388

NEW PLAN FOR INTERNATIONAL MONETARY RESERVES

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND PAYMENTS

OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

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NEW PLAN FOR INTERNATIONAL MONETARY RESERVES

THURSDAY, SEPTEMBER 14, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON INTERNATIONAL EXCHANGE AND
PAYMENTS OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, in room 1202, New Senate Office Building, at 10 a.m., Hon. Henry S. Reuss (chairman of the subcommittee) presiding.

Present: Representatives Ruess and Widnall; and Senators Sparkman, Javits, and Percy.

Also present: Representatives Rees and Halpern (guests), and John B. Henderson, staff economist.

Chairman REUSS. The Subcommittee on International Exchange and Payments of the Joint Economic Committee will please come to order.

We are delighted to have with us this morning the Honorable Henry H. Fowler, Secretary of the Treasury, the Honorable Frederick L. Deming, Under Secretary for Monetary Affairs, together with George H. Willis, Office of International Monetary Affairs of the Treasury Department, and William B. Dale, Executive Director of the International Monetary Fund.

We are honored to have you here with your associates, Mr. Secretary, to hear your evaluation of the recently concluded international monetary pact.

It is a welcome occasion and I wish to offer to you, to Mr. Deming as your deputy, and to your associates, as well as those in the Federal Reserve System, and to all the negotiators throughout these 4 long years, our heartiest congratulations on achieving this first, very significant step in the necessary progress toward international monetary reform. You have, I know, Mr. Fowler, paid generous tributes to the work performed by this subcommittee in examining the issue of monetary reform and we intend to maintain our interest.

Your statement today will, I am sure, be of assistance to us in estimating how the new special drawing rights will contribute to the provision of international monetary reserves.

As you stated in your earlier press conference, the agreement reached in Geneva is unprecedented. Creation of credit has always occurred by the evolution of a system under the ageis of a national government. But now, on this occasion, the creation of a new special drawing right follows a conscious act of agreement between the finance ministers of governments. The ultimate obligation is not that of any one nation, but that of the collectivity of nations. It is in no way to minimize the achievement of this agreement or of the excellent public service

performed by our negotiators when I say that it has to be recognized as a preliminary step. The actual implementation of these arrangements and their contribution to the growth and stability of monetary settlements are things that remain to be seen and to be proved.

I hope that this morning, Mr. Secretary, we may have your comments on your expectations, and that our questions will contribute to the congressional understanding of this technical but vitally important innovation.

Both Secretary Fowler and Under Secretary Deming have prepared statements which, without objection, will be received into the record.

I am going to now ask Secretary Fowler to proceed.

STATEMENT OF HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY, ACCOMPANIED BY HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS; WILLIAM B. DALE, U.S. EXECUTIVE DIRECTOR, INTERNATIONAL MONETARY FUND, AND GEORGE H. WILLIS, DEPUTY TO THE ASSISTANT SECRETARY FOR INTERNATIONAL MONETARY AFFAIRS

I

Secretary FOWLER. Mr. Chairman and members of the subcommittee, a little over 2 years ago—on August 27, 1965—the members of this subcommittee urged major improvements in the international monetary system, and particularly prompt action by the United States and other leading financial nations to insure an adequate and orderly expansion of the world's monetary reserves.

In a report to the Joint Economic Committee, your subcommittee warned that failure to provide increased international liquidity would inevitably result in a scarcity of reserves, a decline in international trade and commerce, and a slowing of world economic progress.

The subcommittee's report at that time was not its first expression of concern about the need for a mechanism to create additional reserve assets. In previous reports, both the subcommittee and the Joint Economic Committee had called for free world action toward this end.

Last spring the Joint Economic Committee included in its report on the January 1967 Economic Report of the President a "statement of agreement by majority and minority members of the Joint Economic Committee." Two of the points made in paragraph 6 of that statement reiterated the urgency of this problem in the following words:

> 6. In the field of international trade and finance, there is also general accord on the following conclusions:
>
> Agreement on international monetary reform is a matter of increasing urgency.
>
> We cannot rely on supplies of new monetary gold being sufficient to assure the growth of international reserves, in keeping with the rising liquidity requirements of trade.

Moreover, the subcommittee's 1965 report performed the invaluable services of directing attention to the growing urgency of the problem—"the need for action is pressing," the subcommittee stated—and of suggesting guidelines for monetary improvements, including possible ways in which new reserves could be created.

The subcommittee also gave its strong support to the decision by President Johnson, which I was privileged to announce in a speech at

Hot Springs, Va., on July 10, 1965, that the United States was prepared to participate in an international conference to seek substantial improvements in monetary arrangements.

I am pleased to be able to report to you today that the first and perhaps most critical step toward the goal which you urged, and which the United States has pursued through 2 years of difficult and intense negotiations, has now been achieved.

The Executive Directors of the International Monetary Fund and the finance ministers and Central Bank Governors of the Group of Ten major financial countries have agreed on an outline plan that "is intended to meet the need, as and when it arises, for a supplement to existing reserve assets."

That is a quote from the introductory paragraph of the plan.

This outline plan has now been made public by the International Monetary Fund, prior to consideration of the plan by the Board of Governors of the Fund at the annual meeting to be held in Rio de Janeiro during the last week of September.

Attached to the statement, Mr. Chairman, is attachment A, the outline plan.

(The outline plan referred to follows:)

Attachment A

INTERNATIONAL MONETARY FUND

Outline of a Facility Based on Special Drawing Rights in the Fund

INTRODUCTION

The facility described in this Outline is intended to meet the need, as and when it arises, for a supplement to existing reserve assets. It is to be established within the framework of the Fund and, therefore, by an Amendment of the Fund's Articles. Provisions relating to some of the topics in this Outline could be included in By-laws adopted by the Board of Governors or Rules and Regulations adopted by the Executive Directors rather than in the Amendment.

I. *Establishment of a Special Drawing Account in the Fund*

(a) An Amendment to the Articles will establish a Special Drawing Account through which all the operations relating to special drawing rights will be carried out. The purposes of the facility will be set forth in the introductory section of the Amendment.

(b) The operations of and resources available under the Special Drawing Account will be separate from the operations of the present Fund which will be referred to as the General Account.

(c) Separate provisions will be included in the Amendment for withdrawal from or liquidation of the Special Drawing Account; Article XVI, Section 2 and Schedules D and E on withdrawal and liquidation will continue to apply as they do at present to the General Account of the Fund.

II. *Participants and Other Holders*

1. *Participants.*—Participation in the Special Drawing Account will be open to any member of the Fund that undertakes the obligations of the Amendment. A member's quota in the Fund will be the same for the purposes of both the General and the Special Drawing Accounts of the Fund.

2. *Holding by General Account.*—The General Account will be authorized to hold and use special drawing rights.

III. *Allocation of Special Drawing Rights*

1. *Principles for decisions.*—The Special Drawing Account will allocate special drawing rights in accordance with the provisions of the Amendment. Special considerations applicable to the first decision to allocate special drawing rights, as well as the principles on which all decisions to allocate special drawing rights will be based, will be included in the introductory section of the Amendment and, to the extent necessary, in a Report explaining the Amendment.

2. *Basic period and rate of allocation.*—The following provisions will apply to any decision to allocate special drawing rights:

(i) The decision will prescribe a basic period during which special drawing rights will be allocated at specified intervals. The period will normally be five years in length, but the Fund may decide that any basic period will be of different duration. The first basic period will begin on the effective date of the first decision to allocate special drawing rights.

(ii) The decision will also prescribe the rate or rates at which special drawing rights will be allocated during the basic period. Rates will be expressed as a percentage, uniform for all participants, of quotas on the date specified in the decision.

3. *Procedure for decisions.*—(a) Any decision on the basic period for, timing of, or rate of allocation of special drawing rights will be taken by the Board of Governors on the basis of a proposal by the Managing Director concurred in by the Executive Directors.

(b) Before formulating any proposal, the Managing Director after having satisfied himself that the considerations referred to in III.1 have been met, will conduct such consultations as will enable him to ascertain that there is broad support among participants for the allocation of special drawing rights at the proposed rate and for the proposed basic period.

(c) The Managing Director will make proposals with respect to the allocation of special drawing rights: (i) within sufficient time before the end of a basic period; (ii) in the circumstances of III.4; (iii) within six months after the Board of Governors or the Executive Directors request that he make a proposal. The Managing Director will make a proposal for the first basic period when he is of the opinion that there is broad support among the participants to start the allocation of special drawing rights.

(d) The Executive Directors will review both the operations of the Special Drawing Account and the adequacy of global reserves as part of their annual report to the Board of Governors.

4. *Change in rate of allocation or basic period.*—If there are unexpected major developments which make it desirable to change the rate at which further special drawing rights are to be allocated for a basic period, (i) the rate may be increased or decreased, or (ii) the basic period may be terminated and a different rate of allocation adopted for a new basic period. Paragraph III.3 will apply to such changes.

5. *Voting majority.*—(a) For decisions on the basic period for, timing of, amount and rate of allocation of special drawing rights, an 85 per cent majority of the voting power of participants shall be required.

(b) Notwithstanding (a) above, the decisions to decrease the rate of allocation of special drawing rights for the remainder of the basic period will be taken by a simple majority of the voting power of participants.

6. *Opting out.*—The Amendment will include provisions that will prescribe to what extent a participant will be required initially to receive special drawing rights, but will stipulate that beyond any such amount a participant that does not vote in favor of a decision to allocate special drawing rights may elect not to receive them under that decision.

IV. *Cancellation of Special Drawing Rights*

The principles set forth in III relating to the procedure and voting for the allocation of special drawing rights will be applicable, with appropriate modifications, to the cancellation of such rights.

V. *Use of Special Drawing Rights*

1. *Right to use special drawing rights.*—(a) A participant will be entitled, in accordance with the provisions of V, to use special drawing rights to acquire an equivalent amount of a currency convertible in fact. A participant which thus provides currency will receive an equivalent amount of special drawing rights.

(b) Within the framework of such rules and regulations as the Fund may adopt, a participant may obtain the currencies referred to in (a) either directly from another participant or through the Special Drawing Account.

(c) Except as indicated in V.3(c), a participant will be expected to use its special drawing rights only for balance of payments needs or in the light of developments in its total reserves and not for the sole purpose of changing the composition of its reserves.

(d) The use of special drawing rights will not be subject to prior challenge on the basis of this expectation, but the Fund may make representations to any participant which, in the Fund's judgment, has failed to observe the expectation, and may direct drawings to such participant to the extent of such failure

2. *Provision of currency.*—A participant's obligation to provide currency will not extend beyond a point at which its holdings of special drawing rights in excess of the net cumulative amount of such rights allocated to it are equal to twice that amount. However, a participant may provide currency, or agree with the Fund to provide currency, in excess of this limit.

3. *Selection of participants to be drawn upon.*—The Fund's rules and instructions relating to the participants from which currencies should be acquired by users of special drawing rights will be based on the following main general principles, supplemented by such principles as the Fund may find desirable from time to time:

(a) Normally, currencies will be acquired from participants that have a sufficiently strong balance of payments and reserve position, but this will not preclude the possibility that currency will be acquired from participants with strong reserve positions even though they have moderate balance of payments deficits.

(b) The Fund's primary criterion will be to seek to approach over time equality, among the participants indicated from time to time by the criteria in (a) above, in the ratios of their holdings of special drawing rights, or such holdings in excess of net cumulative allocations thereof, to total reserves.

(c) In addition, the Fund will, in its rules and instructions, provide for such use of special drawing rights, either directly between participants or through the intermediary of the Special Drawing Account, as will promote voluntary reconstitution and reconstitution under V.4.

(d) Subject to the provisions of V.1(c), a participant may use its special drawing rights to purchase balances of its currency held by another participant, with the agreement of the latter.

4. *Reconstitution.*—(a) Members that use their special drawing rights will incur an obligation to reconstitute their position in accordance with principles which will take account of the amount and the duration of the use. These principles will be laid down in rules and regulations of the Fund.

(b) The rules for reconstitution of drawings made during the first basic period will be based on the following principles:

(i) The average net use, taking into account both use below and holdings above its net cumulative allocation, made by a participant of its special drawing rights calculated on the basis of the preceding five years, shall not exceed 70 per cent of its average net cumulative allocation during this period. Reconstitution under this subparagraph (i) will be brought about through the mechanism of transfers, by the Fund directing drawings correspondingly.

(ii) Participants will pay due regard to the desirability of pursuing over time a balanced relationship between their holdings of special drawing rights and other reserves.

(c) Reconstitution rules will be reviewed before the end of the first and of each subsequent period and new rules will be adopted, if necessary. If new rules are not adopted for a basic period, the rules for the preceding period shall apply unless it is decided to abrogate reconstitution rules. The same majority as is required for decisions on the basic period, timing of, or rate of allocation of special drawing rights will be required for decisions to adopt, amend, or abrogate reconstitution rules. Any amendment in the rules will govern the reconstitution of drawings made after the effective date of the amendment, unless otherwise decided.

VI. *Interest and Maintenance of Gold Value*

(a) *Interest.*—A moderate rate of interest will be paid in special drawing rights on holdings of special drawing rights. The cost of this interest will be assessed against all participants in proportion to net cumulative allocations of special drawing rights to them.

(b) *Maintenance of gold value.*—The unit of value for expressing special drawing rights will be equal to 0.888 671 grams of fine gold. The rights and obligations of participants and of the Special Drawing Account will be subject to an absolute maintenance of gold value or to provisions similar to Article IV, Section 8 of the Fund's Articles.

VII. *Functions of Fund Organs and Voting*

1. *Exercise of powers.*—The decisions taken with respect to the Special Drawing Account, and the supervision of its operations, will be carried out by the Board of Governors, the Executive Directors, the Managing Director, and the staff of the Fund. Certain powers, and in particular those relating to the adoption of decisions concerning the allocation, cancellation, and certain aspects of the use of special drawing rights, will be reserved to the Board of Governors. All other powers, except those specifically granted to other organs, will be vested in the

Board of Governors which will be able to delegate them to the Executive Directors.

2. *Voting.*—Except as otherwise provided in the Amendment, all decisions pertaining to the Special Drawing Account will be taken by a majority of votes cast. The precise formula for the voting power of participants, which will include basic and weighted votes, and possibly the adjustment of voting power in relation to the use of special drawing rights, will be the subject of later consideration.

VIII. *General Provisions*

1. *Collaboration.*—Participants will undertake to collaborate with the Fund in order to facilitate the proper functioning and effective use of special drawing rights within the international monetary system.

2. *Nonfulfillment of obligations.*—(a) If the Fund finds that a participant has failed to fulfill its obligations to provide currency in accordance with the Amendment, the Fund may suspend the right of the participant to use its special drawing rights.

(b) If the Fund finds that a participant has failed to fulfill any other obligation under the Amendment, the Fund may suspend the participant's right to use any special drawing rights allocated to, or acquired by, it after the suspension.

(c) Suspension under (a) or (b) above will not affect a participant's obligation to provide currency in accordance with the Amendment.

(d) The Fund may at any time terminate a suspension under (a) or (b) above.

3. *Accounts.*—All changes in holdings of special drawing rights will take effect when recorded in the accounts of the Special Drawing Account.

IX. *Entry into Force*

The Amendment would enter into force in accordance with the terms of Article XVII of the Fund's Articles.

Secretary FOWLER. At the annual meeting of the Board of Governors of the International Monetary Fund, the Governors will have before them a resolution requesting the Executive Directors to translate the outline plan into the legal text of the necessary amendment or amendments of the articles of agreement of the Fund which, after acceptance, would bring the plan into effect. The United States will support this resolution, and we hope that the Governors of the other 105 member nations of the Fund will also give it their support.

After the Executive Directors have completed the draft amendment of the articles of agreement of the Fund and it is approved by the Board of Governors, the amendment will go to the member countries for their final acceptance. In the case of the United States, legislation will be proposed to the Congress to permit the United States to give its acceptance. Section 5 of the Bretton Woods Agreements Act requires that, before the United States accepts an amendment to the articles, the approval of the Congress must be obtained.

We must leave to history the final judgment of the contingency plan. Time alone can measure its value and the worth of our efforts during the 2 years of study and 2 years of negotiation that preceded the agreement.

I am confident, however, that the agreement represents one of the great forward steps in international financial cooperation—the greatest since Bretton Woods—and that our action ultimately will advance the well-being of countless millions of people throughout the world.

As your subcommittee urged in its report, the outline plan is based on the constructive suggestions and views of many nations. It does not favor the interests of any one country or any group of countries. Instead, it will promote the interests and welfare of all members of the International Monetary Fund who, together, make up a very large part of the world community.

The proposals in the plan also parallel, in other important respects, the suggestions contained in your 1965 report, as I shall discuss later in my testimony.

There has been considerable public discussion, and generally favorable reception for the outline plan and for the role of the United States in developing it and obtaining agreement on it.

Federal Reserve Chairman William McChesney Martin and I have been privileged to represent the United States in the discussions and negotiations of the finance ministers and Central Bank Governors of the Group of Ten.

Under Secretary Deming, who is here with me, and Governor Daane of the Federal Reserve Board have represented the United States in the meetings of the deputies of the Group of Ten which have been very frequent in the last 10 years. Mr. Dale, who is the U.S. Executive Director of the International Monetary Fund, has represented us in the Board of the Executive Directors who have been meeting with the deputies of the Group of Ten. Mr. George Willis, who has been the principal staff architect of our work in this area, is also with me here today.

However, if praise is due to the United States' contribution to the outline plan, it is praise that rightfully belongs to the Members of Congress and the executive branch who have participated in, and contributed to, our years of study and negotiations. Just as the plan itself represents the collective efforts of people from many nations, the formulation and presentation of the U.S position, and our success in achieving a consensus, are the result of the work of numerous individuals and groups.

Officials of the Treasury, the Federal Reserve Board, the Office of the President, the Council of Economic Advisers, the Department of State, the Advisory Committee on International Monetary Arrangements, and Members of the Congress have all contributed to the success of our efforts.

We are particularly indebted and grateful for the support and guidance we have received from your distinguished chairman, Congressman Henry S. Reuss, the members of your subcommittee, the Joint Economic Committee, and individual Members of the Congress. Many thoughtful addresses have been devoted to this subject by leading Senators and Congressmen, not serving on your committee, such as Senators Hartke and Clark.

Because an expansion of international liquidity is essential to the economic progress of our country, and to world economic growth generally, our efforts to resolve the problem have received strong bipartisan support from the Congress. Republicans no less than Democrats have encouraged, assisted and guided us. In a letter to me of July 14, 1965, and in subsequent actions, Congressman Gerald R. Ford of Michigan and other Republican congressional leaders have supported and contributed to U.S. leadership in monetary reform.

I should also mention and express appreciation for the valuable contributions to our thinking, and to the development of the U.S. position, made by former members of the Joint Economic Committee, Congressman Robert F. Ellsworth of Kansas, and Senator Paul Douglas of Illinois.

The Members of Congress of both parties have helped immeasurably with our long and difficult task. We hope and expect to receive your continued guidance and support in the future.

II

In evaluating the agreement that has now been reached, it is useful to look back briefly along the road we have now traveled. It was in October 1963 that the ministers and central bank governors of the Group of Ten countries asked their deputies to "undertake a thorough examination of the outlook for the functioning of the international monetary system and of its future needs for liquidity." Following this directive, the deputies of the Group of Ten held a number of meetings in 1963–64, which resulted in the publication of a ministerial statement and report by the deputies in August 1964. In this statement the ministers and governors set in motion a study group to "examine various proposals regarding the creation of reserve assets either through the International Monetary Fund or otherwise."

During 1964–65, this study group, under the chairmanship of Rinaldo Ossola of Italy, prepared a comprehensive technical report on the creation of reserve assets, which was made public in August 1965. This report provided an inventory of the techniques by which reserves could be created and an analysis of the arguments for and against the use of each of these techniques.

While this work was in progress, but contemplating its completion President Johnson said in his balance of payments message of February 10, 1965, that:

> We must press forward with our studies and beyond, to action—evolving arrangements which will continue to meet the needs of a fast-growing world economy. Unless we make timely progress, international monetary difficulties will exercise a stubborn and increasingly frustrating drag on our policy for prosperity and progress at home and throughout the world.

During most of the work in 1963–65, there was an underlying assumption that the matter was primarily a problem of creating reserves under the aeigis of a limited group of major countries.

As I have mentioned, it was in July 1965 that President Johnson authorized me to announce, in a speech at Hot Springs, Va., that the United States was ready to participate in negotiations of a political nature on reserve creation, thereby launching the initiative that culminated in the present agreement. Shortly after this, in August 1965, this subcommittee under the chairmanship of Congressman Reuss issued its "Report on Guidelines for Improving the International Monetary System," which concluded that the need for action was pressing.

I, accordingly, undertook personal and individual consultations in Europe with the European ministers and governors of the Group of Ten, having previously consulted with the Japanese and Canadian ministers in Washington. These individual consultations revealed an underlying basis for further negotiations. During the year 1965–66 the deputies of the Group of Ten countries made a searching examination of the various proposals for reserve creation to ascertain whether or not there was a basis for agreement on major points. During this year, the executive directors and staff of the International Monetary Fund also carried on constructive studies of the problem.

