some clear problems and challenges in the field of national economic policy.

The problem of maintaining price stability in the world economy has become greatly accentuated by the strain on resources that is associated with the high levels of employment and activity currently prevailing in nearly all the industrial countries. These countries have shown perseverance and ingenuity in their pursuit of economic growth and full employment, but they have been notably less successful in reconciling this with a reasonable degree of price stability. In my view, the increases that have occurred in the domestic prices of many industrial countries in recent years should not be taken as a sign of overabundant international liquidity, but rather are attributable to the difficulties encountered by economic management when unemployment gets down to low levels and structural factors come into play. Such difficulties, experience shows, can afflict countries having deficits in their external transactions as well as those in surplus positions. Coping with inflationary forces in the leading industrial nations will not be easy, as it will require advances in our understanding of economic processes, more effective uses of a wide variety of policy instruments, and--in some cases--giving a higher priority to the maintenance of price stability among the objectives of policy.

The fact that containing cost and price pressures for domestic reasons has become a common problem in the industrial world also has relevance for the balance-of-payments adjustment process. It may be recalled that during recent years the marked advances of prices and costs that occurred in

European countries--combined with essentially stable prices and costs in the United States--worked in the direction of reducing the U.S. payments deficit and moderating major surplus positions in Europe. However, with emergence of the problem of cost increases and incipient inflation in the United States, there would appear to be less assurance that price movements among industrial countries will continue, in general, to support the adjustment mechanism. The adjustment of balance of payments positions is dependent on an interaction between surplus and deficit countries, and the relative shares of the responsibility that they should assume for the adjustment will vary with the nature of the imbalances and with the underlying world economic situation. At this juncture, the assumption by the deficit countries of a major share of the responsibility for proper functioning of the adjustment process seems indicated not only on the basis of current price trends among industrial countries, but of other considerations as well.

Following reductions in their balance of payments deficits in 1965, both the United States and the United Kingdom experienced payments developments in 1966 which, though of a very different character, have been disappointing. As noted by the Executive Directors in their Annual Report, the continuance of deficits in the two reserve centers no longer necessarily produces a growth in world reserves and makes it more difficult to reach agreement on constructive solutions to the problem of ensuring an adequate growth of reserves for the future.

Notwithstanding a tightening of monetary conditions and a sharp upsurge of interest rates, aggregate demand in the United States expanded rapidly in the past year. This has led to a further shrinkage in the customary current-account surplus of the balance of payments, offsetting the reductions in capital outflow. It is essential that policies in the period ahead be directed toward the achievement of an effective payments equilibrium, and one which safeguards the needs of other countries for capital and aid. The several measures of fiscal restraint proposed by the U.S. Administration earlier this month in order to diminish inflationary pressures would contribute to the desired equilibrium in external payments.

The balance of payments position of the United Kingdom, which showed gradual improvement after the crisis of 1964 but remained weak, has been made difficult by lack of confidence. The program adopted in July, together with the earlier measures, represents a substantial disinflationary effort. This should do much to relieve the pressure on British resources and so to correct the external imbalance. The various measures now in effect will entail some slowing down in investment and growth over the short term, but the efforts being made to improve the allocation of resources and to make incomes policy more effective should serve to strengthen the basic structure of the British economy and help ensure adequate growth with internal and external stability in the longer run.

In both the United States and the United Kingdom, a rise in interest rates was appropriate in the prevailing situation of payments deficits combined with excess pressures of domestic demand. However, its contribution to the capital account of the balance of payments of the two reserve centers has been limited by a broadly parallel rise of interest rates in many countries on the continent of Europe.

In view of the strength of economic expansion throughout the industrial world, it is perhaps not surprising that interest rates in most leading countries have been high and rising over the past year or so. In part, the dramatic rise of interest rates has been a natural phenomenon reflecting the intensity of credit demands accompanying economic growth. However, there have been various other causes, the most important of which has been the way that industrial countries have managed their financial policies. Most of these countries have relied mainly on monetary policy to combat domestic inflation. However, it would have been more appropriate from the standpoint of international payments equilibrium if European countries in relatively strong payments and reserve positions had made greater use of fiscal policy for the purpose of checking inflation. Within the over-all degree of restraint obtained by the financial policies of such European countries in the recent period, a combination of greater restraint through fiscal policy and lesser restraint through monetary policy would have meant lower interest rates in those countries and thus would have been helpful to the international adjustment process.