In July 1966, the ministers and governors of the Group of Ten reviewed a second report from their deputies, that set forth a number of essential elements of agreement for a contingency plan of re-

serve creation, and narrowed down the many possible approaches to this problem to five alternative schemes providing for ways and means for reserve creation. During this year there was a growing realization that the subject of creating a supplementary reserve asset was of vital interest to all of the members of the IMF and not to just a few major countries. The ministers therefore instructed their deputies to undertake a further stage of negotiations, in which the views of the whole world would be represented, through a series of joint meetings between the deputies of the Group of Ten and the executive directors of the Fund, representing the 106 nations who are members of the International Monetary Fund.

Four such joint meetings of the deputies and the Executive Directors were held in 1966–67. There emerged from the fourth and final joint meeting a draft outline plan which has now been refined and agreed. A number of important issues were resolved in July and August of this year, largely through two meetings of the ministers and governors of the Group of Ten on July 17–18 and August 26.

Throughout the course of these negotiations, the support and interest evidenced by this subcommittee has given additional strength to the negotiators of the executive branch, and has helped them to put the U.S. positions effectively before the delegations of other countries.

I would also like to acknowledge the effective work that has been done by an interdepartmental group which has met frequently to plan U.S. positions and estimate those held by those other nations. This group, under the chairmanship of Under Secretary of the Treasury Frederick L. Deming, consists of Federal Reserve Board Governor J. Dewey Daane, Francis Bator, formerly Deputy Special Assistant to the President for National Security Affairs, Arthur Okun, member of the Council of Economic Advisers, Anthony Solomon, Assistant Secretary of State for Economic Affairs, William B. Dale, U.S. Executive Director of the IMF, Winthrop Knowlton, Assistant Secretary of the Treasury for International Affairs, and George H. Willis, Deputy to the Assistant Secretary of the Treasury for International Affairs, who serves as secretary of the group.

Vigorous and effective assistance in this endeavor was provided by former Secretary of the Treasury Douglas Dillon, and I have deeply appreciated it. Secretary Dillon, in an address in June 1965, had also called attention to the "urgent need to strengthen the international monetary system so as to insure that the needed increases in reserves will be forthcoming."

Shortly after this, the President announced that I was naming an Advisory Committee on International Monetary Arrangements under the chairmanship of former Secretary Dillon. This committee, consisting of distinguished economists and financial leaders, has met some 20 times during the past 2 years with me and with the principal U.S. Government officials concerned, and has kept its finger closely on the pulse of these negotiations, giving me invaluable advice from their judgment and depth of experience. The members of this committee at the time of the London meeting were: Edward M. Bernstein, EMB Ltd.; Kermit Gordon, president, The Brookings Institution, former Director of the Bureau of the Budget; Walter W. Heller, professor of economics, University of Minnesota; Andre Meyer, partner, Lazard Freres & Co.; David Rockefeller, president, Chase Man-

hattan Bank; Robert V. Roosa, partner, Brown Brothers, Harrisman & Co., and former Under Secretary of the Treasury for Monetary Affairs; Frazar B. Wilde, former chairman of the board, Connecticut General Life Insurance Co., and chairman, Board of Trustees, Committee for Economic Development. Prof. Charles P. Kindleberger served as a member of the committee until September 20, 1966.

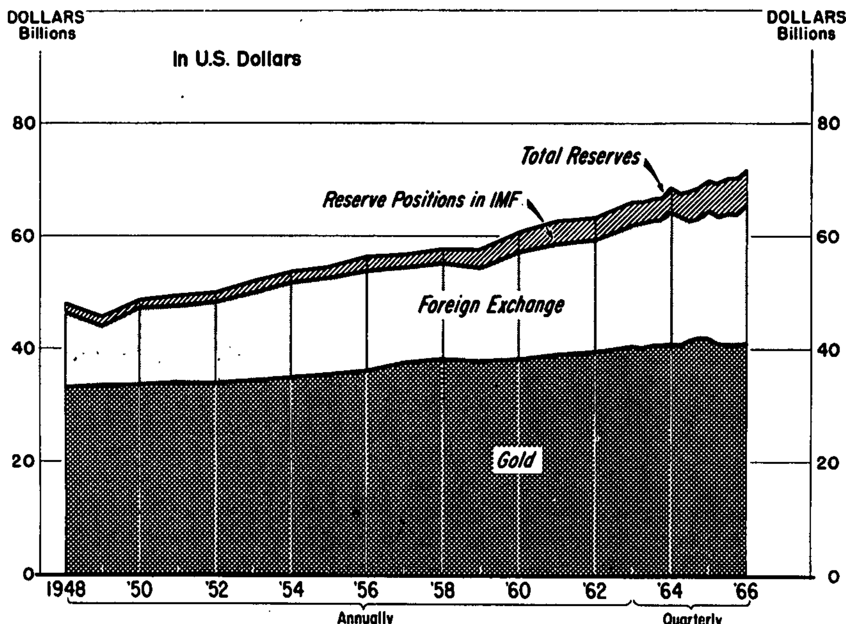
III

The main underlying facts which led to the conclusion—reflected in the initiative launched 2 years ago—that the international monetary system needs a major new supplement to existing reserve assets are now fairly well known. But these facts are so fundamental to an understanding of why the effort to establish a supplement to existing reserve assets was launched that a brief summary of them is necessary at this point.

The special drawing rights are distinguished from gold and foreign exchange, the two major components of reserves in the past, by the fact that these two types of reserves have not been created by a conscious and deliberate international decision. The historical development of reserves—the two major components, gold and foreign exchange—as well as reserve claims on the Fund—is shown in a chart which appears as attachment B to this statement.

(The chart referred to follows:)

ATTACHMENT B



Secretary FOWLER. So far as gold is concerned, the amount available for monetary reserves is a residual that remains available for monetary purposes after new gold production has met the demands

for private industrial, artistic, and professional use. In addition, there is some absorption of gold in countries in which traditionally there is hoarding of gold, and there is a speculative demand for gold that fluctuates in intensity from time to time. Projections of new gold supplies for monetary purposes indicate that the amount available, which averaged $655 million a year in 1955–59 and $565 million in 1960–64, is likely to be much smaller in the future, unless there is a reflow of gold from speculative hoards. During 1965–66, the combined gold reserves of individual countries and international financial institutions rose only $170 million.

The other main component in the recent growth in reserves has been the accumulation of liquid dollar claims on the United States by other countries. While this method of reserve creation has much flexibility, it depends on the decisions of a number of individual countries, and the growing volume of dollar liabilities places an increasingly heavy potential strain on the gold reserves of the United States. Moreover, it provides reserves only to other countries, and does not provide any addition to the reserves of the United States. There is a general realization that it would be unwise to depend in the future on additional supplies of dollar liabilities for the secular growth of world reserves. In 1965, this subcommittee concluded that "the United States should seek neither to expand nor reduce the international role of the dollar." They felt that the dollar will continue to have an important or even a growing international role, as a private transactions currency, and through the voluntary holding of the dollar by foreign central banks. But they did not believe that the dollar can or should contribute as much to international liquidity in the future as it has in the past. This latter opinion was generally shared by the countries with which we have been negotiating in the Group of Ten and in the Fund.

From these considerations it became evident that, as sources for reserve growth, gold and foreign exchange were likely to dwindle in the future; at best, they are highly uncertain. What can be said about the future demand for reserves?

During the past 16 years world imports have grown about three times as fast as global reserves. To a large extent this was made possible by the willingness of the United States to permit a decline in its reserves while its import trade, along with its exports, was advancing at a relatively rapid rate. If we disregard the United States, and make a comparison between the trend lines of the growth of reserves and the growth of imports for the rest of the world, there is a closer relationship. During these 16 years the import trade of the rest of the world increased at the very satisfactory rate of nearly 8 percent per annum, while reserves rose at the rate of about 5½ percent per annum.

Even though the reserves of the rest of the world outside the United States have been growing at what appears to be a relatively high rate of 5½ percent per annum, the more rapid growth of imports has meant that reserves, on the average, now cover only about 4 months' imports for the rest of the world. In the last decade, total reserves of all members of the Fund have slipped from about 56 to 36 percent of world imports.

There was a substantial slowdown in the growth of reserves in 1965–66, largely because the United States provided much smaller amounts of dollars to add to the official reserves of the rest of the

world. In fact, about two-thirds of the additions to reserves outside the United States in 1965–66 came from other and nontraditional sources, largely related to the balance of payments of the United Kingdom. The United Kingdom made substantial drawings on the IMF which created, for the time being, reserve claims on the Fund for continental European countries and some other nations, and the British also converted some $800 million of marketable securities into liquid reserve assets.

One cannot now anticipate the relationship that will be considered desirable in the future between the growth of reserves and rising levels of world trade. If, however, there were to be a continuation of the relationship of the past 10 years to world trade, this would call for something like $2½ to $3 billion a year in annual increments of reserves of all types when world trade reaches $250 billion a year.

IV

I shall refer in more detail later in this statement to the subcommittee's report on "Guidelines for Improving the International Monetary System."

I am happy to say at this point, however, that the outline plan has incorporated a very large portion of the suggestions made by the subcommittee.

The first guideline pointed out that world liquidity needs cannot be adequately met by existing sources of reserves—gold, dollars, and pounds sterling—or even by the addition of new reserve currencies. The subcommittee concluded that "new ways of creating international reserves must be sought." The draft outline plan does provide, in my judgment, a satisfactory constitutional framework for achieving this objective. It will provide, once it is embodied in an amendment and the amendment has been ratified in accordance with regular Fund procedures, a way to create reserves that will supplement existing reserves in the form of special drawing rights (SDR) in the International Monetary Fund.

Agreement on this outline plan, therefore, represents a major breakthrough in international monetary arrangements. It is more than a mere evolutionary step in the development of the Bretton Woods system. It is a breakthrough that has been achieved by 2 years of thorough study of the problem by the major financial powers, followed by 2 years of intensive negotiations. It is proposed to give effect to the outline plan through the first formal amendment to the articles of agreement of the International Monetary Fund that has ever been adopted. All previous evolution within the Fund has taken place during the past 22 years without the necessity of an amendment.

The new outline plan is, in my judgment, a major new substantive departure in the international monetary sphere. This is not to deny that many of the actions taken in that sphere in the postwar period have been important and highly constructive. The quotas of the International Monetary Fund were increased by international decisions in 1959 by 50 percent and again in 1966 by 25 percent. In 1961 an agreement was negotiated, known as the general arranagements to borrow (GAB), under which a group of 10 leading financial countries provided additional credit lines to the Fund up to $6 billion, for use by the Fund to forestall or cope with an impairment of the international monetary

system. All three of these international actions committed substantial additional resources to support and maintain the international monetary system.

In addition to these multilateral decisions, a network of bilateral credit facilities of a short-term character has been developed by the United States and other countries through swap arrangements of the Federal Reserve System with foreign monetary authorities.

All of these arrangements have helped greatly to strengthen the monetary system which has facilitated a sustained growth of world trade, international investment, and general economic prosperity that has unrivaled in past history. There is, however, an important difference between these improvements that have taken place and what is now being provided in the outline plan.

The essential difference is that these earlier improvements did not consciously deal with the problem of supplementing international reserves. The resources of the Fund are used to provide medium-term financial support in the form of credits to be extended to individual countries that are faced with temporary balance-of-payments or reserve problems. Apart from an amount corresponding to the gold paid into the Fund, the resources provided through these enlargements of the scope of the Fund have been essentially conditional credit facilities that have been available to individual countries only in conjunction with a review and appraisal of a country's economic policies, by the staff and Executive Board of the Fund.

As a byproduct of the use of the medium-term credit facilities in the Fund, reserves have been created from time to time while these credit facilities were outstanding, but only for the countries which were, in fact, lending their resources to borrowing countries through the Fund. A return of the borrowing country to equilibrium and a repayment of these medium-term credits would have the effect of canceling these temporary additions to international reserves. The use of the bilateral facilities under the swap network provides only short-term credit to the borrowing country, and also results in the creation of reserves for the lending country. These reserves are even more short term in character than those which have, for a time, been outstanding as a result of the lending operations of the Fund.

The new special drawing rights (SDR) are consciously aimed at a different and more fundamental problem. Their objective is to provide a means by which global reserves can be expanded on a permanent basis by international decisions.

V

What has now been achieved through arduous negotiations is to bring the monetary authorities of the whole free world together in agreement on a single specific plan to provide supplementary reserves in the future by a conscious international decision. This brings us to a new phase in international monetary cooperation.

Reaching agreement on this outline plan has not been easy. Negotiating problems have resulted from differing assessments among the nations as to the future needs for reserve assets. Some countries tended to judge the world's needs for reserves perhaps too much in the light of their own current experience and their current reserve position—and not enough in terms of past experience or future trends. This

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tendency has had a pervasive effect on their attitudes toward a whole range of specific problems.

Another problem—which, like the one just cited, was less of a negotiating difficulty in itself than the cause of differences in view on various specific negotiating points—had to do with fears that the establishment of a supplement to existing reserves would cause or intensify domestic inflationary pressures in some countries. Monetary authorities are of course very conscious that the creation of money in any form is a very useful but dangerous tool. In the right quantities, the growth of the domestic money supply is necessary to facilitate the continued growth of business activity. If too much is created, inflationary pressures are enhanced. If too little is created, deflationary pressures result.

The experience with domestic monetary systems has influenced the approach taken by most countries to the creation of international reserves. On the one hand, there has been recognition that while international reserves and domestic money are not fully analogous, an evolution of international reserves broadly similar in some basic respects to that of domestic money, toward more reliance on conscious and planned decisions as to reserve growth, is a logical and necessary development. On the other hand, widespread awareness that money can be managed has as a corollary a widespread recognition that it can also be mismanaged. Fears of mismanagement of deliberately created international reserves—in particular, fears of excessive creation of such reserves, with the possibility that this might cause or greatly intensify domestic inflationary pressures in some countries—have been one of the underlying issues throughout the negotiations.

While the mere creation and allocation of new reserves to various countries need not, in themselves, have any inflationary consequences, it may not always be easy for monetary authorities in a particular country to neutralize or sterilize all inflows of reserve assets from abroad, or to offset in their money markets all outflows of reserves to other countries. But, on the whole, the evidence of the past 6 years seems to indicate that the rate of growth in the domestic money supply has substantially exceeded the trend of international reserves in most important countries. This suggests that international reserve growth has not been the real governing causal factor in monetary expansion even in those countries that have gained reserves.

Nevertheless, it is important that this initial breakthrough be carried out in such a way that the first experience with the special drawing rights does not give rise to misgivings regarding misuse of the abi ity to create reserves. I am convinced that the procedures adopted in the outline plan are fully adequate to provide assurance against any possibility of excessive use of this new authority to create reserves.

VI

In appraising the agreement we have reached, it is also useful to review the extent to which we have been able to attain international agreement along the lines set forth 2 years ago by this subcommittee.

There follows, Mr. Chairman, three or four pages of a more or less point-by-point analysis comparing the guidelines in the report with what has actually emerged in the agreement.

Chairman REUSS. I note the parallel between what the Joint Economic Committee set forth 2 years ago as perfect guidelines and what has in fact been accomplished, which seems to me to be quite remarkable.

Secretary FOWLER. It is almost astonishing. It is a parallelism.

Clearly, we have accomplished the first point in the guidelines, that a new way of creating international reserves must be sought. We have sought and we have found and agreed upon a plan that will make it possible to add supplementary reserves to the existing sources of reserves.

Secondly, the subcommittee cautioned that the plan should not encourage or require countries to convert existing balances or new acquisitions of reserve currencies into gold or the new reserve medium. They wished to maintain the role of the dollar both as a transactions currency and as an official reserve medium, without basically expanding or reducing its present role. In this connection, the committee concurred with the view that we have continually expressed in the executive branch, "that the Nation's objective in international monetary reform is not to find a device for enabling the United States to finance balance-of-payments deficits painlessly." The agreement that we have reached has, in my judgment, avoided impairing the role of the dollar in the future and leaves the position of the dollar in the status desired by the committee.

Third, the committee found that gold should continue its present role but that nothing should be done to enhance its value in relation to other forms of reserve assets. The outline plan should confirm the permanence of the price of gold, and it is our hope that it will also increasingly operate to remove any special enhancement of the position of gold that may have developed as a result of uncertainty regarding the future growth of the world's reserves.

The subcommittee's fourth point called for a new method of reserve creation combining minimum annual increases with supplements determined by annual decision. At a relatively early stage in the negotiations, it became clear that there was a strong feeling that it would not be feasible to reach international decisions, on the difficult matter of the amount of special drawing rights to be created, at periods so short as 1 year. Decisions on the amounts of special drawing rights to be established will normally cover 5-year periods, with actual allocations made at intervals within those 5 years—which intervals could be annual. It is, however, possible to review a 5-year plan at any time if there are important changes in the world situation.

As the fifth point, the "Guidelines" called for the arrangements to be carried out under the International Monetary Fund, and there has now clearly been a full acceptance of this point. It was also suggested that the new reserves should be distributed to all fund members who qualify under criteria applicable equally to all countries. After extensive negotiation, the principle of participation of all IMF members, with distribution across the board to all participating fund members in proportion to their quotas, has been fully agreed.

The committee found that the new reserves could not be used as a primary foreign aid device, and this view was strongly evidenced by other Group of Ten countries. There is no direct connection between the new special drawing rights and the financing of economic development. The developing countries will, however, obtain benefits like

other countries, in the form of additions to their reserves, and will also benefit more generally, insofar as adequate growth in reserves serves as a protection against a cumulative tendency to excessive restrictions on capital flows, aid expenditures, and trade expansion that could be the result of a global shortage of reserves.

On the eighth point, the "Guidelines" suggested that the distinction between owned and borrowed reserves should not be critical, and that reserve units or drawings rights could be used by the fund to create reserves. While there was considerable feeling that there are important differences between owned reserves and borrowed reserves, there was agreement that reserve assets can be created in the form of drawing rights or of units.

The committee went on to suggest an expansion in IMF quotas, both general and selective. They suggested that provisions should be made for periodic increases in the Fund's conditional borrowing facilities to maintain reasonable balance between them and owned reserves. There were general and selective increases in IMF quotas early in 1966, following a review that was made in 1964–65. While there is a general recognition that periodic quota increases are desirable, there is no present indication that the member countries wish to proceed at the present time with action along this line. The next quinquennial review of quotas would be due about 1969–70.

A recommendation was made that bilateral arrangements should be expanded as a second line of defense against short-term instability. The network of these arrangements has been enlarged from time to time.

As point 12, the subcommittee suggested that substantial improvements are needed in the adjustment process. As mentioned elsewhere a basic study on this matter was prepared by working party 3 of the OECD in 1965–66. Efforts to improve national policies through cooperation and consultation are going forward as a continuing process.

This brief catalog of the points covered in the 1965 "Guidelines" makes clear that the largest part of the subcommittee's judgment as to the practical course to follow, made in 1965, has now become the collective international judgment of 1967. This is an impressive tribute to this earlier judgment.

VII

Under Secretary Deming has prepared a statement explaining the outline plan in some detail and will be glad to present it to the committee and to answer technical questions. In this statement, however, I should like to call your attention to several major questions that have arisen in the negotiations and in public comment on the outline plan. These relate to (1) the effectiveness of the special drawing right as a supplement to reserve assets equivalent to these other assets, (2) the relationship of the outline plan to the U.S. balance of payments, and (3) the provisions relating to voting and making decisions to activate the plan.

It is not surprising that an agreement which brings together 106 nations may not take the form that would be favored by every monetary expert in the field. In fact, many of the negotiators might have produced somewhat different plans in some respects if they had been able to achieve their own personal formulations of the plan. It was, how-

ever, essential to reach agreement and in the process of negotiation these individual views were hammered into the shape of an agreed outline plan to create a supplement to existing reserve assets.

The answer to the question as to whether we have a good reserve asset is, in my judgment, strongly affirmative. The practical test in the future will be the attitudes of monetary authorities toward the special drawing right. It is important that they count it as a part of their official reserves and they be prepared to make effective use of it in their transactions with other monetary authorities. I believe it is the judgment of the group that these two tests will be met, on the part of most, if not all, members of the fund. It is the intention of the United States to treat 100 percent of its holdings of special drawing rights as part of its international reserves.

The second main point to which I would like to draw your attention is the relationship of the outline plan and the special drawing right to the U.S. balance of payments.

In a few quarters it has been suggested that the plan is weak because it does not provide a solution to the balance-of-payments problem of the United States. Throughout the course of these negotiations I have done my best to make it very clear—as I note the subcommittee report did 2 years ago—that the United States was fixing its eyes on the global needs for reserves and did not expect that the plan for reserve creation would solve the U.S. balance-of-payments problem. That is a matter which I associate with the general subject of the adjustment process. At an early date in the negotiations there was a complete and full understanding that negotiations with regard to a supplementary reserve were to deal with global needs and not with the problems of the balance of payments of individual countries.