In short, interest-rate developments in the industrial countries have not contributed significantly to a lessening of the disequilibrium in international payments. But, at least in some cases, these developments may also have disadvantages from a domestic viewpoint. There is room for concern that the later impact of a rapid advance in interest rates upon investment activity may be greater than desired. Moreover, in a few countries the upsurge of rates in the last year or so has been symptomatic of a somewhat disorderly scramble for funds. Also deserving of attention is the potential danger that further squeezes on liquidity, and further rises in interest rates, could have an adverse impact on particular categories of financial institutions or borrowers, with consequent repercussions on confidence and on real economic activity.

In any event, these considerations regarding interest-rate developments point clearly to the need for better fiscal policies in the industrial countries. Some improvement--perhaps not inconsiderable--could be realized through a greater willingness on the part of national authorities to face fiscal problems promptly, within the framework of existing arrangements. More fundamentally, every effort should be made to bring greater short-run flexibility into the instruments of fiscal policy in the industrial countries. This would contribute materially to the general effectiveness of demand management, enabling the authorities to cope more successfully with rapid changes in domestic conditions or in the balance of payments. If fiscal policies were better developed and could be adjusted more readily to changing circumstances, less reliance would need to be placed on monetary policies to influence domestic demand, and this, in turn, would permit more attention to be paid to the effects of monetary policy on the international movement of capital. With the convertibility of major currencies, an unduly heavy reliance on monetary policy may induce capital inflows or outflows which are disequilibrating to the balance of payments and also hamper the use of monetary policy for domestic purposes.

The industrial countries, by and large, have achieved some fundamental success in meeting their objectives of national economic policy in recent years. However, in one vital respect the record has not been good. Preoccupied with their domestic problems of pursuing economic growth, combating inflationary pressures, and protecting payments or reserve positions, the industrial countries as a group have not expanded their various forms of assistance to developing countries. In view of the sheer immensity of the problems and needs facing the developing world, this situation is of the gravest concern.

High growth in the industrial countries, to be sure, has provided an expanding market for the developing countries' exports during the 1960's. However, the beneficial effects of this would have been greatly enhanced if the industrial countries, by continuing to lower trade barriers, had eased further the access to their markets. Only slight progress has been made along these lines in recent years.

High growth in industrial countries, moreover, might be expected to facilitate the flow of resources to the developing world. But, in spite of increased efforts by some countries, foreign aid in the aggregate has stagnated since the beginning of this decade. Its terms have hardened in the sense that the proportion of assistance in the form of grants has fallen and that of tied aid has risen. Furthermore, the volume of private long-term capital flowing to the less developed countries has increased relatively little over the past few years. Although the industrial countries that impose restrictions on capital outflows have attempted to insulate developing countries from the effects of such measures, the general economic environment in the industrial world has not been one of positive encouragement, by tax incentives or otherwise, to investment in less developed countries.

In view of this situation, the industrial countries should give a high priority to measures which ease the access to their markets and stimulate the flow of investment and development assistance. These countries should make all possible efforts to avoid having such measures become contingent on the state of their balances of payments or of their budgetary positions. If these principles, which appear to find broad acceptance, were to be put into practice, we could then look forward to a time in which the potential benefits of high growth in the industrial countries would be shared more fully with the developing world.

On the other hand, the developing countries themselves must play an important role in any such improvement. Financial prudence on their part is more than ever necessary, not only in the interests of internal balance but as a means of stimulating the inflow of foreign resources, both private and official. While the control of some of the more conspicuous inflationary situations in the developing world has met with a measure of success, there has been some deterioration in many of the milder cases and the over-all outlook for internal price stability remains clouded. On the supply side, too, the developing countries must do more to marshall and redirect domestic resources if a higher level of exports to fill expanded markets is to be generated and if an increasing flow of foreign resources is to be used effectively. Particularly important, in view of the rapid growth in population, is the need in many countries for a strengthening of the agricultural sector.

The external position of many less developed countries remains precarious. The burden of servicing their accumulated foreign indebtedness has grown heavier, and the level of their reserves remains low. As a group, these countries have made sizable additions to their foreign exchange reserves over the last three years, but these reserves in many cases had fallen to very low levels and, besides, much of the over-all increase has been concentrated in only a few countries. Whatever strengthening of reserves has occurred is certainly to be welcomed; the less developed countries must have adequate reserves if they are to be able to deal with balance of payments uncertainties.

The Fund's resources are available to the members, within the established policies governing their use, to supplement their own reserves at times of temporary balance-of-payments difficulty. A frequent cause of difficulty is a shortfall in export earnings, and ordinary drawings can be made on the Fund in such circumstances. However, in February 1963 the Fund extended its policies by making special provision for the compensatory financing of payments deficits arising out of export shortfalls. Taking account of suggestions made by Governors at the 1965 Annual Meeting and of a Resolution passed by the United Nations Conference on Trade and Development, the Fund in the past year undertook an intensive re-examination of its compensatory financing facility. This resulted in the improvement of the facility that is fully explained in a new report that has been made public today.

Here, I might note briefly that outstanding compensatory drawings under the special facility--previously limited to 25 per cent of a member's quota--may in the future rise to 50 per cent of quota, with the provision that net drawings will ordinarily not exceed 25 per cent of quota in any one year. Henceforth these drawings will be outside the Fund's tranche policies and therefore they will not affect the member's ability to draw under those policies. The facility can now be said, in colloquial terms, to be a "floating" one. This is, of course, an important liberalization of policy for the benefit of countries eligible to use the facility. Countries making use of this facility will repurchase in accordance with the Fund's established policies which, in general, call for repurchases within three to five years. At the same time, the Fund will in these cases recommend that countries apply to repurchases approximately one half of the amounts by which their exports are above their calculated trend values in any year.

The compensatory financing facility provided by the Fund has been useful to some Fund members and in the future is likely to be useful to many more. It is for this reason that we have sought and achieved agreement on the expansion and liberalization of that facility. This has been done within the broad framework of the Fund's policy on the use of its resources, especially the requirement that those resources are available to assist members in meeting temporary balance-of-payments difficulties. As a result of our latest decision on this subject, the Fund is better equipped to help countries which have encountered export difficulties not of their own making.

I turn now to the subject of international liquidity--a subject on which the Fund has done a great deal of constructive work over the past year. The main results of this work are discussed at considerable length in Chapter 2 of this year's Annual Report of the Executive Directors. It is clear from this Chapter that the work done during the past year, both in the Fund and elsewhere, has produced significant advances in understanding and agreement. I may mention as one example the issue of the distribution of such reserves; very wide agreement has been gained on the principle that all members of the Fund should participate in any distribution of newly created reserves and that Fund quotas (or a closely related measure of the relative economic position of countries) should serve as the yardstick for the allocation of such reserves among Fund members. On other major points, too, there is a growing convergence of views.

There still remain a number of unresolved issues, including some important ones of both technique and policy. I do not want to minimize the difficulties involved but I am convinced that, given the will to establish a mechanism for the creation of reserves, these difficulties can be resolved in a reasonably short time. On the basis of the experience we have had this far, I conclude that there are no technical reasons why concentrated work could not provide Governors with fully developed suggestions for arrangements for reserve creation in time for next year's Annual Meeting. As an illustration of how certain aspects could be worked out, I put forward some specific ideas last February for the consideration of Executive Directors. These ideas, which are also covered in Chapter 2 of the Report, reflect the basic principle of universality and incorporate those safeguards that are indispensable whenever the creation of money is undertaken.

I may perhaps draw attention to the large increases, announced two weeks ago, in the bilateral credit facilities and swap arrangements of the U.S. Federal Reserve System and the Bank of England with each other and with a number of other central banks. These arrangements are designed to cope with the problem of heavy short-term movements of capital between financial centers and are not intended to be a substitute either for the conditional liquidity extended by the Fund or for the deliberate creation of new reserves, but I mention them here because they provide impressive evidence that decisive action can be taken quickly in the area of international liquidity.

I suggested in my address a year ago that it would be very useful if the efforts of the Fund and the Deputies of the Group of Ten could be directed towards a common view on desirable lines of action in the field of reserve creation. In my view, these efforts might now be helped by informal meetings between the Fund's Executive Directors and the Deputies. I am discussing practical arrangements for this purpose, and I hope to be able to submit proposals to the Executive Directors in the near future. It may well be that informal discussions with other groups would also appear useful during the year, and if the Executive Directors wish these to be arranged I perceive no difficulties. The most important consideration is to leave no procedure and no channel untried which can advance the work in which we are engaged.

I have made it clear that I consider it important that concrete arrangements for the deliberate creation of additional reserves be agreed among member countries without undue delay. I do not hold this view because I believe that the international monetary system is in imminent danger without injections of additional liquidity. But I do believe that world confidence in this system will be greatly strengthened once it becomes established that the members of the Fund have agreed on a system of deliberate reserve creation intended to insure that reserves increase by such amounts as are judged necessary for the full, free, and noninflationary growth of the world economy.

I do not harbor the illusion that reserve creation can serve as a panacea for the economic problems of the world. But many of these problems can more readily and more successfully be tackled if countries following prudent policies can expect their reserves on the average to increase--that is to say, if countries can acquire the reserve increases they need over the long run out of a growing total rather than at the expense of other countries. It is to assure such an economic environment that agreement should be reached on arrangements for deliberate reserve creation. For that reason the most determined efforts of all of us should be devoted to this problem in the coming year.