The questions of improving and developing the processes of adjustment in international imbalances were examined in a separate study undertaken by working party No. 3 of the OECD in 1965–66, which I know has been made available to and generally understood and appreciated by the subcommittee. A continuous search for improvement in adjustment policies goes forward in working party No. 3 of the OECD at its frequent meetings, and is also carried on through the annual and special consultations held by the International Monetary Fund with its member countries. Accordingly, as a matter of design and logic, we should dissociate this outline plan from balance-of-payments considerations, affecting individual countries.

The third point of the outline plan on which I would like to comment is the decisionmaking provisions. These provisions call for an 85-percent majority vote to create special drawing rights. They represent a change from the practice of the International Monetary Fund where an 80-percent majority is required to take a decision to increase quotas. Under the provisions of the new scheme, both the United States with 21.9 percent of the votes, the European Economic Community with 16.5 percent of the votes, and any other group of countries with more than 15 percent of the total voting power could block a proposal to undertake the creation of reserves.

It was widely recognized in the Group of Ten and in the Fund that in the new venture we were undertaking involving the creation of reserves where confidence and the availability of resources to back the new asset are so important, it was necessary to have the widest participation. The possible abstention of a major country such as

the United States, or a majority group of countries such as the EEC, would in practice make any decision to create reserves meaningless. Therefore, the 85 percent majority is a recognition of the fact that, with this breakthrough into a major new area of international cooperation, this provision was considered a reasonable requirement for an effective plan.

Moreover, I firmly believe that this voting majority is consistent with a workable decisionmaking process. The IMF has operated in practice on a consensus basis. I am sure that this effective and successful cooperation will continue in the future. Our ability to reach agreement on this new outline plan is additional and convincing evidence of the willingness of all countries to take a constructive and responsible attitude toward the problem of the international monetary system.

VIII

I have noted how prophetic the "Guidelines" of the subcommittee have proved to be in foreshadowing the agreement that is now before the Governors of the International Monetary Fund for their consideration and approval. If we now leave the structure and content of the agreement and attempt to evaluate its significance for the future, what can be said?

President Johnson on August 28, 1967, rightly pointed out:

> Certainly no human being today can fully appraise the potential of this new development in the international monetary field.

But he ventured to state that it will stand out in the history of international monetary cooperation, and that it marks the greatest forward step in world financial cooperation in the 20 years since the creation of the International Monetary Fund itself. The President went on to point out three major consequences of the agreement.

First, the fact that agreement had been reached on this outline plan makes it unmistakably evident that all the major industrial nations of the free world have shown their clear and sincere intent to build strongly and securely on the base of our current international monetary system. If the plan achieves the approval of 106 nations, this intent will be solidified into a truly global determination.

Secondly, the President pointed out that a firm foundation has been developed for another reserve asset to join gold, dollars and other reserve currencies as a needed means of payment for a world of growing trade and commerce.

Third, the gold and exchange markets can now reflect a new sense of confidence in the adequacy of future reserve supplies. With the United States unquestionably committed to convert gold into dollars at $35 an ounce and with the availability of a new facility to draw on when needed, there can be no reasonable basis to fear a shortage of reserves.

In my view, the idea of international cooperation to insure orderly and adequate growth of monetary reserves in the years to come was basically an idea whose time had arrived. It became clear to all enlightened financial experts in the free world—certainly to an overwhelming majority of these experts—that there was a dilemma resulting from the uncertain and limited supply of new reserves to be expected of existing types of reserves, and the irresistible onrush

of growing world trade and investment which in turn will make the need for more reserves uncontestable and compelling.

This agreement should, in my judgment, give reasonable insurance that there can be an orderly and adequate growth of monetary reserves in the future. The new facility should provide a dynamic element of growth in the world's reserves for the future—a growth element of a deliberate character subject to joint, collective, and responsible processes of international decision.

This will be its contribution to the growth and evolution of the monetary system. But the special drawing right facility can also provide useful insurance gainst the impairment of the existing structure of the international monetary system. Thus, looked at either from the point of view of growth and expansion of the world's financial and economic system, or from the point of view of maintaining and serving the essential element of confidence which is so vital to the whole structure of finance and banking, we may legitimately claim a real contribution from this landmark step in alineing the governments and monetary authorities of the world in support of a single specific plan for supplementing reserves.

I know that the international monetary system may seem to some to be a matter for experts and far removed from the daily concern of the average American family. Yet the average man may have an instinctive and well-founded feeling that the world's financial structure is important to him. Some of us are old enough to remember that the financial problems of the early thirties in the United States were closely related to the breakdown of the international monetary system which took place in the early years of the great depression. We do not expect that we have to deal in the future with such dramatic demonstrations of the connection between the welfare of the average citizen and a smoothly functioning and adequate international monetary system. But American business interests have clearly become more and more farflung, and the prosperity of many towns, cities, and farms is closely related to the earnings which they derive from international transactions. The most obvious and clear-cut practical impact of failure to provide for adequate reserve growth is the danger that world markets and world business will be handicapped and the world's economic growth slowed down if countries are driven by a shortage of reserves into competitive restraints on their dealings with other countries.

In sum, the outline plan represents the first stage in establishing an international constitutional structure under which a good, effective and sound supplement to other reserve assets can be created by a reasonable and responsible process of international decision. This is the essence of what we in the executive branch sought, and it is my understanding of what the subcommittee has envisaged.

Chairman Reuss. Thank you very much, Secretary Fowler. It seems to me that the draft which you have just described is one very much in the national interest of the United States. I cannot imagine any thoughtful person desiring to cast aside an agreement which can only give us the very necessary form of assurance against real difficulty in certain years. I think it is a real achievement. And speaking for myself, I would be quite confident that the Congress, having been kept closely apprised at every stage of the negotiation from the begin-

ning, and, being confronted with the signing of the subsequent agreement which has been reached, will give the necessary legislative authorization to it.

Secretary Deming, you have prepared a remarkably expert summary of some of the most important details of the draft agreement. Your paper will be received in full into the record. I see no way of compressing it. It just has to be taken as written.

I think, with your permission, we will ask the Secretary some questions, many of which may cover the details of your reports.

(The prepared statement submitted by Hon. Frederick L. Deming, Under Secretary of the Treasury for Monetary Affairs, reads in full as follows:)

STATEMENT BY HON. FREDERICK L. DEMING, UNDER SECRETARY OF THE TREASURY FOR MONETARY AFFAIRS

I would like to join Secretary Fowler in expressing appreciation for this opportunity to make a progress report on the international monetary negotiations and to explain in more detail the workings of the "Outline of a Facility Based on Special Drawing Rights in the Fund." I would particularly like to join him in thanking this committee for the inspiration it has given to this endeavor as well as for the timely and thoughtful guidance it has provided throughout the negotiations.

The basic concept embodied in the plan is quite simple. The plan provides for a new international asset which will be an effective supplement to existing reserve assets—gold, reserve currencies, and reserve claims on the Fund—one that will be a permanent addition to world reserves. The problem of elaborating this simple concept was partly technical and partly political—the new asset had to be endowed with qualities that would make it usable and acceptable. It not only had to be a high-quality asset—it had to be regarded as such.

The plan is embodied in the outline you have before you. As Secretary Fowler has explained, the outline will be implemented through amendments to the articles of agreement of the International Monetary Fund. I can sum up the essential elements of the outline plan to create special drawing rights (SDR) in four basic points:

1. *Quality as a reserve asset.*—SDR are to be denominated in units of account equivalent to the gold value of 1 dollar; they will have the strong backing of the solemn obligations of Fund members to accept them and pay a convertible currency in return. It is planned that they will bear a moderate rate of interest.

2. *Mode of creation.*—SDR are to be created under an IMF procedure which will assure wide support for their creation, with final responsibility for decisions resting on the Fund Board of Governors. Each decision to create will authorize a specific amount of SDR.

3. *Mode of allocation.*—SDR are to be allocated to participants in proportion to their IMF quotas. All IMF members are eligible to participate. Allocations of SDR will take the form of book entries in a special drawing account of the Fund.

4. *Mode of transfer.*—SDR will be transferred by debiting the SDR account of the user and crediting the SDR account of the receiver, with the receiver paying convertible currency to the user. There will be rules on eligibility to use, on eligibility to receive, and on partial reconstitution of the amount used. The Fund will act as a kind of

traffic director, guiding the flow of SDR as they are transferred from one country to another.

These are the main elements. I would now like to go into some of the more significant aspects of the main elements in more detail.

Perhaps, first I should emphasize an essential difference between existing reserves and SDR. This difference is that SDR will be created by deliberate international decisions. How are these decisions to be taken?

The Managing Director of the Fund will be generally responsible for initiating proposals to start the machinery working, although it will be possible for the Fund Executive Directors or Governors to request a proposal for SDR creation from the Managing Director. The principal criterion for making a proposal is that there must be a widely recognized global need for reserve creation.

In arriving at a decision to propose creation of the new asset, the Managing Director will have to take into consideration a number of factors and developments—both quantitative and qualitative. Some obvious ones that come to mind are: the general trend in reserve growth, the supply of gold and reserve currencies, the volume of international trade and its relationship to international reserves, the general climate in the international monetary system, the state of the international exchanges, the reserve policies of participants, the workings of the adjustment process, and so on. This list is not meant to be exclusive or to emphasize one factor as against another. In fact I believe it would be a mistake to attempt to fix an elaborate or detailed listing of criteria and relative priorities, because conditions change and the relative importance of criteria change. Certainly it would not be useful to incorporate a fixed list in the agreement or the report. But, in coming months, some general principles for guidance on proposals to create the new asset will be included in the introductory section of the amendment and there may be some special considerations noted with respect to the first decision.

I want to underline one point that Secretary Fowler noted in his statement. Early in the negotiations it became apparent that the present state of knowledge and prospective institutional arrangements did not lend themselves to attempts to make short-term and cyclical adjustments to the volume of international reserves. Central banks can do this in their domestic spheres, but it did not seem possible to attempt this on an international scale. This principle bears repeating because of its significance for understanding the nature of the decisions to be taken to create SDR. It was agreed that decisions would be taken from time to time to create a specific amount of reserves for a period as a whole. Such decisions would not be changed unless unexpected major developments required modification of the established trend. It was also agreed that a reasonable period for which decisions about the future could be made was 5 years forward. Therefore, proposals to create SDR will normally be for 5 years ahead. Allocations, however, will be made to participants at regular intervals during the period.

The nature of decisions taken after the first 5-year period would depend on the 5-year prospective need for reserves as conceived from that point in time. The outline plan provides that the Executive Directors must keep the adequacy of global reserves under review and the Managing Director is required to make a new proposal to allocate SDR within sufficient time before the end of a basic period.

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The essential point is that the outline plan envisions that the reserve creation machinery would continue to operate in the future and that any SDR created would remain a permanent addition to world reserves.

Once a proposal is made, it must be considered and approved by the Fund. To assure that decisions for reserve creation will have the widest possible approval, the outline plan provides that the Managing Director shall undertake full consultations to ascertain there is broad support for his proposal. The proposal, once put forward, and concurred in by the IMF Executive Directors, would be submitted for the approval of the Fund Governors voting by 85 percent weighted majority. If there were unexpected major developments, a simple majority could reduce the trend amount and an 85 percent majority could increase it. The technical possibility of cancellation of SDR by an 85 percent majority will also be provided for, although we would not expect this provision to be used.

The proposal to create an amount of new assets will be for a specific amount. Obviously, we cannot tell now what that amount will be—it will be the product of a wide consensus, with judgment based on various factors. But perhaps a little guidance may be obtained from the recent past.

Over the past 16 years—since the end of 1950—global reserves have increased at an annual average of $1.4 billion, or 2.4 percent. As Secretary Fowler has noted, U.S. reserves have been declining during this period and reserves in the rest of the world have grown at an annual rate of about 5.4 precent.

If one projects world trade growth at about its present rate, world imports in 1970 will reach about $250 billion in contrast to 1966 volume of $192 billion. At that level, annual increments to reserves—assuming that the same relationship of reserves to trade as now prevails—should be $2.5 to $3 billion.

Thus, total reserve growth of some $2 billion a year or so would seem reasonably consistent with the recent path. How much of the total growth would be in the form of the new asset naturally would depend on judgments as to growth in other forms of reserves. Given present and prespective conditions of new monetary gold supply and the intention of the United States to reach equilibrium in its international payments position when the situation in Vietnam makes this feasible, those other sources might be quite small.

For illustrative purposes, however, let us assume that the plan enters into effect in 1969 and a proposal to create $1 billion of SDR a year for 5 years is adopted. How would this affect the participants in the plan? SDR will be allocated to members of the Fund in proportion to their Fund quotas. For example, the United States has 24.6 percent of the total Fund quotas and thus would receive $246 million of SDR created each year—a total of $1,230 million for the 5-year period. Receiving an allocation of SDR means that in each of the 5 years the Fund will credit the United States on the books of the special drawing account in the Fund with $246 million SDR.

Assuming the annual creation of $1 billion and assuming present IMF quotas are those applying when the first creation and allocation takes place, the annual amounts credited to the accounts of various countries or groups of countries would be about as follows:

	Million
Germany	$57.2
France	47.0
Italy	29.8
Netherlands	24.8
Belgium-Luxembourg	20.9
Total EEC	179.7
United Kingdom	116.3
Canada	35.3
Japan	34.6
Sweden	10.7
United States	245.9
Total group of 10	622.5
Other Europe	66.9
Middle East and North Africa	43.0
Other Asia	107.5
Other Africa	39.6
Latin America	89.0
Australia and New Zealand	31.3

Now, just what kind of asset will these countries have to supplement their other international reserves? What are the factors which give it high quality and acceptability?

Each SDR is to be denominated in terms of 0.888671 grams of fine gold. This is the gold value equivalent of one U.S. dollar. Thus, each SDR will be equal to the gold value equivalent of $1. Let me be clear that SDR will be gold value guaranteed, but they will not be redeemable in gold. Further, I also want it to be clear that it would be against the rules for a country to use its SDR merely to change the composition of its reserves. In other words, it would be inappropriate for any country observing the rules to use its SDR to obtain dollars and in turn use those dollars to buy gold from the United States.

Countries will earn net a modest rate of interest on holdings in excess of their cumulative allocations. The formal amendment probably will not set a specific interest rate, but rather a range which will allow the rate to be set in the light of the circumstances at the time of creation of SDR.

The backing of SDR will be unimpeachable. It will consist of a firm, unequivocal, and solemn obligation to accept the new asset when it is presented and to pay a convertible currency in return. That obligation is the fundamental backing of the asset, and is the principal factor which will give it value as an asset. The obligation is qualified, but the limits are broad enough so that there can be no doubt about the usability of SDR to obtain convertible currencies. Each participant will be obligated to accept SDR up to an amount equal to its cumulative allocations plus two times its cumulative allocations. This obligation makes unnecessary and takes the place of the pool of currency used to back present IMF drawing rights. This concept of acceptance obligations is so important to understanding the working of the scheme that I would like to devote some time to explaining it.

Put in its simplest form, a country's acceptance obligation is always the difference between its actual holdings of SDR and three times its cumulative allocations. Thus, using the previous example of creation of $1 billion SDR a year for 5 years, the United States would receive $246 million SDR per year. In the first year, assuming we used none of our $246 million SDR, our potential acceptance obligation would

be $492 million SDR—that is, three times our cumulative allocations of $246 million ($738 million), minus our actual holdings of $246 million SDR. If we had transferred all of our $246 million SDR allocation to other countries, our potential acceptance obligation would be $738 million SDR. If we held our allocation of $246 million SDR and had received $246 million SDR in transfers from other countries, our potential obligation would be $246 million SDR.

By the fifth year, we would have cumulative allocations of $1,230 million SDR and, assuming that we held this amount and that we had already accepted $1 billion SDR from other countries, our potential additional acceptance obligation would be $1,460 million SDR

For the EEC countries, the aggregate allocation would be $180 million SDR per year, or $900 million over a 5-year period. The aggregate acceptance obligation is three times $900 million, or $1.8 billion more than the Community's allocation.

These examples indicate that the potential acceptance obligations of the United States will be large enough to accommodate a transfer of all EEC holdings and the EEC acceptance obligations will be large enough to take a transfer of all U.S. holdings. Obviously, these are extreme examples, and the system simply would not work that way. But they demonstrate that the acceptance obligations are quite ample. The margin between the amounts created and the acceptance obligations normally should insure ample coverage for SDR transfers.

The obligation to accept SDR is the foundation of the outline plan. Yet one might ask what would happen if a country should fail to honor its obligations to accept or if there were a major calamity and the plan were liquidated or if a member were to withdraw. We have given careful thought to these remote contingencies, which we do not expect will occur but which a prudent man must guard against. There are three points that are relevant:

1. Because the obligation to accept SDR against the payment of convertible currency is the essence of the plan, the outline provides its most severe sanctions—suspension of the right to use any SDR held by a country—for failure to honor this commitment.

2. Most of the transfer of SDR will be directed by the Fund to countries in strong balance-of-payments and reserve positions, and it is quite a remote possibility that such countries would default on their obligations. Moreover, even in the unlikely event a default were to occur, the acceptance obligations of the major industrial countries are large enough so that rransfers could be directed toward these countries. It is worth recalling, at this point, that the allocations of the group of 10 countries are 62 percent of the total and that these countries have potential acceptance obligations more than three times the total amount allocated to the rest of the world. In addition, a growing number of countries are demonstrating the financial capacity which will qualify them as receivers of SDR.

3. To cover the unlkiely event of liquidation of the plan or a withdrawal, detailed provisions will be made for redemption in acceptable means of payment of countries' holdings of SDR in excess of their cumulative allocations. The specific provisions will be worked out in the coming months and incorporated into the amendment implementing the outline. We expect that, should there be any losses in the event of a withdrawal or liquidation, such losses would be shared among all members in proportion to their allocations. Thus, countries

would not be exposing themselves to special risks by holding a large amount of SDR relative to other countries' holdings of SDR.

In concluding my comments on acceptance obligations, I want to make one point very clear. I have called these acceptance obligations "obligations," and they are exactly that from two points of view; that is, (a) they are obligations to provide backing for the SDR, and (b) they are limited so that each country knows what its maximum constitutional obligation is. But I want to stress still a third viewpoint.

These new assets, as I have indicated, are high-quality assets designed to supplement existing reserve assets. Countries that get SDR from other countries—over and above their regular allocations—normally will be surplus countries and, thus, countries gaining reserves. Some of their reserve gains will be in the form of the new asset—which will be usable, as are its other reserves, when it needs to use them. Thus, accepting the new asset is no more of a burden than accepting gold or foreign exchange or reserve claims on the Fund. In this sense, the acceptance obligation is misnamed and, because of this fact, the acceptance limit of three times allocations is not a fixed limit. Countries, if they wish, can accept and hold more than their acceptance limits—the limits merely state their obligations to accept.

Why, then, are any limits set for acceptance? There are none for holdings of gold and dollars. The answer is a simple one. In the initial periods, while the world gets used to these new assets, it was judged to be the conservative course to say that no country need take more than a proportion of the new assets. Their quality is good, but they are new and people proceed with more caution with a new asset. I suspect that, in time, the concept of acceptance limits will be dropped.

I have already made the point that SDR are usable to obtain convertible currencies, mainly dollars. This is essentially how countries use gold. They use gold to buy convertible currencies, mainly dollars. Because SDR are new and do not have a tradition of use as a monetary asset, as do gold and dollars, a few basic principles to guide their transfer have been provided. They are:

1. Countries will be expected to use SDR only for balance-of-payments needs or to protect their reserve position. A country's judgment as to its eligibility to use may not be challenged, but the Fund may make representations and direct drawings to a country which the Fund believes has failed to observe this expectation.

This expectation simply expresses existing practice, under which present reserve assets are used almost exclusively for balance-of-payments needs or to protect reserve positions. It will help to assure an orderly flow of SDR and avoid instability resulting from shifts in the composition of reserves which might come about if, at a particular time, one of the three principal reserve assets—gold, dollars, and SDR—happened to look more attractive than the others. When a country—say the United States—is eligible to use SDR, and wants to do so, it would request the Fund to debit, say, $100 million of its SDR account and credit a country, or countries, eligible to receive SDR with $100 million SDR. The receiving country, or countries, will then credit the U.S. account with the equivalent in convertible currencies of $100 million SDR. This brings us to the second major principle of use—how is eligibility to receive determined?

2. I have already mentioned that normally countries in strong balance-of-payments and reserve positions will be eligible to receive

SDR. It is only natural that countries in this situation should receive SDR, since they would be the ones which would be gaining reserves because of their balance-of-payments positions. Transfers of SDR could also go to countries in a strong reserve position even though they have moderate balance-of-payments deficits. Among the countries eligible to receive SDR, the Fund will try to maintain equality, over time, in the ratios of their holdings of SDR to their total reserves or in the corresponding ratios to total reserves of their holdings in excess of their allocations. The purpose of this rule is to achieve a generally fair distribution of the SDR among the countries that meet the standards entitling them to receive SDR.

3. The third principle of use concerns what is known as reconstitution. I would expect that a very considerable amount of use of SDR will be reconstituted through the normal processes of balance-of-payments adjustment. Countries that are in deficit and that use the asset will switch to a surplus position and will become eligible to receive transfers of SDR. It is, of course, natural for countries that lose reserves when in deficit to try to regain them when in surplus. However, some countries were concerned that a few countries might use DSR to the exclusion of other reserves and that these countries might not become eligible to receive a reflow of SDR, because they would remain in balance-of-payments deficit. While all countries agreed that some reconstitution provisions were necessary, it was important to avoid a compromise of the quality of the asset as a supplement to gold and dollars. The rules on reconstitution that were adopted assure that the asset will not be abused, yet do not interfere with its reserve asset status.

First, a general obligation to reconstitute, related to time and amount of use, is set down. The specifics are to be elaborated in rules subsidiary to the agreement. The purpose of this was to make it possible to change the reconstitution rules without formally amending the agreement. It was widely agreed that it was not possible to lay down reconstitution rules for all time, as they would have to be adjusted as experience is gained with the use of SDR and, perhaps, in time dispensed with, as concern about exclusive use of this one asset is dissipated by actual experience.

Rules were made for the first 5 years of creation of SDR. The reconstitution rules will be reviewed before the end of this and each subsequent basic period and new rules adopted, if necessary and if approved by an 85 percent majority. During this initial period, a country's average net use of allocations of SDR, calculated on the basis of the preceding 5 years, "shall not exceed 70 percent of its average net cumulative allocation during this period." If any country exceeds this rate of use, the Fund would direct part of the natural flow of SDR to it, in order to maintain this standard. Thus, reconstitution will take place through a restoration of holdings of SDR in the account of the user with the Fund, with payment of convertible currency by the user to other users. The term reconstitution aptly describes the substantive intention. A country "reconstitutes" its reserve position in SDR by purchasing SDR from other countries. It should be clearly understood that there is no bar to the use of 100 percent of allocations of SDR; a reconstitution obligation is incurred only with respect to average use above 70 percent.

In addition to the net average use rule, it is also provided that "Participants will pay due regard to the desirability of pursuing, over time, a balanced relationship between their holdings of special drawing rights and other reserves." A rigid application of such a relationship is not called for; this provision is intended, rather, to draw attention to the idea of a balanced use of all three assets over time and, thus, maintain stability, in a general way, over time in relative holdings of the new asset and existing reserve assets.

In implementing the basic principles of use, the Fund will act as a kind of traffic director, making known to eligible users which countries are the eligible receivers of transfers and assuring that the flow to receivers is distributed in an equitable manner. It may provide that using and receiving countries may deal directly with each other in arranging transfers, but the Fund must be informed of the transaction so that the proper entries may be made on its books, and it may act as an intermediary to bring eligible users and receivers together. The Fund will also have the obligation to direct the flow of SDR to countries that have become eligible receivers because they have incurred a reconstitution obligation and to promote voluntary reconstitution transactions between countries having an obligation to reconstitute and countries whose holdings are in excess of their cumulative allocations of SDR.

There is an area to which the Fund role as traffic director does not extend. This is the provision in section V(3)(d) of the outline, which allows an eligible user to select the country to which it wishes to transfer its SDR for the purpose of purchasing balances of its own currency held by the other country, provided the latter agrees to accept SDR. This provision is of particular interest to the United States, although it applies generally to any participant. It will remove a disability that would otherwise impair the effective use of SDR by a reserve center. It gives the United States the option to acquire dollars held by a given foreign country by using SDR, but only if the dollar holding country agrees. Normally, we use our reserve assets to buy balances of our own currency, and this provision would allow us to use the new asset in much the same way as we do existing assets, provided both parties agree to the transaction. Of course, it does not modify, in any way, our firm commitment to buy and sell gold at $35 an ounce.

In closing, I would like to emphasize that the outline is a constitutional document that must be implemented by specific legal provisions. This applies particularly to the provisions on holding and use, liquidation and withdrawal. With this caveat, I welcome any questions you may have on the details of the operation of this new supplement to existing international reserves.

Chairman Reuss. First, let me inquire about the probable date of the going into effect of this agreement. Let us assume that it is accepted, that the lawyers then sit down for the drafting of the final agreement and present it to those countries whose domestic constitutional processes require such presentation, and that it is approved. It would only go into effect when 85 percent of the voting power voted for it; is that correct?

Secretary Fowler. No, the facility itself comes into existence when approved by the Board of Governors of the Fund and then accepted by 80 percent of the weighted vote plus three-fifths of the members of the International Monetary Fund. These are the regular procedures

for amending the Fund articles. The facility itself, once in existence, would not be activated without the approval of 85 percent of the weighted vote.

Chairman REUSS. As a practical matter—and I am here referring particularly to statements contained in Mr. Deming's paper—as a practical matter, the best guess is that the trading world is going to need about $2 billion worth of new reserves a year for the next 2 or 3 years; and starting in 1970, probably, will need $2,500 million to $3 billion. I think those are the figures—the best educated guess you can make.

Mr. DEMING. Yes, Mr. Chairman. The growth of reserves over the past several years, as the Secretary has indicated—and I have indicated—have been on this order of magnitude. The amount of new reserves, obviously, will depend upon what amount of reserves are coming from what you might call traditional sources, but in board terms this might be something in the order of the magnitude of about $1 to $2 billion annually over the next 3 or 4 years, and with the growth of trade additional reserves will be required.

Chairman REUSS. It looks to me as if this plan is going to be activated when, and only when, the war in Vietnam is settled. I say that because $2 billion of new reserves per year seems to be about what is needed nowadays, and our balance-of-payments deficit which has been the subject of considerable discussion in recent years is currently running at the rate of around $2 billion a year, give or take some several millions of dollars. The foremost element, as I read it, in the balance-of-payments position is military. I, therefore, see a very real linkage between the war in Vietnam and the going into effect of this agreement.

Secretary FOWLER. Your analysis is in part correct. I would like to add one ingredient to it: The amount of our deficit is not necessarily reflective of the amount of growth in foreign dollar reserves. We have seen during this period of the Vietnamese war that our deficits have been running on a very considerable basis, about $1.3 billion and $1.4 billion, but at times a large amount of those deficits has gone into the dollar market, in other words, into private rather than into official hands; so that there is not the direct connection between the amount of our deficit and the amount of the reserves creation that comes in the form of dollars held in official reserves.

Chairman REUSS. I think that is an important qualification that you make, because it could be that if the dollar continues to be popular in the hands of private traders and financial people and does not get into the hands of the central banks, there could be quite a severe shortage of reserves in the world at a time when we are still running, quite unhappily, deficits. Therefore, you might——

Secretary FOWLER. The experience of the last year or 2 years highlights this possibility

Chairman REUSS. Equally, of course, this would be most welcome, because the applicant traders, the private traders, might rush to the central banks with their dollars and thus the additional free world reserves would be depleted; whereas they would be adequate for global purposes, however unpleasant that the reaction might be for us.

Secretary FOWLER. There are other factors that are hard to figure with respect to the creation of reserves. For example, the correlation

between a good wheat crop in the Soviet Union and the amount of gold that comes from that source is another variable in this equation.

Chairman REUSS. Let me now turn to another facet of the agreement; namely, the provision as to currency—and I am thinking here particularly of the currency of the EEC.

In your paper, Mr. Deming, you project an acceptance of engagement on the part of the EEC of some $1,800 million over the next 5 years—assuming a full reserve, the creation of a full reserve of $1 billion a year. This sounds good, I must say. One of the great shortages has been enough marks, francs, and so forth. How does this compare with the current quota arrangements under the regular IMF, particularly for 1967 with a 25-percent increase—how much of these Common Market currencies are available without this agreement?

Mr. DEMING. Most of the Common Market countries at the present time have substantial reserve positions in the IMF, which means there is less available currency in the International Monetary Fund. Their currencies have been used in IMF drawings.

I would like to say this in respect to the acceptance limit: This is the thing that makes the whole plan workable. It represents the backing of the SDR provided by the members of the IMF who will participate in this new agreement. They undertake an obligation to accept the drawing rights in an amount that is three times their allocation, or to put it another way, twice as much plus their allocation. In the case of the Common Market, the allocations, if their Fund quotas at the time of activation are the same as they are now, would be $180 million drawing rights per year out of a total of $1 billion. They would undertake to accept twice that amount in special drawing rights from the countries that were using special drawing rights to settle their balance-of-payments deficits. They would undertake to provide that amount of convertible currency for these special drawing rights. At the present time, the Common Market countries have about $840 million of their currencies available to the Fund and you will see that the new plan will obligate the Common Market countries to supply more than twice the amount of their allocations. But even more important, of course, is that the new special drawing rights will be unconditional in terms of usage, when a country does draw them. The country will have to observe the rules of the game; they may use these special drawing accounts, when a balance-of-payments deficit occurs, or when their reserves decline.

Chairman REUSS. It seems to me that an important achievement that has been brought about here. One of the troubles of recent years is that there has not been enough of hard currencies—there have been plenty of dollars and sterling around, but not enough of the other currencies.

Senator PERCY. Mr. Chairman, I just would like to commend Secretary Fowler for what I think is the most distinguished job which has been done in this respect in a long time.

I want to congratulate those who participated and the members of the distinguished committee that you put together under Secretary Dillon—including men who are authorities such as David Rockefeller and the others—some of the finest talents that we have in this country who have been working on an extremely complicated problem.

I certainly commend what you have done.

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I have noticed an article in the London Economist—a recent article—which states that the United States balance-of-payments statistics have become so sophisticated that it was almost impossible to follow. The article continues with a statement that no matter what figures are used, the real balance of payments of the United States is not disclosed—in the last 2 years. Would you care to comment on that, Mr. Secretary?

Secretary FOWLER. I would say that this year it is slightly worse than the 1966 figures. The figures, you will recall, were a $1.3 billion deficit in 1965, and a $1.4 billion deficity in 1966.

On the official settlements basis, we had an unusual situation in 1966 in which we had a surplus. At the time we indicated that it would probably go the other way this year. So, on an official settlement basis we are running a deficit this year, but taking the 2 years together, I think it would represent about the same picture as the liquidity deficit. The liquidity deficit is running somewhere between $1.4 and $2 billion.

It is hard at this time of the year to be more precise than that.

Senator PERCY. They also point out that in the second quarter the foreign central banks invested $607 million of their liquid dollar assets over 1 year. This was a record high. Has our Government actively encouraged this?

Secretary FOWLER. We welcomed it. We believe that in a time such as this in which there are unusual and temporary levels of military expenditures in the Far East affecting the balance-of-payments position, as had been indicated by the chairman—where the difference between the levels of military expenditure in early 1965 and those current this year is better than $1,250 million, and this is added to the reserves to the countries in that area, such as Japan, Thailand, and Taiwan and a number of other countries—that it is a very logical way of meeting this problem, this temporary phenomena, to encourage and to proceed with the longer term commitments of those funds beyond the 1 year level. I have no apology to make on this procedure.

Senator PERCY. Would you not feel, though, that the improvement of our balance-of-payments position which results from such actions is more apparent than real?

Secretary FOWLER. This is temporary, as temporary as the character of the drain in South Vietnam. One is a temporary phenomenon which more or less balances out the other.

Senator PERCY. Is there likelihood that the new drawing rights will be activated when the U.S. deficit is between $1.5 billion and $2 billion?

Secretary FOWLER. Well, that is a judgment that will have to be made. I think that the question becomes involved. The colloquy I have had with the chairman, on how much of the deficit is reflected in accretions to the central banks' holdings and how much is held in private hands, is relevant to that question.

We could address ourselves to the question, for example, of reserve creation under present conditions. A rather interesting case could be made that there is some need for supplementary reserves to be created now.

Under the plan the Managing Director of the Monetary Fund and his staff will appraise and assess the relationship of reserves with the

position of trade and the pattern of growth in both areas and come to a judgment that some supplement is needed to the regular sources. He will, undoubtedly, canvass that situation, getting the opinions of many of the leading and influential members of the Fund, and if he arrives at a judgment from that canvass that a recommendation is in order, he will make one, and I believe it will be adopted.

I think one of the factors he will take into account—but only one of the factors—is the amount of reserve creation that is in fact resulting from the U.S. balance-of-payments deficit.

Senator PERCY. I intend to support a tax increase—I will support it—as I have publicly stated, if certain criteria are met.

I wish to report to you that a group of distinguished businessmen with whom I met yesterday, were almost unanimous in their statement that a tax increase will be necessary. They also concur with me that highest priority must be assigned to expense reduction.

We have been quite free with our advice in the past 25 years, and we have gone around the world helping countries, trying to give them advice on what they should do to strengthen their financial affairs.

Could you tell us what the foreign financial leaders' attitude would be toward the proposal to impose a 10-percent surtax? What would be the impact on the confidence in the dollar if there were no tax increase in the face of general expenditure control and still a deficit of around $25 or $30 billion?

Secretary FOWLER. Senator Percy, I think that I can say without qualification that it is the informed view of financial experts in other countries that fiscal restraint, which is embodied in the proposal for an increase in taxes and the holding down of increases in Federals expenditures, given the outlook and the situation that now confronts us, is necessary, desirable and in full accord with the prescription for using the combination of fiscal and monetary policy, for good policymaking. I believe this would be the view, and is the view, of those who have commented in the process of multilateral surveillance, as it is called, in the discussions that take place in Working Party 3 of the OECD, and in commentary of the International Monetary Fund on policies in various countries.

I do not have any doubt but what a fair reading of the report of the International Monetary Fund which was written in July, before the President's tax proposal went out, would indicate that this fiscal measure is desirable, given the outlook for the economy at the time. Of course, they do not have the close knowledge of the outlook of our economy which we can expect of our own business and financial experts. But, on the assumption of the outlook for the domestic economy by the overwhelming body of opinion—the opinion of the business economists as reflected in their policy which was announced on Monday, I believe, and the academic economists which was reflected in the testimony before the Ways and Means Committee on Tuesday, and of the business and financial leaders which was reflected in the testimony yesterday—assuming that analysis is the accurate one, I believe it would be the judgment throughout the world that this is a necessary and responsible view of fiscal policy.

The second question is: Would it shake confidence if we do not measure up and take the necessary action?

I can only say this in answer to this question: I honestly believe and feel that if there were no other reasons for this surcharge proposal

that the demonstration of the willingness of the U.S. Government to take this kind of action, which is tough and difficult we all recognize, and unwelcome to those of us who pay taxes, would be an action that would further strengthen the economy in the world and give confidence abroad that the United States has the capacity and the will to do that which is necessary to maintain a favorable position.

Certainly, I think that the threat that too much demand would again cause a turndown in the level of our trade surplus, and, therefore, undermine one of the greatest single factors that maintains our balance-of-payments position, that is of itself enough of a reason for us to go ahead.

Now, there are a number of other reasons which I know you do not want me to get into here. But I do think that there is a definite relationship between responsible fiscal action on the part of the U.S Government at this time and meeting our balance-of-payments problem—it is an indispensable element in maintaining our competitive position. It will give that extra added element of strength and confidence in the international monetary field, which I think is so important.

Senator PERCY. Some have taken the position and expressed the hope that the U.S. Government should remove the gold cover from the Federal Reserve notes and do so at a time when it would strengthen the dollar rather than at a time when it might have to be done under emergency conditions. I was surprised at the widespread support that proposal had among many people, that is, at this time to remove the gold coverage from the Federal Reserve notes and to make all of our gold available as international reserves to meet our situation.

Secretary FOWLER. This legislative proposal to which you refer is one of a number of matters that we have had under active and heavy consideration for a good part of this year. We have kept the status of this problem under constant review, taking counsel with others in the executive branch and in the Federal Reserve System. Whether one considers it fortunate or unfortunate is not the problem, but it does not have the same priority as some other matters that are pressing for legislative action at this time. I hope that we will be able to devote more time to this question later this year. We do expect to present our views on it to the appropriate committees of the Congress in the near future. I am not, however, able to give you a definite position today.

Senator PERCY. I have this closing question. It has reference to our balance-of-payments and budget statistics. I think that we are making great progress, and I am sure that the periodic reports which you are now planning to make on the budget will be helpful. But I see beyond that other possibilities. Is there any hope that we can look forward to a more simple Federal budget that will make Government fiscal affairs more understandable to the American people as well as to the legislative people?

Secretary FOWLER. I have two comments, Senator Percy: first, on the balance-of-payments position, and, secondly, on the budget situation.

I remember hearing once that the Chancellor of the Exchequer was asked the question as to why a century ago, when she had widespread responsibility throughout the world Britain did not seem to have any balance-of-payments problem, but now that her responsibilities are

greatly diminished she seems to have a terrific balance-of-payments problem. He thought for a moment about it and came up with the view that 100 years ago Britain did/not have a balance-of-payments problem because she did not have balance-of-payments statistics. Sometimes I share that view.

It is, however, I am afraid, a necessary element of life. It is one we have to live with.

We have had, as you know, a study and a report made on the balance-of-payments statistics. The report was made several years ago. We now are putting many of the recommendations into use.

When it comes to the question of the budget, the President's Commission on Budget Concepts is in the process of completing its report on the budget's presentation. The Commission was named earlier this year and is chaired by an eminent banker, Mr. David Kennedy. The Commission includes Members of Congress: Chairman Mahon and Congressman Bow; Senator Hayden and Senator Young on the Senate side, and some outside experts in the field. Mr. Schultze and I also serve on it. Under the leadership of Chairman Kennedy, this group has done a quick and thorough job over the past six months. We had a 1-day meeting this week. The report will be available sometime this fall. I think it will make a very valuable contribution not only to the understanding of the budget but in working toward a unified budget presentation which will get us away from the three sets of figures we now have.

Senator PERCY. One comment there: I know that I, for one, will be happy to know that has been completed.

Secretary FOWLER. It will never be simple, but I think it will be better understood.

Senator PERCY. Thank you.

Chairman REUSS. Senator Javits?

Senator JAVITS. Mr. Secretary, I apologize for not being here during your presentation. I have been in a committee marking up an appropriation bill. However, I did want to come even for a few minutes, to express my support for the draft agreement on international monetary reform. I think that reform in this area is long overdue. I think the draft agreement is a landmark. I think it could eventually help free world economics from shackles and restraints. I hope that you will go forward and implement it. Certainly, as one of the Members of the Senate, I intend to do my utmost to support you.

Secretary FOWLER. I know of your long and zealous espousal of this, Senator Javits.

Thank you, for those remarks.

A good deal of my presentation this morning is really a kind of a report to this subcommittee on how much I think the present arrangement reflects the ideas and the attitude of this subcommittee, which this subcommittee gave to us in its "Guidelines" report. I feel that it is well to come back and say, in effect: "We have carried out the commission that you gave us."

Senator JAVITS. Will any legislation be needed on this?

Secretary Fowler. Yes, as soon as the outline of the plan is put in legal form, as an amendment to the Articles of Agreement of the International Monetary Fund. Under section 5 of the Bretton Woods Agreement Act, it is provided that the Congress must give prior approval to U.S. acceptance of any amendment to the Articles of

Agreement. So, hopefully, we would expect to have an amendment to the Articles of Agreement presented to the Congress sometime next year.

Senator JAVITS. On the part of the United States—will it increase the U.S. obligation in the Fund?

Secretary FOWLER. There will be no increase in obligation to the Fund in the normal sense that you and I have known, in the past. In other words, there will be no increase in the regular U.S. quota in the Fund. There will be commitmentt o join in and support the establishment of the new facility which is described in the outline plan, and in more technical detail in Secretary Deming's statement which is before the subcommittee.

Senator JAVITS. It would not involve, you say, any new commitments by the United States?

Secretary FOWLER. There will be certain new commitments. For example, if we participate in the activation, the first activation of the new facility, to take a hypothetical example, if there should be an agreement to create $1 billion of special drawing rights each year for 5 years, if that would be the original basic activation, our allocation of the special drawing rights would be around $240 million, based on our share of the total quotas in the IMF. But a specific obligation would be to accept for dollars an amount equal to this allocation, if we should use any of it, plus up to twice that amount of special drawing rights held by others and presented to us as a basis for settlement.

Senator JAVITS. I am very glad to see us embark on this course.

I would like to have a word with you about the tax situation, as described by Senator Percy.

I am tremendously concerned about the fact that an effort is being made by the administration to rush us, instead of waiting until January 1 and to have it made retroactive, in order to see whether or not the expectations of the inflation are likely to be realized or whether a tax increase is not likely to be counterproductive and develop into some kind of a recession which many fear.

I gather that the administration wants it immediately; so, I raise this question with you:

Is the administration prepared to represent to us that genuinely and sincerely it sees no chance of inducing a recession, or working just the other way?

Secretary FOWLER. That is our solid prediction and has been for several months. Of course, it is a matter that we weighed most carefully in the months of May, June, and July. And rather than coming with a new and specific proposal to the Congress at a time when uncertainty was still clearly apparent, we waited until we felt that it was clear. When the President sent up his message on August 3, we at that time felt that there was an overwhelming consensus, not only of opinion but of signs in the indicators, that a resumption of the expansion in the economy existed, sharply contrasting to the first 6 months, and that that would be the pattern and was the pattern. The only area of debate, the real debate, was whether or not expansion would be moderate or immoderate, and because of the risk that it might be immoderate, given the various economic factors, we believe that prompt enactment of the surcharge is desirable.