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September 22, 1966

Talking Paper on Balance of Payments for
WP-3, September 23

While circumstances are preventing achievement of balance in our international payments this year, we do feel that keeping the deficit in the bounds we have, in the face of many difficulties, particularly Vietnam, should be gratifying to this working party.

The deficit on the liquidity basis in the first half of this year was \$1.4 billion at an annual rate - virtually the same as for the year 1965.

The deficit on the basis of official settlements was at an annual rate of \$0.9 billion in the first half compared to \$1.3 billion in 1965.

The deficit in the third quarter on the liquidity basis will probably be within \$100 million - plus or minus - of the deficit in the third quarter of last year, which was about \$530 million.

While there has been no change in the over-all liquidity balance from last year there has been a substantial change in the composition of our balance of payments. The trade surplus, military account and Government grants and capital have worsened. These losses, however, were offset by gains in the capital account.

Following are the changes in the major accounts between 1965 and first half 1966 at annual rates, millions of dollars:

Trade balance	-850
Military	-850
Services and remittances	+230
Government grants and capital	-610
U. S. private capital*	+410
Foreign capital*	+1,810
Errors and omissions	-240
Liquidity balance	-90

The balance-of-payments cost of Vietnam is considerably more than perhaps is generally realized. In the first half of this year, our military expenditures in Japan and other countries in Asia were at an annual rate about $900 million higher than in 1964. Most of that rise can be attributed to the hostilities in Vietnam.

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*Excludes Delaware sub issues of $203 million in 1965 and $475 million in first half of 1966.

A second kind of impact on our balance of payments from Vietnam is in the form of the import content of military procurement in the U. S. A recent analysis indicates that defense needs have been a major reason for higher imports of such items as chemicals, engines, telecommunication equipment, textiles and light transport aircraft.

The need to meet tight military delivery requirements is important here. The military demand has been so great that present capacity is inadequate and our normally sufficient domestic supplies must be supplemented by imports.

Finally, there is the demand or income effect of domestic military procurement which, of course, stimulates imports.

Our balance of payments in the first half of this year also was adversely affected by the unevenness of receipts under the German Military Offset Arrangements. These receipts have been running at a rate below the quarterly average that would result if they were spread evenly over the eight quarters (from July 1965 through June 1967) covered by the current arrangements.

The fact that these receipts have been running substantially below the quarterly average for the entire first year of the agreement suggests that they will come in at a higher rate in the second year.

In addition to the demands of Vietnam, the high level of our civilian economy has taken its toll on the trade surplus. Imports in the first half were at an annual rate of 14 percent above the year 1965 and 21 percent above the first half of 1965. The commodity distribution of this rise is across the board. Comparing the first half of 1966 with the first half of 1965 we find the following percentage increases in the major commodity groups:

Industrial supplies and materials	10%
Food and beverages	25%
Consumer goods	41%
Capital equipment	44%

Exports in the first half were running 8 percent above the year 1965 and 12 percent above the first half of 1965 (after adjusting for the shipping strike in early 1965). However, the export increase leveled off after the third quarter of last year. This flattening trend primarily reflected a slowing in the rate of expansion in exports to Europe and Latin America in the first quarter and an absolute decline in the second quarter. There is also some evidence that the high rate of capacity utilization has retarded the filling of export orders.

We feel that the deterioration in our trade surplus is due to cyclical rather than structural factors. There is a very close correlation between rates of increase in our GNP and our imports.

For the period 1960 through the first half of 1966, comparing each quarter with the same quarter of the previous year, we have found that GNP increases of 6 percent or more (in current dollars) have elicited more than proportionate increases in imports, while increases of less than 6 percent in GNP have brought about less than proportionate increases in imports. Consequently, during the past 2 1/2 years when GNP increases have ranged from slightly over 6 percent to nearly 9 percent imports have been increasing at considerably greater rates. By the same token, the more moderate rates of increase in GNP which we look for in the months ahead should bring about a more than proportionate moderation in the growth rate of our imports.

The President's economic message of September 8 should have a salutary effect on both exports and imports in two important respects.

The suspension of the investment tax credit and accelerated depreciation will cut back over-all investment demand which has been one of the major causes of the overheating of the economy. This should relieve the pressure on imports of some industrial raw materials as well as imports in response to over-all demand.