I will say, Senator Javits, that the indicators, the signs, the economic developments that are treated as most important by the experts have almost solidly confirmed that earlier conviction.

Senator JAVITS. Mr. Secretary, I do not want to seem to be in opposition to you, but it is a fact that the forecasting of the administration has not been the best. You advocated a tax increase in early 1966. You mentioned that when the general opinion seemed to be that we had a very much greater effect on inflationary trends. You had the argument about $10 billion underestimation in fiscal 1967. You advocated the 7 percent investment tax credit suspension.

Should not something be said that the people have a reason and a right to be a little dubious about the forecast of this administration, no matter how it is put before us?

Secretary FOWLER. If you do not want to accept it on the basis of the forecast of the administration, there are plenty of other forecasts from other areas which I would think you would have the greatest respect for. This is not a subject on which there is a great widespread division and diversity of opinion as to what is desirable from the standpoint of economic policy such as characterized the earlier discussions back in 1966 on what course to follow. For example, Chairman Martin and Mr. Hayes of the Federal Reserve System are testifying today before the House Ways and Means Committee. I have not seen their testimony, but from conversations with them, I have no doubt but what every member of the Federal Reserve Board—and I daresay most of, if not all, the presidents of the Federal Reserve Banks—every member of the Council of Economic Advisers, the Treasury Department—practically unanimity among the leading academic economists of the country, 75 percent of the Association of Business Economists—all support an increase in taxes.

This is not a point of view that is loosely held. There is a solid body of opinion and analysis from other sections, and, as Senator Percy has indicated, 400 or 500 men who have their fingers close to the pulse of our business and financial system were represented yesterday by Secretary Dillon, Mr. Roosa, Mr. Saunders of the Pennsylvania Railroad——

Senator JAVITS. I appreciate what you have said. I gather that the administration, on its own, from the supplementary and sustained debate on this, may feel that way.

Is it not a fact, too, speaking of the international community that we have just talked about, that there is a great concern in the international community as to the closing of loopholes, and to have an economy in expenditures?

For example, there has been a new zeroing-in on armament and similar matters. The question of establishing international monetary reform may be important in view of the fact that we are at war, as a necessary corollary to the relatively small dent which the tax increase, with all of its risk, will make in the total amount of the estimated deficit which runs as high as close to $30 billion now.

Do you think that with the international interest of the United States what it is, we ought not at least evaluate those matters also as an element, an essential element?

Secretary FOWLER. I have heard no one in the international community express any interest in the closing of the loopholes because I think that they all, even at that remote distance in which they

operate, recognize that this is a long-distance and timetaking operation. The international community believes that it is necessary that prompt fiscal action be taken both in the form of a tax increase and a holding down or a reduction in actual planned or continued expenditures so that the combination of expenditures control and prompt fiscal action in the confines of the present system can reduce the prospective deficit to something more manageable than the projected $29 billion. The target area that the program is designed to meet is one that brings it down in terms of the administrative budget to around $14 to $18 billion, in that scale, which would represent a decline in the pattern of deficit on the national income accounts from an annual rate in the third quarter of this year to an annual rate in the second quarter of calendar 1968 of around $3 to $6 billion.

Senator JAVITS. May I just say that I am concerned about the loophole question; that I am very much concerned about national priorities, especially with reference to urban parts of the country, and the fact that when you are at war you have to expect to borrow. We cannot question the fact that we are not at war expect for the fact that it is not as costly a war as World War II. All of these factors need to be taken into consideration.

And, perhaps, January 1, as a date, is a more likely date for this tax increase than otherwise, but you have certainly given us your view, and I am very grateful to you for it.

Thank you.

Secretary FOWLER. Thank you.

Chairman REUSS. I have a couple of questions, based on some of the fine print in the monetary agreement.

I refer to that section which speaks of the selection of participants to be drawn upon. It seems to limit those to be drawn upon to those who would have a strong reserve position. I am a little puzzled at this selectivity. Why is anybody worried about this, if they get drawn upon? This is not a compulsory drawing. If somebody wants to hold gold or convertible currencies, what is to stop them?

Mr. DEMING. I think that this merely reflects the fact that, first, these are reserves, of course, to meet balance of payments deficits or losses in reserves, and, second, reserves are what would normally be used to pay; so, given the general rules that are established in this agreement, in this framework of the prospective legislation, the normal process would be for a country in deficit to use any type of reserves, special drawing rights, gold or exchange, to pay over to a country that would be receiving reserves. Use of special drawing rights will be channeled to the country receiving reserves and its currency which is convertible, will be obtained in return as the language is here, "convertible in fact." That is the normal way that the transaction would go

There are, however, a couple of special provisions in here with respect to this channeling.

For example, a reserve currency center, may utilize a provision allowing use of the special drawing rights to purchase its own currency balances that are outstanding in the hands of other countries, with the consent of the latter. This is the way such a reserve currency country normally works. It pays for its own deficits with its own currencies, and then it may repurchase or convert that currency.

There is also a provision which permits a voluntary transfer of these assets between countries of the type you have in mind, for certain purposes. If a country has used up some of its special drawing rights, and wants to get some of them back, it is perfectly possible for it to engage in this type of transaction on a voluntary basis. There is no prohibition against this.

The point here is that the normal flow of these assets would be from countries that were temporarily in deficit position to those that temporarily were in surplus.

There is a rule that a country would not use the special drawing rights solely to change the composition of its reserves. There would be a destabilizing element in the monetary system, if this took place.

These guidance rules, as laid out, are to avoid that.

Chairman REUSS. What we did not want, of course, was for countries to accept special drawing rights, then use them to buy dollars, and then turn the dollars into gold.

Mr. DEMING. That is correct. But there is a reason over and above that. If that is done, it cancels out the increase in global reserves provided by the special drawing rights, by reducing the reserves of the United States, and we, generally, agree that this is not a plan for creating reserves only to have it offset by action which would reduce the global level of reserves.

Chairman REUSS. Is there anything wrong with changing the composition of the reserves?

Suppose that little country X, which has some reserves—not enough, but some reserves—decides that the special drawing right is the greatest thing that ever came down the pike to them—it is not subject to anybody's unilateral devaluation; it is not subject to change in the world gold price policy which would reduce the monetary gold to the value of that used for commercial purposes. What stops a little country like "X" from going on such a binge? What is the harm in it? If something is good, people would want to hold it. They would not like to let go of it.

Mr. DEMING. The provision under section V, 3(d), might techically permit special drawing rights to be so used. However, theUnited States would be on the other end of this transaction and receive the dollars. Such a transaction could conceivably take place, but it could reduce our holdings of special drawing rights and thus reduce global reserves.

We believe that one has to have rules so that you could not have wholesale shifts in the composition of reserves, that would be destabilizing. We do have to have rules.

Chairman REUSS. I have just one more question. Roman III, Arabic 3, little b, describes how allocations of special drawing rights are made, and what happens with the managing director going around and making a sort of an informal poll of the possible participants and asking them what they think of this. I have this question. The members of the monetary community have shown in the past few weeks a remarkable spirit of cooperation, which is shown by this agreement itself. But suppose that in the future there is a relapse into a dog-in-the-manager attitude; what happens?

I would like to have such antisocial conduct or attitude by a member or group of members out in the open, so that world opinion can play its part upon them. But here is the managing director going out around

behind the scenes. Is there not a danger that he will give up if he gets frowned upon or smiled upon by some of the participants, the world will never know about it, and the dog-in-the-manger attitude will be allowed to escape responsibility for its act?

Mr. DEMING. This is a remote possibility. I think it is a rather remote possibility. There is a provision in III.3.d. as to the decisions on the special drawing right, providing for an annual review of the adequacy of global reserves as part of the annual report of the Fund to the Board of Directors. The managing director, in arriving at a decision, has to take into account a lot of additional factors. I think that there would be a whole series of things that he would be required to look into. He is going to look at the growth in trade and the international money market and the reserve policies of countries, and so on, and come to a conclusion that it is time to create a certain amount of these new drawing rights. This information is going to be available to all of the members of the International Monetary Fund. It is going to be available to all of the groups in international planning, and I think it would be very difficult to have someone act purely as a dog in the manger. I do not think that the managing director would take guidance from one or two or a few. It is consensus of opinion. I suspect that in the process of consultation, this is the normal way that it is done, and, perhaps, 3 months or 6 months would yield a result which would be fairly well agreed to before he actually put a proposal before the executive directors, and the governors of the International Monetary Fund. It is always possible for somebody to disagree in this instance, but the history of the last 20 years of the IMF is that it has turned out to be almost unanimous in its consensus on most questions. I think that this is a good deal of insurance.

Chairman REUSS. I think that is a good answer.

Mr. Widnall?

Representative WIDNALL. I apologize for not being here to hear your testimony.

I appreciate the paper that you have presented to the subcommittee this morning.

I was interested in listening to the testimony of Mr. Wallace before the House Banking and Currency Committee.

Our gold outflow has moderated substantially this year. What are the reasons?

Secretary FOWLER. The confidence in the dollar in international business transactions and financial transactions.

For example, one factor has been the tendency of private business and financial organizations who want to have dollars to use in the European dollar markets, to hold them rather than let them flow into the hands of the central banks.

Another factor is, given the amount of the dollars that do come into the hands of the central banks, there is a feeling on the part of a great many monetary authorities that this is not only a question of confidence in the dollar but that it is more desirable to hold them in reserves rather than hold gold. They become earning assets rather than static assets.

And I think, also, the third element is that the central bank authorities of many countries, feel that further unnecessary drawdowns and drains on the United States gold supply—which serves as a link between the dollar and gold through convertibility of the dollar, as

the real matrix of our exchange rate system—if these drawdowns were to continue to deplete our reserves willy-nilly and for no good reason, this would not be good for the international monetary system in practice. This is not to say that there are not many other reasons for and many situations in which the conversion of the dollar into gold goes on.

Representative WIDNALL. Do you see a continuance of this?

Secretary FOWLER. I think, like these factors, Congressman Widnall, there have been a lot of other relevant circumstances, too. I have to be frank to say that I think that the matter of the handling of the tax bill would be a relevant fact. I think the development in our balance-of-payments problem is relevant as a factor also. I think the general outlook for trade and the resumption of economic growth in other countries is a relevant fact.

It is a compound of a number of things. I am quite pleased with what has gone on so far this year, despite a continuance of the deficit in our balance of payments, that there has been a very minimal call upon our gold supply.

Representative WIDNALL. France has been drawing on our gold supply. Have they done so this year?

Secretary FOWLER. They have not drawn since last September.

Representative WIDNALL. Is it anticipated that they will make further drawing this year?

Secretary FOWLER. I have no view, either as to the reason for their drawing or not drawing, or any expectation.

Representative WIDNALL. In view of their past action, I was delighted to read in the paper about the drop in the amount during the last year. It would seem to indicate that possibly that was because of a change in view of the American public with respect to tourism which has affected them.

Do you expect that the creation of the new drawing rights, the new special drawing rights, will ease pressure on our gold stock?

Secretary FOWLER. I think that it will certainly, in the sense that any concern about a scramble for reserves or the like ought to be allayed by the action that has been taken and by the agreement that has been reached. It ought to have an indirect stabilizing result. I do not believe for one moment that the new facility will or should change in any way our continuing policy of converting gold and dollars at $35 an ounce which is the matrix of the existing system, but I would expect, over the years, there would be less pressure. Of course, I am assuming, Congressman Widnall in answer to this question, that we do bring our balance of payments into equilibrium. This will largely determine whether or not there is going to be less erosion of our reserves.

This agreement does not eliminate or reduce in any degree at all the necessity, from my point of view, of doing whatever we can as soon as possible to come into equilibrium.

Representative WIDNALL. Is there to be a conscious effort to have the total supply of monetary reserves grow in relation to a prospective growth of trade?

Secretary FOWLER. Yes, I think so, but not necessarily on a 1-to-1 basis or a dollar-for-dollar basis but in some ratio that gives assurance and a feeling that the movement of trade and of capital can go forward without ultimately leading to restriction. As my statement indicated,

the total of world reserves as it relates to imports has diminished from about 56 percent to about 36 percent of annual imports over the past 10 years, despite the fact that there has been a considerable growth of reserves in that period of time. Undoubtedly, the experts will continue to address themselves to the subject—and as Mr. Deming's statement shows—will be hammering out a great deal of know-how in this field, just as in the domestic field.

Representative WIDNALL. In the case of the liquidity deficit of the United States which continues at a relatively high level, say $2 billion annually, enough of these dollars go into reserves to prevent a global shortage, but the liquidity position of the United States continues to become more precarious. At the same time, there is relative price deterioration of the dollar and an insufficiently well-maintained current U.S. surplus. Will there be a case for supplying new SDR's in these circumstances?

Secretary FOWLER. Last year the liquidity deficit was a billion four, and before you came in I answered, I believe it was a question of Senator Percy, indicating that the deficit is running slightly above that level, so that my best estimate today would be that it would be somewhere between a billion four and 2 billion. That is just a guess.

Representative WIDNALL. To repeat, enough of these dollars go into official reserves to prevent a global shortage, but the liquidity position of the United States continues to become more precarious; that is, this happens when it goes into other countries.

Secretary FOWLER. That is correct; that is a great paradox which I pointed out in my statement, that we have been confronted with all along. This agreement, if it is carried through and becomes what we hope it to be, will move us away from the situation where when we reach equilibrium in our payments position we may be cutting off the increase in world reserves in the form of dollars held by central banks.

Representative WIDNALL. And at the same time, to repeat, there is no relative price deterioration of the dollar and a sufficiently well-maintained current U.S. surplus. Would be a case for supplying new SDR's in these circumstances?

Secretary FOWLER. Because of the supply of gold that is going to the requirements for industrial use, the amount of newly mined gold getting into the hands of the monetary authorities has been diminishing, because of the fact it is going into industrial and other non-monetary uses. And in recent years, the new supply for monetary purposes has been thoroughly inadequate for monetary growth.

Representative WIDNALL. I have just one more question.

Do you think that the provision that no country be obliged to supply more of its currency than twice the equivalent of its own drawing rights is too restrictive or is it good security for the acceptability of SDR's?

Secretary FOWLER. We think that it is an excellent first approach to this problem. I think the experience in the early years with the SDR may suggest a reexamination, but we were quite satisfied with that provision. Perhaps, Secretary Deming may want to add something to that.

Mr. DEMING. There have been detailed technical studies made on this. The acceptance limit is two times the cumulative allocations plus the allocations—or three times the allocation—this seems to be about the right number. It is not that precise. We wanted to get enough

room for the plan to operate. For example, if the European common market received an allocation of $900 million out of $5 billion, then combined acceptance limit would be a $1,800 million on top of the allocation. This allows for plenty of room for use of special drawing rights. We take it that this is about the right number. It is not too restrictive; it is ample enough to make the plan work satisfactorily but not so ample that it would run out of control. In time, I would expect that the acceptance limit would be eliminated. If the SDR gets wider acceptance we will be happy to modify it.

Representative WIDNALL. I would like, personally, to thank you for the cooperation you have given and the work that you have done in order to bring about a conclusion in this situation, Mr. Secretary. I hope that it will prove very fruitful; at least, we now have a beginning.

Secretary FOWLER. Thank you.

Representative WIDNALL. I am certain that just a few weeks before you reached agreement, that it was pretty hopeless.

Secretary FOWLER. I would like to just say this, to reflect again on what I said in the statement, that we, on our side, certainly do appreciate the support and the sense of urgency that this subcommittee and the representatives of both parties have given to this initiative from the very beginning back in 1965. It has been quite encouraging to go forward, to take the initiative and be aggressive about it, because we were aware that you and others on your side, as well as Chairman Reuss and the others, felt strongly that this was a necessary, desirable measure. I, therefore, think of it as an example of an bipartisan initiative on the Hill which has found, apparently, a willing acceptance.

Representative WIDNALL. Thank you, again.

Chairman REUSS. We are privileged to have with us a representative of the subcommittee of the Committee on Banking and Currency which has legislative jurisdiction over whatever may come out.

Mr. Rees?

Representative REES. In terms of the actual amount of the special drawing rights, in the press reports I have read they were talking of $1 to $2 billion as the annual provision. In your discussion, Mr. Secretary, you were talking about a fund of $2.5 to $3 billion. Is this something that will be negotiated?

Secretary FOWLER. No, I think that at the time when the exact amount will be created, it will probably be a different figure. The figures that we are using are largely illustrative. The time when it comes into sharp focus, will be after the Congress and the parliaments and the governments have approved their participation in the facility and it fully comes into being, as it will with the approval of the countries representing 80 percent of the weighted areas in the fund, including at least three-fifths of the members of the fund. The Managing Director will then make an assessment of the outlook for the demand for reserves in the light of world trade and financial movements. There is no precise figure that we expect to have on an annual basis. I think it will involve a bit of negotiation of the various opinions. The figure of one billion dollars that you see and has been made reference to has been largely used for illustrative purposes to indicate how much of the present drawing rights would accrue to the United States if it were a billion dollars a year or what that would add up to over a 5-year period of time. The figure of 2½ billion is really a longer term projection of what might be the likelihood of overall additions to

world reserves in the form of gold reserve currencies, and SDR's some years ahead.

Representative REES. You might say that we would need this drawing right, perhaps more than other nations right now. What is our bargaining position? Does it not look like we will have a strong one?

Secretary FOWLER. As I said in my statement, the plan is not devised to be an answer to any individual country. It is to see that the total of the global reserves are adequate to facilitate growth in trade, and, as I said in my statement, the amount of the SDR's that would accrue to us under any prospective level of acquisition would, in no sense, be an answer to our problem of balance of payments or be a rationale for activation in any given amount. We do feel that this plan has many advantages for the United States. One of them is that under the existing system we do not have a very good opportunity to build back our reserves, but under this plan we can build our reserves back up by sharing in the new facility. So, over the long pull, the new facility would enable the United States to rebuild the level of its reserves. I think that is a welcome and desirable thing from our point of view; however, we do not look at it in any sense as being an answer to our balance-of-payments problem.

Representative REES. Thank you very much.

Chairman REUSS. Mr. Halpern?

Representative HALPERN. First, I would like to commend the Secretary for his outstanding leadership in the field of monetary reform and his work in this area which reflects the able stewardship that he has given to this.

He emphasizes the need for the expansion of international reserves and suggests that this new plan will meet this need, but if the expansion of the reserves is through the special drawing rights actually sought, the country that has made use of these SDR funds never has to repay these credits?

Secretary FOWLER. It does not repay, strictly speaking, but may have to reconstitute in part. These are permanent additions to the reserves of the world as a whole. They are on the books and available for use when and if circumstances call for the holding country to use these reserves.

A short answer to your question is that we will consider them as determined and declared additions to our reserve assets, of the same type as gold or foreign exchange, and we will think of them in that light.

I want, however, to take note of the elements of reconstitution which have been discussed and are a part of this particular plan. You will find in the plan, in the outline of the plan itself, that while you can use 100 percent of the special drawing rights year after year, you have an obligation to reconstitute 30 percent, representing the excess over 70 percent net average use, by the end of a 5-year period. That simply means that you must reacquire part of the SDR you have used, by accepting them back from other countries and giving up your currency that is convertible, in fact. In effect, you reverse the process of using the SDR, but need not do so unless you have used more than 70 percent of your allocations, on the basis of a net average use formula that takes account both of the amount you have used and how long it was in use. There is also a very general objective set forth that

countries should over time pay "due regard" to the desirability of a "balanced relationship" between SDR and other reserves.

Representative HALPERN. As I understand, the special drawing rights are to be used in connection or conjunction with the gold and various types of foreign currency. In fact, the SDR is inclined to turn some gold back.

Has any consideration been taken of the possible consequences of the devaluation of the dollar; that is, the stability of this depends upon the agreement of the United States as to the value of the dollar?

Secretary FOWLER. There is a specific provision in the outline dealing specifically with devaluation by any holder or any user of the drawing rights. It is in VI(b) and I will read it.

Maintenance of Gold Value. The unit of value for expressing special drawing rights will be equal to .888671 grams of fine gold. The rights and obligations of participants and of the special drawing account will be subject to an absolute maintenance of gold value or to provisions similar to Article IV, section 8, of the Fund's articles.

So that, in effect, there is a guarantee by the using country that it will supply whatever additional currency will be necessary to live up to the arrangement, in event of devaluation of its currency. This applies not only to the United States but to all of the other participants.

Representative HALPERN. You mentioned that the U.S. balance-of-payments problem was probably more in the category of other problems other than under the heading of the international monetary reform part, and that this was the attitude of the U.S. negotiators in the monetary reform plan negotiations. The problem of adjustment is being investigated. You pointed out that there was a working party of the OECD working on this. Do you still feel that any amount of investigation in this area can come up with a solution where so many of the balance-of-payment problems result in difficulties with basically more of a political than strictly an economical international nature?