The suspension of the investment tax credit should also have a direct effect on our exports and imports of capital equipment by reducing the demand for foreign machinery and eventually releasing capacity to fill export orders for U. S. machinery. Continued increases in new export orders for machinery, which lead deliveries by about six months, indicate that these shipments will rise in the second half of this year.

A second major part of the President's message was his commitment to take strong measures to reduce lower priority federal expenditures.

Federal civilian agencies have been directed to defer, stretch out, and otherwise reduce contracts, new orders and commitments. Each major agency has been given a savings target, with orders to meet that target.

The President stated that he is prepared to defer and reduce Federal expenditures

- by requesting appropriations for Federal programs at levels below those now being authorized by the Congress,
- by withholding appropriations provided above his budget recommendations whenever possible, and
- by cutting spending in other areas which have significant fiscal impact in 1967.

The President also called upon the banks to rely less on high interest rates and more on the rationing of credit.

Finally, the President has stated that he will take whatever <u>further fiscal measures</u> are necessary when the figures indicate that such measures are needed. The President is determined to bring revenues and expenditures into balance.

The two major uncertainties in the budgetary picture now are what the future requirements will be for the war in Vietnam and the total amount appropriated by the Congress for FY 1967. The President stated that once these figures are available they will be given a careful review and then it would not take him long to decide what to do.

The 1965-1966 level of U. S. private capital outflows - $3-3 1/2 billion (excluding Delaware sub issues) is considerably below the 1963-1964 levels of $4 1/2 and $6 1/2 billion, respectively, and, with the exception of one year, is as low as any level over the past decade.

We would not think it in the interest of the economic health and growth of the free world if our capital outflow were reduced to the degree needed to maintain an over-all equilibrium at our present rate of trade surplus. Thus, barring sharp cut-backs in our military and foreign aid expenditures, or further restrictions on private capital outflows, regardless of the impact on other nations, or restrictions on our current account, the answer must lie in expanded current account receipts, particularly exports.

The past months have given us further experience with restrictive monetary policy. I am now going to ask my Federal

Reserve associate to review developments in this area over the past year.

At the last EPC meeting the U. S. Representative suggested some further study of the effects and the limitations of monetary policy as a technique to restrain demand. Events of the past two months reinforce the view that such a study would be useful.

The U. S. is moving now to put additional weight on fiscal policy. If the need for further measures should become apparent, additional action will be taken.

U.S. BALANCE OF PAYMENTS
1963 through First Half 1966

(Million of dollars)

	1963	1964	1965	First Half 1966 at Annual Rates
TRADE	5,079	6,676	4,788	3,942
Exports	22,071	25,297	26,276	28,464
Imports	-16,992	-18,621	-21,488	-24,522
TRAVEL (incl. fares)	-1,653	-1,601	-1,743	-1,841 2/
Receipts	1,052	1,245	1,377	1,500
Payments	-2,705	-2,846	-3,120	-3,341
MILITARY 1/	-1,932	-1,859	-1,723	-2,572
Receipts 1/	1,004	975	1,158	962
Payments	-2,936	-2,834	-2,881	-3,534
OTHER SERVICES & TRANSFERS (excl. direct inv. income)	749	953	994	1,167
GOV. GRANTS & CAPITAL NET	-3,542	-3,325	-3,492	-4,100
Outflows	-4,551	-4,263	-4,277	-4,642
(Dollar outflow)	(-814)	(-685)	(-708)	(-728)
Debt repayments	970	703	902	824
U.S. Gov. non-liquid liabilities	39	235	-117	-282
DIRECT INVESTMENT	1,158	1,254	590	830
Capital outflows	-1,976	-2,416	-3,371	-3,288
Investment income	3,134	3,670	3,961	4,118
BANK CLAIMS	-1,535	-2,464	94	264
Short-term	-781	-1,523	325	110
Long-term	-754	-941	-231	154
NON-BANK CLAIMS	159	-966	345	-366
Short-term	-4	-623	436	-220
Long-term	163	-343	-91	-146
FOREIGN SECURITIES	-1,104	-677	-758	-634
New issues	-1,250	-1,063	-1,206	-1,296
Outstanding issues & redemptions	146	386	448	662
FOREIGN CAPITAL	303	222	-3	2,552
ERRORS & OMISSIONS	-352	-1,011	-429	-668
OVERALL (Liquidity) BALANCE	-2,670	-2,798	-1,337	-1,426
OFFICIAL SETTLEMENTS BALANCE	-2,044	-1,546	-1,305	-864

1/ As published by the Commerce Department; includes advance receipts.
Source: Survey of Current Business, June and September 1966.
2/ Fares are estimated for 1966.

September 23, 1966