Secretary FOWLER. I think that you have a very good point. Last August of 1966 the report by working party 3 on the adjustment process clearly indicates that there are some modern rules and practices and procedures that go to make up the adjustment process and that many of these—many of the most important ones such as, for example, a flexible use of fiscal and monetary policies by nations, by national bodies, do involve very deeply this question. For example, the proposal which is now before the Congress would be to consider, in the framework of the adjustment process, the flexible use of fiscal policy designed to avoid a deterioration of our trade surplus which would compound the difficulties with our balance of payments But, clearly, the will or the decision on whether the surcharge will be invoked, given that analysis, or otherwise, is a national political situation as well as a national economic situation and there are many other factors,

other than the balance-of-payments adjustment process, which are relevant and affect that decision. Certainly, another excellent example is South Vietnam which has a serious impact on the balance-of-payments deficit, and yet it is clearly beyond the purview of any multilateral surveillance of working party 3 or any other international organization to say to the United States: "Look, you have to make this military or political decision, because that is what it is."

Representative HALPERN. Thank you, Mr. Secretary.

Chairman REUSS. Thank you, Mr. Secretary, Mr. Deming, and your associates.

The hearing of the Subcommittee on International Exchange and Payments will now stand adjourned.

(Whereupon, at 12:20 p.m., the subcommittee adjourned.)

APPENDIX

(The following letter and accompanying publication are included herein at the request of Chairman Reuss:)

THE UNDER SECRETARY OF THE TREASURY
FOR MONETARY AFFAIRS,
Washington, D.C., September 18, 1967.

Hon. HENRY S. REUSS,
Chairman, Subcommittee on International Exchange and Payments, Joint Economic Committee, Rayburn Office Building, Washington, D.C.

DEAR HENRY: The Secretary and I wish to thank you for the opportunity you provided us to report to the Subcommittee on International Exchange and Payments of the Joint Economic Committee, on the progress of the international monetary negotiations.

The question of the need for reserves was discussed to some extent during the Hearing. This subject will of course be studied very closely from now on, by governments, by the International Monetary Fund, as well as within the academic community throughout the world. It occurs to me that the Subcommittee might find useful a first attempt to dig into this subject made by some members of the Treasury staff, and I am enclosing a copy of this study. While very preliminary, this paper contains some useful data and may stimulate further work on the world's demand for reserves, and on criteria which should be weighed in considering the timing and possible magnitudes of reserve creation in future years. We are planning to publish this study, and if you would consider it helpful to include it in the documentation associated with the Hearing on September 14, this would be agreeable to us.

With best regards.

Sincerely,

FREDERICK L. DEMING.

Enclosure.

THE NEED FOR INTERNATIONAL RESERVES

GEORGE H. WILLIS
FRED L. SPRINGBORN

UNITED STATES TREASURY DEPARTMENT
September 1967

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ACKNOWLEDGEMENTS

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The responsibility for any views expressed in the text of this paper rests solely with the authors. They are very conscious that it has been prepared in intervals of time that could be snatched during a busy year, and that it is essentially a preliminary statistical survey.

I

Introduction

This paper presents a statistical analysis of the past trends in the supply of and the demand for international reserves, together with some comments on the probable effects of a slowdown in the rate of new reserve creation. It does not attempt to present an argument as to what the theoretical optimum secular rate of reserve creation should be for the world as a whole. It does suggest that changes in the rate of growth in reserves, either for the world as a whole, for the world excluding the United States, or for the United States alone, are likely to have important effects on the policies of major countries with respect to selective policies of restraint affecting international trade and international investment.

That is, the approach is empirical, pragmatic, and statistical, rather than an attempt at building up a logical structure based upon certain given objectives. It is hoped, however, that the data presented and the commentary given on the data will throw some additional light on the fundamental question: At what rate should the world's reserves grow?

For the analysis, it was found useful to bring out the substantial difference in the trend of reserves for the world as a whole and for the world excluding the United States, because the United States has lost reserves while the rest of the world has gained them at a substantial rate. One result of this division is that there has been a considerably closer correspondence between the slopes of the trend lines for growth in imports and growth in reserves for the world excluding the United States than for the world including the United States (see Charts I and II). Another point that emerges is the probability that the downtrend in U. S. reserves will be halted or reversed, and the past divergent trends of declining U. S. reserves and rising imports brought closer together.

An attempt has also been made to ascertain what portion of the aggregate growth of reserves in countries gaining reserves has been covered by losses of reserves, and what portion has been covered by newly created reserves. For this purpose, also, it is necessary to look at what has happened

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to the rest of the world, excluding the United States. There is, of course, an interaction between the amount of reserves created and the total aggregate reserve gains. Nevertheless, it is quite interesting that, in the period 1961-66, at least half of the gross reserve gains of those countries gaining reserves was accounted for by new reserve creation. The point is that the secular trend of reserve growth has been as important or more important quantitatively than reserves gained at the expense of nongold-producing deficit countries. A question suggested by the data is whether, as a practical matter, the world can operate a reasonably unrestricted system of trade and payments with a smaller ratio of new reserve creation to aggregate surpluses. That is, can we really expect the adjustment process to function smoothly to reduce this ratio, or would the consequences be a shrinkage in trade and investment under policies of restraint, in a vain attempt to reduce the ratio? Deeper historical analysis might throw further light on this question.

A third point as to method may also be worthy of mention. In the tables covering the 16-year span from the end of 1950 through 1966, there has been no attempt to pay particular attention to the components of reserve increases, although the trends in the growth of the major reserve forms may be noted in Chart III. This is a matter of design. Over the broad sweep of 16 years, the paper has concerned itself with the relationship of the trend of aggregate reserves to trade and to domestic liquidity, rather than with an examination of the composition of reserve growth.

It may be argued that the demand for reserves is not the same as the need for reserves, and that the paper should draw a clearer distinction between these concepts. Presumably this would imply that need must be tested against more clearly defined subjective value judgments. The authors basically maintain the approach that, in the absence of some clear reason for concluding otherwise, there will be a secular demand for new reserves that will range within somewhat the same relationship to the rate of growth of world trade as in the past, and that reserves will probably be created to meet this demand. They have not tried to refine this concept by a definition of need that goes beyond this.

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It may be observed that in attempting to analyze various data on past financial trends, especially in a first approach such as this, causal relationships are difficult to establish. One cannot expect, with a satisfactory degree of confidence, that relationships apparent in past periods will accurately and meaningfully hold for future periods.

This paper has three sections, following the summary and conclusions. One deals with the supply of reserves since 1950. Next there is an attempt to probe further the demand for reserves, in the quantitative sense, exploring past relationships with trade and with the aggregate surpluses. In a very rough way, some illustrative projections are ventured of the demand for reserves in 1970 and 1975. Finally, some tentative suggestions with respect to qualitative criteria are offered.

II

Summary and Conclusions

During the past 16 years, the fact that world imports have grown three times as fast as global reserves has been made possible to a large extent by the willingness of the United States to experience a decline in its reserves while its imports grew, as did those of other countries. For the rest of the world, import trade has grown at the rate of 7.8 percent per annum and reserves at the rate of 5.4 percent per annum. While there have been wide short-term variations in the relationship between these two growth curves, there is no period of several years in the time interval examined when the world, excluding the United States, has seen its reserves grow at less than half the rate of growth in its imports.

The substantial decline in U. S. reserves also explains the fact that global reserves grew at an annual rate of 2.4 percent, while outside the United States the corresponding figure was much higher, at 5.4 percent. Even at this rate, the more rapid growth in imports has meant that outside the United States reserves are equal to only about 35 percent of annual imports, and thus cover only about four months' imports.

Moreover, for the world as a whole, reserve growth slowed in 1965-66, and the fact that there was any growth at all was due entirely to special nontraditional factors, as gold and foreign exchange reserves actually declined; drawings on the IMF and the monetization of securities by the United Kingdom provided temporary, one-shot, additions to global reserves.

Considering only the rest of the world, since the U. S. deficit cannot create reserves for the United States but only for the rest of the world, the U. S. international accounts provided 73 percent of reserve growth in 1961-64, and only 34 percent in 1965-66.

This calls attention to the dwindling role of new monetary gold supplies in providing for world reserve growth, and to the extent to which, prior to 1965, the world had become dependent upon an expansion of official dollar liabilities and U. S. sales of gold to provide the largest share of reserve growth outside the United States. With a general realization that continuation of the process of

attenuating the U. S. reserve position to feed reserves to the rest of the world is no longer wise, and that the reserves of the United States should also now begin to grow, there is a clear need for a supplementary form of reserve asset.

The charge is sometimes made that reserves have grown too fast in some areas and have led to domestic credit expansion. It can be shown, however, that in 1961-65, even within the European Economic Community, domestic credit grew at a rate almost double that of the rising level of reserves.

In exploring the demand for reserves, particular attention is given to the relationship of the aggregate imbalances in world payments to the rate of growth in reserves. This analysis is related to the basic idea that surplus imbalances have always tended to exceed deficit imbalances, for the world as a whole or for a part of the world, with imbalances measured by reserve changes. The difference between the two represents the growth of reserves for the world as a whole, or for the area concerned. The classic example of such a difference is new monetary gold supplies.

Aggregate reserve surpluses averaged 3.2 percent of world imports in 1954-66, and fell to 1.5 percent in 1966. In 1927 and 1928, the corresponding ratios are estimated at 2.2 percent and 7.4 percent. Looking ahead, potential reserve surpluses might be $5 billion in 1970 at 2 percent of world trade (assumed to reach $250 billion in 1970) or $7.5 billion at 3 percent of world trade. Corresponding figures are $7.5 billion to $10.5 billion in 1975.

The next step was to make some rough assumption as to what portion of these reserve surpluses might appropriately be covered by new reserves, rather than by reducing someone else's reserves. Aggregate reserve losses ranged between 1.7 percent and 3.7 percent of world imports in 1954-60, and between 45 and 108 percent of aggregate reserve gains. The unweighted average annual rate was 71 percent of gross gains. For the seven-year period as a whole, the corresponding figure was 69 percent; put another way, new reserve creation provided 31 percent of the aggregate reserve gains in 1954-60.

Since 1960 reserve losses have fallen both absolutely and particularly in relation to world imports and to aggregate reserve gains. New reserves were created up to 47 percent of the reserve gains in 1961-66. The pattern of 1961-66 may be useful as an indication as to the future relationship of reserve gains and reserve losses. It is true that this ratio has been accompanied by some restraint on capital transactions, but probably a continuation of a higher rate of reserve losses would have intensified the pressures for such restraints.

If it is reasonable to assume that at least half of the reserve gains should be covered by reserve losses, a very rough guide emerges to the total new reserves of all types that might be desirable: \$2.5 billion-\$3.75 billion in 1970 and \$3.75 billion-\$5.25 billion in 1975.

At the close of this section, it is suggested that the 1965-66 situation is not a stable or continuing one, and that new reserves in some form may be needed at the rate of at least one percent of world imports, even with considerable selective restraints on capital movements. It seems doubtful that the adjustment process could compress aggregate reserve surpluses below \$4 billion, or 2 percent of world imports (now \$200 billion per annum). Without an offset to this of at least half the amount through new reserve creation, rather than fully through drains in the reserves of other countries, it may be hard to avoid a rather serious cumulative spiral of restrictive measures affecting international transactions.

There would therefore seem to be risks in delaying a plan for collective reserve creation -- risks that the pressure of events will fill the vacuum in a less collective way, but perhaps not in sufficient amounts or with the optimum timing.

Section V offers a few suggestions as to qualitative criteria that might be considered. In relating qualitative criteria to the concept that reserves should be created for five-year periods, the secular concept, there should be less concern with cyclical or short-period factors, than with criteria that relate to longer-term trends. Moreover, the bearing of the question of timing is not entirely clear when applied to a continuing long-term problem.

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However, some criteria are suggested that might apply to the first activation. One of these is a tapering off in the rate of growth in international trade. Moves to tighten restraints on capital and current international transactions are other indications that new reserves might provide a useful antidote to these pressures. Maintenance of excessively high interest rates in important sectors of the world's economy, after allowance for price trends and cost of living increases, might also suggest the existence of reserve shortages and of competitive efforts to attract and hold reserves.

As to more sensitive early indicators, one must probably look to deficit countries, since this is where the first indications of reserve shortage appear. Unfortunately, it is difficult to disentangle the impact of a general world shortage of reserves from individual balance of payments problems of particular countries. Perhaps some guidance could, however, be found by observing whether restraints on foreign assistance programs and private capital movements are emerging in such countries, or whether there are indications of competitive interest rate rises. The growing use of credit facilities instead of reserves might also provide a signal. All of these early indicators seem difficult to evaluate with precision. Fortunately, a secular approach does not call for excessively fine tuning, in the sense that the credit facilities provide some short-term flexibility to the system in both directions, by enlarging reserves temporarily when granted and shrinking them when repayments are made. Perhaps the main task of reserve creation is to find the most satisfactory rate of secular advance rather than to overemphasize timing judgments. At the same time, a mounting list of qualitative criteria pointing to global reserve shortage would accentuate the need to be prepared with an adequate collective plan for reserve creation and to activate it in good time.

III

The Supply of Reserves

International reserves consist of the aggregate stocks of assets held by the nations' monetary authorities which are available unconditionally to settle imbalances arising from foreign trade and other international transactions. International reserves comprise three forms of assets, as generally agreed, and as compiled by the International Monetary Fund and published monthly in International Financial Statistics. At the end of 1966, the world total of reserve assets reported was as follows, in millions of dollars equivalent:

Monetary gold	40,905
Official foreign exchange holdings	24,275
Reserve positions in the International Monetary Fund	6,331
	71,510*

Foreign exchange reserves consist largely of dollars and sterling, held by countries other than the reserve centers. Reserve positions in the Fund are the amounts that a member of the Fund, when experiencing a balance of payments deficit, may draw essentially automatically under the Fund's Gold Tranche policy.

What are the salient facts regarding the postwar supply of reserves? How has the rate of increase in reserves compared with the advance of other pertinent economic and monetary factors? What can be said about the future supply of traditional reserve assets? These are some of the questions to be touched upon in this section. The major sources of reserve creation in the period 1961-66 will also be analyzed.

Reserve Trends and Other Economic Indicators

In the sixteen years 1951-66, world reserves have grown at an average annual rate of 2.4 percent (Table 1). The growth rate has not been steady from year to year. There was a small contraction of reserves in 1959, largely due to a redefinition of the foreign exchange component for some countries in connection with the liquidation of the European Payments Union. And in 1960 and 1963 the annual

*Partly estimated by IMF; figure revised since compilation of tables attached to this study.

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increase was unusually high. In 1965 and 1966, global reserve growth was substantially below the average, at 2.0 percent and 1.7 percent respectively. Of the total growth in world reserves amounting to $22.3 billion, the foreign exchange component increased by $10.5 billion, gold by $7.1 billion, and reserve positions in the IMF by $4.7 billion.

World trade has expanded at a much more rapid rate than that shown by reserves. Reserves as a percent of annual value of imports was about 62 percent in 1951; after increasing slightly in 1954 the ratio declined steadily through 1966 when it reached a point at which reserves covered only little more than the value of four months' imports.

These relationships were affected, of course, by the fact that the United States experienced a decline in its reserves almost continuously throughout this period. Thus, excluding data for the United States the average rate of growth in reserves was considerably higher, at 5.4 percent, and the year-to-year variations somewhat wider. Nevertheless, the 1965 and 1966 increases were also below average. The relationship of reserve growth to imports, excluding the United States, has been much closer at about 2 to 3, but it may be seen that for the developed countries as well as less-developed countries generally the ratio of reserves to imports has declined in similar fashion. (Tables 2 and 3.)

Regionally, reserve gains since 1950 have been concentrated heavily in the developed countries, excluding the two reserve centers (Table 4). Other areas have generally experienced only moderate changes for most periods, although during the past four years less-developed countries outside Africa have shown substantial gains.

In 1950, the United States held about one-half the total of reported world reserves. During the following eight years, total reserves increased by more than $10 billion, or at an annual compounded rate of about 2.1 percent. United States reserves declined by nearly $2 billion, and at the end of 1958 the U. S. share of world reserves had declined to 40 percent. Nearly all of the increases accrued to European industrial countries, which added $6 billion to gold and $5 billion to their foreign exchange reserves.

Since 1958, the U. S. share of world reserves has dropped further to 21 percent, as U. S. reserves declined by over $7 billion while the reserves of other countries increased by $21 billion. Globally, total reserves increased at a compounded annual rate of 2.7 percent during this period. In contrast to the earlier period, less-developed countries as a group added to their reserves. But, again, the industrial countries other than the reserve centers registered the major gains. The gold component in world reserves increased by less than $3 billion while foreign exchange holdings expanded by over $6 billion. Reserve positions in the Fund accounted for $4 billion of the increase. (Table 5.)

A statistical tabulation made for this paper compares the evolution of reserves with that of domestic credit and liquidity. Several indications emerge, (Table 6), showing the annual compounded rates of increase in the U. S. dollar value of reserves and domestic credit, in the period from 1950 to 1960, and from 1960 to 1965. For the reserve centers, the United States and the United Kingdom, domestic credit has expanded substantially less than in other developed countries, while reserves were growing only slowly or declining. In the rest of the world, domestic credit has been growing at a substantially more rapid rate than reserves -- almost twice as fast in 1960-65, and at a rate two-thirds higher in 1950-60. Only in the EEC countries in 1950-60 was the pace of growth of domestic credit held below the very steep rise in reserves which occurred during that period. However, domestic credit continued to expand in the EEC at 13 percent a year in the period 1960-65, or at almost exactly the same rate as the earlier period, although reserves were growing at less than half the annual rate of increase of the previous 10-year period. This indicates that, generally speaking, in those cases where a rapid rate of increase in domestic liquidity has been associated with inflationary conditions, the main monetary factor has been a sharp increase in domestic credit. On the other hand, the data in the table do not permit any judgment as to whether the supply of domestic credit in non-reserve countries would be adequate if reserve growth should cease or be reversed.

Major Sources of Growth in World Reserves

Milton Gilbert* termed 1960 the "watershed" year, following which the international monetary system became different. He enumerated a number of ways in which reserves were deliberately created since then by monetary authorities, indicating that the need for reserves was not being met by new accumulations of gold or dollars. He concludes that either no shortage of reserves occurred because these actions were taken, or because there was a shortage, it was necessary to take various actions.

*"International Liquidity: The Present Situation", statement at Bologna Center Conference, January 1967.

In order to measure the effects of some of these actions, an analysis has been made of the major sources of reserve creation during 1961-66. This study shows clearly the marked shift from reliance on the traditional sources, in 1961-64, to nontraditional and transitory sources in 1965-66 when the traditional sources became negative (Table 7).

New gold entering into monetary stocks and foreign exchange reserves arising from settlement of payments imbalances may be termed the "traditional" ways in which world reserves are created. There are other ways, but these tend to be transitory and to lead to subsequent destruction of reserves. The most important of these is the net utlization of IMF credit tranches, which is a measure of the reserves generated by IMF operations in the form of super gold tranche positions including claims under the General Arrangements to Borrow. The other major ways in which reserves have been created recently have added to reserve currency balances. Since 1961 the United States has acquired and held foreign currency reserves, primarily through swap operations. Under some of these swap operations dollars have been generated which have added to the official holdings of other countries. Sufficient data are not available to measure the probable extent to which reserves might have been generated through comparable operations to which the United States was not a party. Finally, in 1966 the Bank of England transferred into its reserves the proceeds of certain sales of securities, thereby creating additional reserve assets.

Whereas during 1961-64 traditional sources of reserves accounted for 80 percent of the total growth in world reserves, during 1965-66 these sources substantially contracted world reserves. During the earlier period, world reserves grew by $8 billion. Additions to foreign exchange not traceable to special operations accounted for $4 billion and new gold supplies for $2.5 billion. Of the remainder, most was accounted for by IMF operations, in particular by the large drawings in 1961. The combined net effect of U.S. short-term bilateral operations during this period added about $0.6 billion to world reserves.

In the past two years world reserves expanded by about $2.6 billion, well below the previous rate. However, the identifiable nontraditional sources generated new reserves amounting to over $3.6 billion. In 1965 (as in 1961) there was a substantial net expansion in the use of IMF credit tranches. This reflected a large U.K. drawing, the proceeds of which were used in large part to repay short-term credit facilities, which in turn had initially caused a growth in reserves. Additional operations to which the United States

was a party further expanded both U.S. foreign exchange reserves and dollars held by other authorities, in 1965 and again in 1966. In 1966 the placement of the proceeds of security sales into reserves by the U.K. represented the largest single identifiable source of reserve growth. Monetary gold stocks declined and foreign exchange reserves grew by an amount smaller than that generated by special transactions. The traditional sources of reserve growth, then, caused a $1 billion contraction of world reserves during 1965-66.

The U.S. balance of payments had no significant net effect on the reserve growth of other countries in the aggregate in 1966 (Table 8). U.S. gold sales and the transfer to other countries of reserve positions in the IMF resulting from U.S. drawings were roughly offset by a decline in dollar reserves as reflected in U.S. liability data. During 1961-64 these factors accounted for nearly three-quarters of reserve growth outside the United States.

For the immediate future the outlook is for a reversal of nontraditional factors, as the United Kingdom continues to retire short-term obligations and repays Fund drawings. In 1967 alone, the impact of these operations could be substantial. Thus, during the interim period before the activation of reserve creation under a new plan, reserves could decline, except to the extent that any remaining flexibility in the traditional sources permits some growth to take place.

Prospects are that future monetary gold supplies will continue to be far from adequate to meet reserve needs. Gold reserves declined in 1966. The demand for gold for industrial and other nonmonetary purposes has expanded rapidly and it is by no means certain that new supplies will increase substantially above present levels. The enactment of timely and sound arrangements for deliberate reserve creation will have a favorable effect on the amount of gold that will be available for monetary purposes. This effect will not occur, however, until the machinery for creating new reserves has been put in place and has been proven to be fully viable. As for the other traditional source of reserve growth, there may be some limited flexibility in traditional sources of reserves in foreign exhange, but this cannot go far without compromising the desired improvement in the gross reserve position of the United States.

IV

The Demand for Reserves

Reasons for Rising Reserves in Surplus Countries

When reserves change hands, they move to countries in surplus. The accumulation of reserves in surplus countries may be in response to a continuing conscious desire to build up reserves, as was the case in Europe in the fifties. Or it may result from the application of policy measures to check declines in reserves in bad times, while permitting reserves to rise in good times. A third possibility is that measures to restrain domestic inflationary pressures lead to the accumulation of reserves as a consequence or even almost as a byproduct, either by enlarging a current account surplus or by attracting capital. Another possibility is that the area in surplus does not have a sufficiently wide spectrum of institutional arrangements to supply capital, or has so many restraints on competition in meeting local capital needs, that entrepreneurs and others seeking to raise capital find it cheaper to do so abroad, lending to an influx of capital even though reserves are rising. Still other explanations for rising reserves can be found, such as movements of speculative or refugee capital, as in the case of the U.S. receipts of reserves in 1936-41. Or one may cite oil-producing countries, or other developing countries that experience gains from rising prices of their products, where there is a lag between the rising international income and the spending of these reserves. Finally, a marked tendency for rising reserves to be associated with defense outlays in foreign areas was noted. In this category, India during World War II, Germany, and, more recently, some countries in Southeast Asia may be cited.

Very few countries have permitted their reserves to fall substantially without taking policy measures to arrest the decline. That is, there are firm indications that countries readily become accustomed to a higher absolute level of reserves, and take action to avoid a drop to earlier levels. This is entirely reasonable, since they are conscious that their imports and other international transactions, as well as their economies and domestic money supplies, are growing steadily. While few countries appear to have established clear-cut quantitative growth targets for their reserves, they generally welcome a rise in reserves and try to avoid declines.

There have been two major exceptions to this latter statement. The first is the United States which until recently permitted very large reductions in both its gross reserves and in its net reserve position. The other instance was the spending by some countries of reserves that were accumlated during World War II.

Looking ahead from the year 1966, the position is well summarized in paragraph 17 of the report of Working Party Three on the Balance of Payments Adjustment Process:*

"In the course of preparing this report countries were invited to submit memoranda describing the configuration of their balance of payments which they considered appropriate over a run of years. A major element in countries' balance of payments aims is the change in their official reserves which they regard as desirable or tolerable. It is recognized that over the short run reasonable variations in reserves and payments positions are inevitable, and need not be regarded as inconsistent with equilibrium. Over the longer run, however, while some countries are not at present seeking an increase in their reserves, it is clear that most countries wish to see a secular rise in their reserves. No country is prepared to have its reserves decrease over the longer run."**

The annual percentage rate of increase in world reserves, both for the world as a whole and for the world outside the United States, has been noted. During the sixteen years 1951-66, the annual average, as well as the compounded rate of growth, was 2.4 percent for the world as a whole. For the world excluding the United States, the corresponding rate was 5.4 percent. Reference has also been made to a comparison of the trends of world reserves and world trade.

Even outside the United States, reserves have been slowly falling in recent years, in terms of the coverage of annual imports. At present, outside the United States, published reserves cover about four months' imports. The most striking feature is, of course, the very steep decline in U.S. reserves.

Aggregate Reserve Gains, 1954-66

The various factors mentioned above have been associated with the existence of substantial annual totals of aggregate surpluses, frequently referred to as "world imbalances." Table 9 shows that during 1954-66, the aggregated surpluses of all the surplus countries in the world, as measured by the aggregate positive increases in gross reserves, reported in International Financial Statistics, averaged about $4 billion a year. This amounts to about 3 percent of the average value of world imports (c.i.f.). These figures are broken down geographically in Table 10.

During 1954-59, when global surpluses were about $3.5 billion a year and new monetary gold supplies were about $650 million, about 19 percent of the aggregate could be covered without corresponding deficits in other countries, by this new gold. Since 1959, the proportion of new monetary gold

*The Balance of Payments Adjustment Process, a report by Working Party No. 3 of the Economic Policy Committee of the Organization for Economic Cooperation and Development, August 1966.
**Underlining supplied.

supplies to gross surpluses has ranged between 5 and 20 percent, averaging 11 percent in 1960-65, and last year became slightly negative.

The United States has been endeavoring for some years to reduce the drain on its reserves, and lowered its contribution to the reserves of other countries from an average of $2 billion in 1961-64 to $1.5 billion in 1965 and to zero in 1966. (See Table 8.) Financing the U.K's deficit provided a large part of the reserve increases for others in 1965-66.

Aggregate Reserve Gains and Aggregate Reserve Losses

Aggregate reserve gains can take place in four forms: (1) gains that are offset by gross reserve losses in other non-reserve countries; (2) gains that are offset by a change in the net reserve position of reserve centers; (3) gains that result from new monetary gold supplies for the world as a whole; and (4) gains that result from a multilateral institutional method of reserve creation. Depending upon the circumstances of the time, these four methods may differ more or less in their economic and financial impacts.

Reserve losses under some conditions can affect general domestic policies and growth rates. More frequently, reserve losses are likely to be associated with selective restraints on international trade and investment transactions. Reserve gains work in the opposite direction, though the effects may be slower and less uniform. Surplus countries may not wish to expand their growth rates because of inflationary fears, and may find resistance to liberalizing restraints on imports or capital transactions, no longer needed to protect reserves. On the whole, it should be expected that reserve losses imply a tendency to a deliberalization of international payments through selective restraints, that are not fully offset by liberalization resulting from reserve gains.

Table 11 presents some historical data on gross reserve losses. For the world as a whole aggregate reserve losses were highest in relation to world imports in 1958-60. Since then they have been brought down, partly through selective restraints applied by the United States and the United Kingdom. It is reasonable to assume that continuing reserve losses by reserve centers could result in pressure for tightening of selective restraints.

Reserve creation in the form of monetary gold from new production reduces reserve losses mainly for South Africa, the Soviet Union, and Canada as the principal gold producers. Dishoarded gold would ease the reserve position of the monetary authorities that received more gold than they paid out in other reserves.

Reserve creation by international action can add to the reserves of all countries, whether in deficit or surplus, by moderate amounts. It can therefore exert a check on the growing pressure for selective deliberalization of world trade and payments. The moderate amounts involved are less likely to affect domestic growth policies in major countries. In surplus countries, the new reserves accrue in the first instance to the monetary authorities and exert no impact as a domestic expansionary pressure unless the monetary authorities decide to follow a policy of monetary ease. Hence reserve creation in this form is subject to less danger of inflation than a corresponding amount of reserve growth in any of the other forms, including gold. The other types of reserve growth add to the income stream and, unless offset by the authorities, to the money supply of the surplus country, whereas with deliberate reserve creation this is true only of the reserves gained from other countries.

Insofar as a desire to protect reserves, in both deficit and surplus countries, leads to higher interest rates, there is a clear possibility of general worldwide escalation of interest rates as countries compete to hold or enlarge reserves. A secular growth in reserves can help to moderate such competitive actions, but by itself may not suffice to avoid the susceptibility of the system to such pressures. They may become especially pronounced if major markets are partially shut off as capital exporters or become capital importers.

There has been some change in the ratio of gross reserve gains to gross reserve losses in 1961-66, as compared with 1954-60. In the earlier period, roughly 70 percent of global reserve gains were offset by reserve losses. In this period the United States permitted some redistribution of its large reserves without reacting strongly to reserve losses. In 1961-66 about one-half the gains were balanced by losses. Presumably this changing ratio reflects the various measures of monetary cooperation which have had the effect of reducing the relative size of reserve losses. The average annual additions to reserves have risen in absolute terms, while the absolute amount of reserve losses has remained relatively constant or, more recently, declined.

It seems doubtful that the world can return to the situation of the late fifties, when reserve losses were unusually high relative both to world imports and to reserve gains. This was made possible by the willingness of the United States to lose reserves without taking strong action to reduce its losses.

However, reserve losses, even at 1 percent to 1-1/2 percent of world imports, can lead to further deliberalization of world payments if they are persistent and if they apply to major countries An infusion of new reserves could reduce this percentage of losses still further, while at the same time enlarging the level of

aggregate reserve gains. A widening of this margin between reserve losses and gains through reserve creation measures, in a sense, the liberalizing effect on world trade and payments, in both deficit and surplus countries. During the years 1954-60, this margin was 1.2 percent of world imports; in 1961-66, the percentage remained the same.* However, it has been lower than this in 1965 and 1966.

Relationship of Global Reserve Needs to Deficit Country Needs

Several problems are encountered in quantifying an appropriate rate for reserve growth. The need for reserves will necessarily appear in its most pronounced form among countries that are losing reserves. The consequences for world trade and investment of insufficient global reserve growth will first become manifest through the actions of deficit countries. As a result, there is a tendency to confusion between the impact of a deficient growth of world reserves on deficit countries and special factors of imbalance affecting these individual countries. The world as a whole has an interest in the degree of restrictiveness that should be applied by deficit countries, in the sense of providing sufficient potential for recovery of reserves to avoid the excessive restrictions that might appear necessary to them if there were an insufficient hope for acquiring additional reserves over time. On the other hand, the surplus countries wish to avoid a situation in which the supply of new reserves seriously reduces the financial incentive for deficit countries to adjust their balance of payments policies.

In its concluding remarks and referring both to reserves and to conditional liquidity, the report on the Balance of Payments Adjustment Process calls attention to the need for striking an appropriate balance between "the adequate provision of means of financing temporary imbalances, and the need to ensure that imbalances are kept within due limits and eliminated in due time."

The difficulties of quantification thus arise in part from the technical problems of measuring the effects of a given rate of reserve loss or reserve growth on the degree of restriction or ease in national balance of payments policies, and in part from the fact that countries differ widely at times with respect to their economic growth rates and the pressures these are generating on economic resources, prices and employment. National objectives as to desired rates of world reserve growth may differ. There is, however, a solid foundation for reserve creation in the fact that there is a universal desire of all nations to see their reserves rise over time.

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*Reserve losses and reserve gains include countries for which individual reserve data are published, and the margin between them does not fully reflect changes in the published figures on total world reserves.

Projection of Trends into the Future

Aggregate "reserve surpluses", as measured by the sum of those national changes in gross reserves that were positive, according to IFS, have been compared with the total of world imports (Table 9). This comparison shows that reserve surpluses averaged 3.7 percent of world imports in 1954-59 and 3.3 percent in 1960-65. In 1964-65, there was a slight fall in this ratio to 2.5 percent, but 1966 recorded a sharp drop to 1.5 percent. This presumably reflects, among other things, a number of measures taken in the United States, under its balance of payments program, which reduced its official settlements deficit. The declining ratio has probably also been affected by European measures to divert some reserve holdings into the assets of the commercial banking system. In a sense, this moderate compression of the aggregate reserve surpluses may be regarded as having bent downward the upward trend which would, other things being equal, have risen along with the growth of trade.

Taking this factor into account, a rough estimate has been made of the possible level of aggregate reserve surpluses in 1970 and 1975, on two alternative assumptions. The first assumes a trend at 3 percent of world imports and implies relatively little resort to restraints on the free flow of capital of the type that have been applied in 1965-66. The second adopts a trend at 2 percent of global imports, making allowance for the use of such restraints by countries in deficit. Both assume continuation or some further development of the practice of channeling reserves into commercial bank holdings.

The first figure of about 3 percent of world imports, estimated at $250 billion,* would mean approximately $7.5 billion of aggregate reserve surpluses in 1970. The second alternative, at 2 percent of the same estimate for world trade, would be $5 billion. The upper limit, related to unrestricted capital flows, would thus call for aggregate reserve increases by the countries in surplus as a group of about $7.5 billion in 1970. The lower limit, corresponding to a regime of selective restraints by countries in deficit, would imply about $5 billion a year in 1970.

This is of course an extremely rough projection to give some general idea of the possible range of magnitudes on the assumptions set forth. It implies no particular geographical distribution of reserve surpluses among the major countries. Also it makes no attempt to distinguish between reserve surpluses that result from allocations of newly created reserves to surplus countries and their earned or borrowed reserve surplus positions, which are likely to involve gross or net reserve losses elsewhere. In effect, the assumption is implicit

*World imports reached an annual rate of nearly $200 billion in the fourth quarter of 1966. A projection of the recent growth trend of about 7 percent a year would raise the level to about $250 billion in 1970.

that allocations of created reserves will satisfy reserve needs as effectively as will earned surpluses. This is a conservative assumption and the level of reserve surpluses could be higher in actuality, if reserve losses and earned surpluses do not correspond with this assumption.

The figures cited do not measure the need for reserve creation, as a substantial part of the reserve surpluses could be offset by reserve deficits of the countries losing reserves. If one were to make a further assumption that half of the reserve surpluses should be covered by new reserve creation, and half by reserve losses, a target ranging from $2.5 billion to $3.75 billion for new reserve supplies in 1970 would result, between the two limiting assumptions.

By 1975 we assume that world imports will equal $350 billion. This would result from an annual compounded rate of increase from the end of 1966 of 7 percent. Aggregate surpluses at 3 percent of this figure would call for a rise to $10.5 billion of reserve surpluses in 1975. The lower figure, at 2 percent of imports, would be $7.5 billion a year. At first glance these very rough illustrative figures may seem large. But it should be realized that absolute magnitudes rise rapidly when the world's economy and trade are growing as fast as they are now.

Table 11 presents a tabulation of aggregate reserve losses, and a comparison with aggregate reserve gains is shown in Table 12. In the most recent period, 1961-66, nearly half of the reserve gains resulted from new reserve creation, and about half were offset by reserve losses elsewhere.

An analysis of aggregate reserve surpluses of nonreserve countries for recent years throws some light on the assumption that half of the aggregate reserve surpluses might reasonably be covered by new supplies of reserves. If we look only at the aggregate surpluses of counties other than the United States, we find the offsets to these surpluses are as follows:

	Increase in World Monetary Gold		U. S. Reserve Creation (inc. net gold sold)		Total Reserve Creation (1) & (2)		Other Offsets		Aggregate Reserve Surpluses Outside U.S.
	Amount ($ mil.) (1)	% of Total	Amount ($ mil.) (2)	% of Total	Amount ($ mil.)	% of Total	Amount ($ mil.)	% of Total	($ mil.)
1961	600	12.4	1,576	32.6	2,176	45.0	2,659	55.0	4,835
1962	335	11.1	2,632	87.4	2,967	93.5	46	1.5	3,013
1963	840	16.9	2,087	41.9	2,927	53.8	2,049	41.2	4,976
1964	750	17.8	1,678	39.7	2,428	57.5	1,796	42.5	4,224
1965	240	5.8	1,502	36.2	1,742	42.0	2,412	58.0	4,154
1966	-100	-3.4	-29	-1.0	-129	-4.4	3,035	104.4	2,906
	2,365	11.1	9,446	39.1	12,111	50.2	11,997	49.8	24,108

In 1961-66, about half of the aggregate surpluses shown above were covered by gold and by reserve creation for other countries arising from the U.S. balance of payments. Only the remainder of the surpluses corresponded to deficits in the rest of the world.* The pressure exerted on other deficit countries by the surplus countries would undoubtedly have been more severe in the absence of the gold supplies and U.S. reserve creation.

The projections given above for 1970 and 1975 are illustrative. They are intended to suggest some concepts and procedures that might be developed further and to throw some light on past performance. While the need for reserves in the future may not necessarily follow the guidelines suggested by past experience, the past relationships cannot be ignored and should at least be a starting point for estimates of future needs.

If the needs for newly-created reserves to cover aggregate reserve surpluses are something like the illustrative magnitudes of $2.5 billion to $3.75 billion indicated for 1970, the previous analysis implies that the need for reserve creation may not be as far in the future as has been assumed. A situation such as 1966, where all of the substantial reserve surpluses were covered by corresponding deficits that did not involve reserve creation in the form of gold and dollars, is probably an unstable and short-lived pattern of world payments. Nor does it seem likely that the reserve surpluses can be rapidly reduced to zero without harsher policies than should be expected to materialize. There will therefore be a vacuum which will probably call for reserve creation in some form. Since presumably the preferred method of reserve creation is a collective one, the perceptible need for introduction of such collective procedures may well be closer than has been realized to date.

* In varying amounts, other factors also affected the financing of surpluses; e.g., substantial drawings in IMF credit tranches in 1961 and 1965 and the monetization of securities by the United Kingdom in 1966.

V

Criteria for Activation of Reserve Creation

The decision to activate a five-year tranche of reserve creation will call not only for some judgment as to the approximate trend of selected basic statistical indicators, but also for seeking a balance among objectives that are not the same for all countries. On the positive side, in favor of activation, we may set a greater measure of calm in the gold markets and reduced threats to exchange stability. We may also cite a tendency to relax and postpone restrictive external measures, particularly in the sphere of freedom of capital movements. A decision to activate a reserve creation plan should also mean less upward pressure on world interest rates in the long run. Finally, we could expect some impetus to economic growth and expansion. It is here that some part of the world may be concerned because the strongest surplus countries may under some conditions be fearful that more expansion could add to their inflationary pressures.

In such cases, it will be natural to take account of the economic weight of the countries that would in their judgment consider it desirable to activate the plan, as compared with the economic importance of those desiring to delay activation. An ultimate decision may have to be taken against the background of a weighted voting procedure. But it would be highly desirable to have as wide a consensus as possible, to make the reserves created serve their purpose most effectively. To this end it may be helpful to indicate some of the criteria that might be used for determining the timing of a decision to activate a cycle of reserve creation.

The reports of the Deputies of the Ministers and Governors of the Group of Ten and of the Study Group on Reserve Creation have indicated in a general way some of the qualitative factors to be taken into account. Extracts from these reports are shown in the Annex to this paper.

It may be desirable to suggest some specific and clear-cut evidence that reserve creation is called for.

One indication would be a definite tapering off in the rate of advance in the value of international trade. In a world of rapidly expanding population, it would be an extreme view to insist upon an actual shrinkage of world trade in absolute terms, before activating a reserve creation plan. It is suggested that a deceleration in the rate of expansion of world trade, particularly if it persists for several quarterly periods, should be a quite strong indicator that reserves are becoming inadequate and that this inadequacy is pinching off trade.

Second, growing pressure for moves to tighten restraints on current and capital transactions indeficit countries would provide an important signal, unless these pressures were entirely unrelated to and unsupported by considerations as to reserve losses.

Third, persistence of historically high interest rates in domestic money and capital markets, despite receding inflationary pressures, could result from competitive actions to maintain reserves, and thus indicate that more reserves are needed. With the development of the Euro-dollar market, a sensitive guide to the global level of short-term international liquidity may be available, which reflects international competition for funds.

Any one of the above developments would make it advisable to consider an activation of a five-year tranche of reserve creation or an expansion of the rate of creation during the next five-years. A combination of several of these criteria would present a strong case.

Since reserve creation is essentially a long-term trend matter, fine tuning in the cyclical sense is normally not required. Once the plan has been activated, the problem of timing would relate rather to changes in the rate of reserve creation than to a stop-and-go cyclical pattern. Nevertheless, in line with the spirit of modern economic policies, there may be times when it is important to apply reserve creation earlier, as a preventive, to strengthen the resistance of the world economy to recession, cumulative restrictions, and underemployment of resources.

It is in countries in deficit that the first impact of deficient reserve growth will be felt. Early signs, for example, may be strenuous efforts by governments to reduce the impact of governmental outlays on the balance of payments. A typically sensitive indicator may be found in moves to tighten restraints on the outflow of capital, and, to a lesser degree, in measures to stimulate an influx of foreign capital. Under this general heading some types of interest rate actions are included, such as those associated with competitive efforts to attract or retain reserves, rather than with more fundamental considerations. The wide variety of actions with many degrees of severity that can be applied in this area makes it difficult to say just when the signal light becomes intense enough to trigger action. But at least one can say that the light is always lit whenever selective restrictions are being tightened or interest rates, adjusted for price changes, are historically high in several major countries.

Another sensitive indicator, though one which may not be easy to assess, is a noticeable tendency for countries representing an important fraction of the world's economy to seek to finance deficits without drawing down their reserves

further, through borrowings of various types or cashing in of nonreserve assets. It might, for example, be possible to develop some estimate of the amount of financing carried out that would otherwise have been reflected in reserve losses by deficit countries. In the qualitative sense, a mere listing of examples of this type of procedure might prove helpful.

Essentially, however, a trend approach implies less emphasis on qualitative criteria, related to timing, than on the development of guidelines that help to determine the slope of a trend curve and variations in that slope at periodic intervals. It is in this sense, rather than as applied to sporadic interventions, that qualitative criteria may be of some value.

EXTRACTS ON QUALITATIVE CRITERIA FROM GROUP OF TEN AND IMF REPORTS

ANNEX

The Deputies Report of 1964,* in paragraph 24, states:

"...On the one hand, the fact that some individual countries find themselves short of external liquidity is not _prima facie_ evidence of a general shortage of _international liqudity_. On the other hand, the existence of a general shortage, in its extreme form, might be accompanied by widespread deflationary developments or restrictions on trade and payments resulting from the efforts of governments to defend or restore their reserves. The aggregate needs for liquidity are presumably in some way related to such factors as the growth of world trade and capital movements, and the amplitude and duration of imbalances in international payments, taking into account the efficacy of adjustment policies in correcting such imbalances; they are also affected by psychological attitudes toward minimum or desired levels of national reserves, toward reserve movements, and toward the use of available credit facilites. While there appears to be no convincing evidence that imbalances will be longer-lasting or more intractable than hitherto in the postwar period, a rising turnover of current and capital payments is likely to entail some increase in the size of fluctuations. Moreover, we have noted that a concern for domestic objectives such as growth, employment and price stability, or for international political, monetary and economic responsibilities, may sometimes lead to wider swings in the balance of payments."

The 1965 Report of the Study Group on Reserve Creation,** in paragraph 10, also deals with this question in general terms:

"We have considered what circumstances might indicate a general inadequacy of reserves. An indication that reserves are inadequate might be found in a reluctance to extend intergovernmental credit, or in an increasing propensity to seek credit, in preference to parting with reserve assets. Clearer evidence of a general scarcity might be found in a marked tendency to make maintenance, increase or

*Annex to the Ministerial Statement of the Group of Ten, August 1964.

**Report to the Deputies of the Group of Ten, May 1965.

restoration of reserves an overriding objective of economic policy, taking priority over other fundamental objectives, such as economic growth, a high level of employment and freedom of international trade. Indeed, a general scarcity might well have been permitted to develop too far when such tendencies became evident. In that situation, the anxiety to retain or increase reserves would probably lead countries to adopt excessively restrictive policies to prevent the emergence of a payments deficit or to achieve a surplus. In such conditions, therefore, the absence of large imbalances would not necessarily be evidence that reserves were adequate. Significant symptoms of strain would be a generalization of trade and payments restrictions, instability of exchange rates, rising unemployment and falling international prices. No doubt, so far as lenders were willing to extend credit in the assumed prevailing scarcity of reserves, the greatly developed credit element in international liquidity would continue to be used to avoid these consequences as far as possible; and this would have the incidental effect of increasing reserve assets of certain kinds. But the additional assets would not necessarily be adequate in amounts, satisfactory in their distribution, or available in the desired forms."

In the 1966 Report of the Deputies,* paragraph 35 deals with the qualitative aspects of the decision to create reserves:

"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

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*Report to the Group of Ten"....on improvements needed in the international monetary system, including arrangements for the future creation of reserve assets, as and when needed ...", July 1966.

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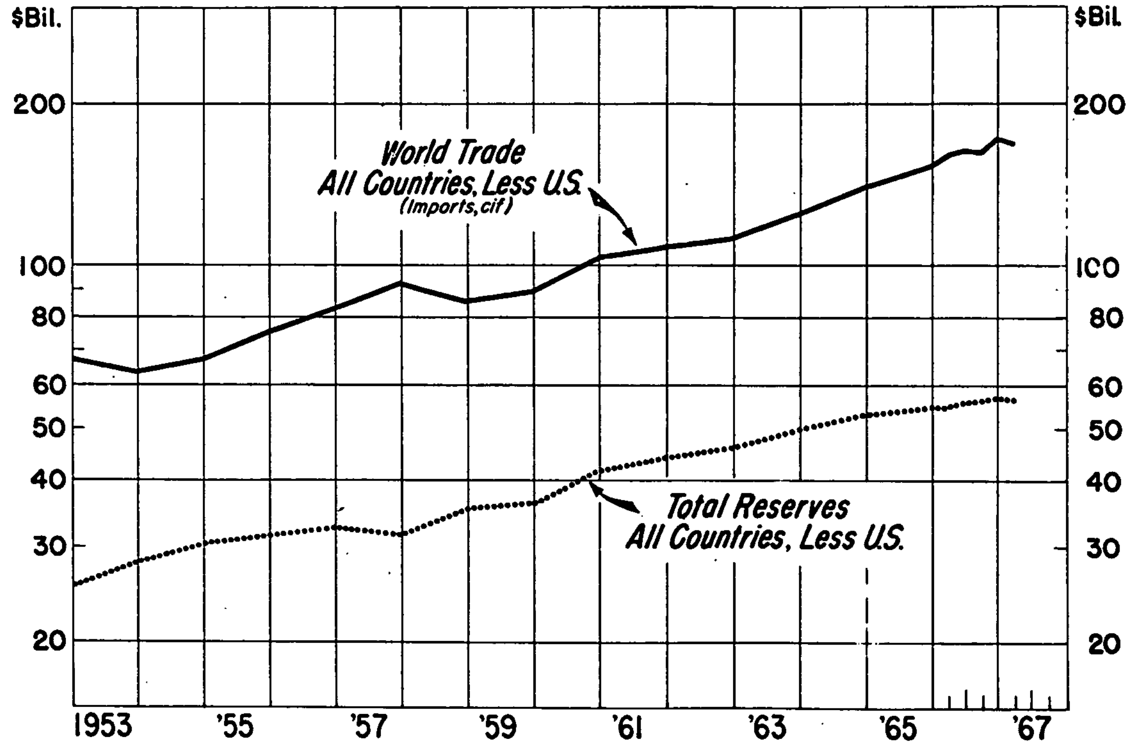
Agreement of the Fund. Some other members questioned whether it will be possible to arrive at a common judgment regarding such criteria, as member countries may differ considerably in the relative weight that they would attach to various factors. They consider that an analysis of the decisions taken will in the course of time provide precedents, derived from the test of actual experience, from which criteria can be developed."

Finally, the Annual Report of the IMF for 1965 has a brief paragraph on this topic:

"Appraisal of general reserve needs is not something that can be carried out on the basis of precise criteria. Resort to qualitative judgment is inescapable. In particular, no close relationship exists between these needs and such simple indices as the value of international transactions. In the exercise of such judgment, attention has to be focused primarily on the nature of the reactions, particularly in the sphere of national policies, which it appears appropriate to encourage or disencourage in the interest of sound development of the world economy with a minimum of monetary disturbance. Some of the consequences, or symptoms, of excess or deficiency in international liquidity were discussed at page 14 above. In the light of this analysis, the following appear to be the main criteria on the basis of which consideration should be given to an increase -- or, on rare occasions, a decrease -- in international liquidity: whether, in circumstances in which countries' financial policies are likely to be influenced by the level of world reserves, it appears desirable on balance to enlarge the scope for an expansion of monetary demand or to influence countries in the direction of counter-inflationary action; whether, on balance, exchange rates are under undue pressure, or needed adjustments in exchange rates are being unduly delayed; and whether there are widespread restrictions in international transactions, or widespread tendencies to speculative capital movements that an expansion in world reserves could to some extent relieve. Some of these conditions might, of course, call primarily for a change in the supply of conditional rather than unconditional liquidity, or for other changes in the techniques of international cooperation, but they are all relevant in some degree to the question of reserve needs." (p. 16)

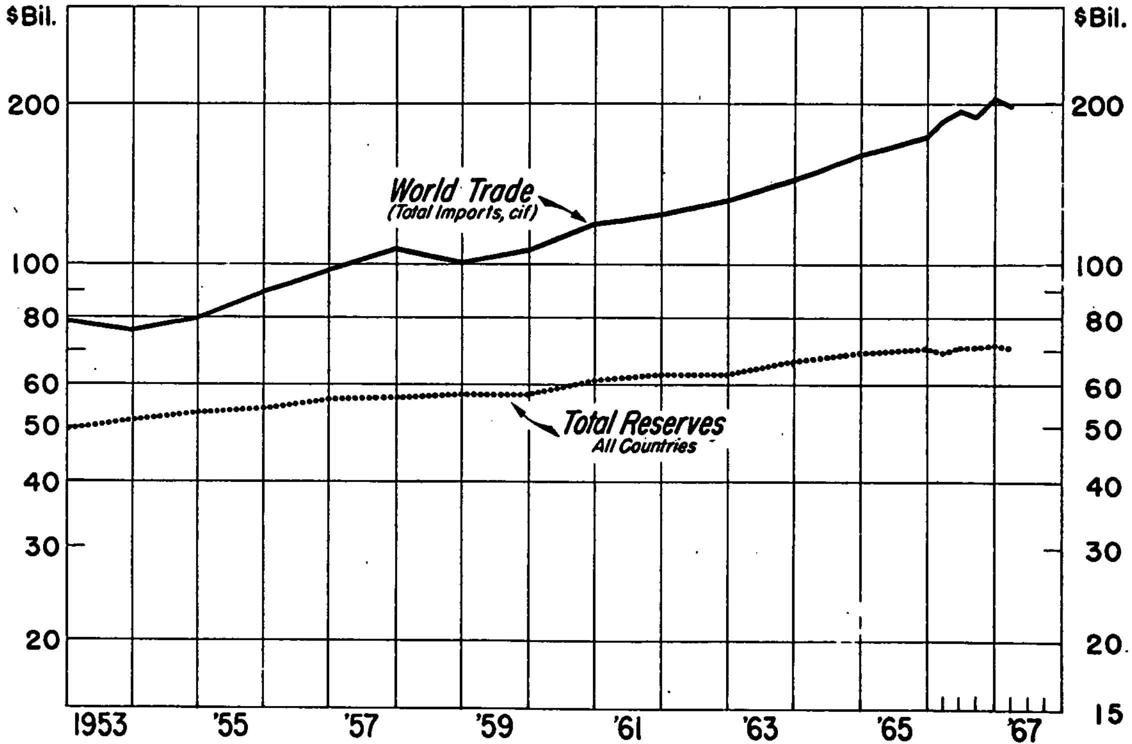
Chart I

WORLD TRADE AND MONETARY RESERVES, LESS U.S.



Source: International Financial Statistics, 1966-'67 Supplement and July 1967.

Chart II



Source: International Financial Statistics, 1966-'67 Supplement and July 1967.

Chart III

COMPOSITION OF WORLD RESERVES, 1948-'66

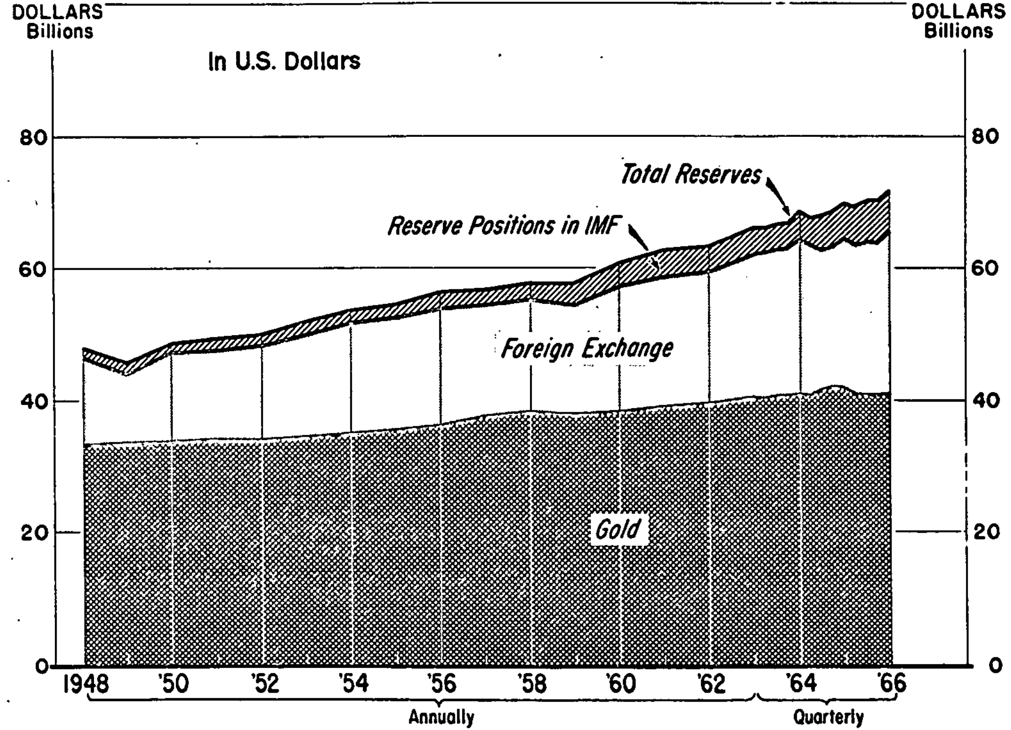


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Table 1

Reserves* and Reserve Growth
All Countries, and all Countries excluding the U.S.
1950 - 1966

	Total Reserves, All Countries		Total Reserves, All Countries excluding U.S.	
	$ Millions	% Annual Increase	$ Millions	% Annual Increase
1950	48,715		24,450	
1951	49,360	1.3%	25,061	2.5%
1952	49,920	1.1%	25,206	0.6%
1953	51,780	3.7%	28,322	12.4%
1954	53,470	3.3%	30,492	7.7%
1955	54,305	1.6%	31,508	3.3%
1956	56,150	3.4%	32,484	3.1%
1957	56,645	0.9%	31,813	-2.1%
1958	57,570	1.6%	35,030	10.1%
1959	57,325	-0.4%	35,821	2.3%
1960	60,250	5.1%	40,891	14.2%
1961	62,285	3.4%	43,532	6.5%
1962	62,590	0.5%	45,370	4.2%
1963	65,990	5.4%	49,147	8.3%
1964	68,440	3.7%	51,768	5.3%
1965	69,800	2.0%	54,350	5.0%
1966	71,010	1.7%	56,129	3.3%
Total Increase, 16 years	22,295	45.8%	31,679	129.6%
Average Annual rate of growth	1,393	2.4%**	1,980	5.4%**

* Gold, foreign exchange and reserve positions in the IMF.
Source: IFS 1966-67 Supplement for 1950-57 data and March 1967 issue for later data.

** Same percentage for annual compounded rate of increase

Table 2

Growth in World Reserves and World Imports*
All Countries and all Countries Excluding the U.S.
1951 - 1966
Amounts in $ Millions

	All Countries				All Countries Excluding the U.S.			
	Increase in Reserves		Increase in Imports		Increase in Reserves		Increase in Imports	
	Amount	%	Amount	%	Amount	%	Amount	%
1951	+645	1.3%	+21,800	27.2%	+611	2.5%	+19,509	40.1%
1952	+560	1.1%	-1,300	-1.6%	+145	0.6%	-1,085	-1.6%
1953	+1,860	3.7%	-3,500	-4.4%	+3,116	12.4%	-3,639	-5.4%
1954	+1,690	3.3%	+3,400	4.3%	+2,170	7.7%	+4,106	6.5%
Average 1951-54	+1,189	2.4%	+5,105	6.4%	+1,511	5.8%	+4,723	9.9%
1955	+835	1.6%	+9,600	10.9%	+1,016	3.3%	+8,251	12.2%
1956	+1,845	3.4%	+9,200	9.4%	+976	3.1%	+7,702	10.2%
1957	+495	0.9%	+9,600	9.0%	-671	-2.1%	+8,967	10.7%
1958	+925	1.6%	-6,700	-6.3%	+3,217	10.1%	-6,699	-7.2%
1959	-245	-0.3%	+5,800	5.5%	+791	2.3%	+3,411	4.0%
Average 1955-59	+771	1.4%	+5,500	5.7%	+1,066	3.3%	+4,326	6.0%
1960	+2,925	5.1%	+12,600	10.6%	+5,070	14.2%	+13,233	14.8%
1961	+2,035	3.4%	+5,000	4.0%	+2,641	6.5%	+5,433	5.3%
1962	+305	0.5%	+7,800	5.9%	+1,838	4.2%	+5,959	5.5%
1963	+3,400	5.4%	+11,500	8.0%	+3,777	8.3%	+13,667	9.4%
1964	+2,450	3.7%	+16,900	10.6%	+2,621	5.3%	+12,228	12.2%
Average 1960-64	+2,223	3.6%	+10,760	7.8%	+3,189	7.7%	+10,104	9.4%
1965	+1,360	2.0%	+14,200	8.2%	+2.582	5.0%	+11,299	8.1%
1966	+1,210	1.7%	+15,800	9.1%	+1,779	3.3%	+11,259	7.5%
Average 1965-66	+1,285	1.9%	+15,000	8.7%	+2,181	4.2%	+11,279	7.8%
Total 16 Years	+22,295	45.8%	+131,700	225.9%	+31,679	129.6%	+113,602	233.4%
Average 16 Years	1,393	2.4%	8,231	6.9%	1,980	5.4%	7,100	8.3%
Compounded rate of increase		2.4%		7.6%		5.4%		7.8%

* Reserves end of year and imports during year
Source: IFS data

Table 3

Reserves as Percent of Annual Value of Imports
1951 - 1966

	All Countries	All Countries Excluding U.S.	Developed Countries	Developed Countries Excluding U.S.	G-10 Excluding U.S.	United States	Less Developed Areas: all LDC	Less Developed Areas: excluding high initial reserve holders*
1951	62	37	68	33	27	204	45	31
1954	68	45	75	43	40	206	49	36
1958	57	41	65	44	42	154	35	32
1959	54	40	60	42	40	126	35	32
1960	51	40	57	43	43	117	32	30
1961	50	40	57	45	45	117	29	28
1962	47	40	53	44	43	97	27	27
1963	46	39	51	43	40	91	29	30
1964	43	37	47	40	38	82	27	29
1965	40	36	43	38	37	67	29	31
1966	37	35	39	36	35	54	30	31

Note: Compiled from separate IFS tables on reserves and trade and some groupings and totals are not completely comparable.

* Excludes Ceylon, Ghana, India, Pakistan, Sudan, UAR

Table 4

Changes in World Reserves, Principal Regions
1950 - 1966
$ Millions

	1951-54	1955-58	1959-62	1963-66	Total 1951-66
United States	-1,287	-438	-5,320	-2,339	-9,384
United Kingdom	-409	71	203	-209	-344
Industrial Europe, Canada and Japan	6,199	5,841	9,359	7,308	28,707
Other Developed Areas	70	-105	1,665	785	2,415
Latin America	-5	15	-1,020	910	-100
Middle East	-145	25	420	1,060	1,360
Other Asia	-250	-980	-60	1,005	-285
Other Africa	1,130	-145	-310	-105	570
Total all Countries*	4,755	4,240	4,880	8,420	22,295

* Totals not completely reflected in data components by region

Table 5

Changes in Total Reserves
Major Countries and Groups
End of 1958 - 1966
(billions of U.S. dollars)

	Gold	Foreign Exchange	IMF Reserve Position	Total Change	% of Gross Increase
Group of Ten and Switzerland					
United States	-7.3	+1.3	-1.6	-7.6	--
United Kingdom	-0.9	+0.9	0.0	0.0	--
Belgium	+0.3	+0.2	+0.3	+0.7	5.2%
France	+4.5	+0.2	+1.0	+5.7	42.5%
Germany	+1.7	-0.6	+1.1	+2.1	15.6%
Italy	+1.3	+0.2	+0.8	+2.4	17.9%
Netherlands	+0.7	-0.1	+0.4	+0.9	6.7%
Sweden	0.0	+0.4	+0.1	+0.5	3.7%
Switzerland	+0.9	+0.3	--	+1.3	9.7%
Canada	0.0	+0.3	+0.4	+0.6	4.4%
Japan	+0.3	+0.5	+0.3	+1.1	8.2%
Total G-10 and Switz.	+1.5	+3.6	+2.8	+7.7	57.5%*
(G-10 and Switz ex.U.S.& U.K.)	(+9.7)	(+1.4)	(+4.4)	(+15.3)	(114.2%)
Other Industrial and Developed	+1.8	+1.1	+0.6	+3.7	27.6%
Less Developed	-0.4	+2.0	+0.4	+2.0	14.9%
Total all Countries	+2.9	+6.7	+3.8	+13.4	100.0%

Note: Totals may not add because of rounding.

* Calculation includes U.S. net loss of $7.6 billion.

Table 6

Annual Compounded Rates of Increase in
U.S. Dollar Values of Reserves and Domestic Credit,
1950-1960 and 1960-1965
(per cent per year)

	1950-1960		1960-1965	
	Reserves	Domestic Credit	Reserves	Domestic Credit
1. Group of Ten and Switzerland				
United States	-2.0%	4.2%	-4.3%	6.9%
United Kingdom	1.9%	2.5%	-3.5%	6.0%
EEC	18.2%	13.5%	7.6%	13.[illegible]%
Other	4.1%	10.0%	6.7%	15.[illegible]%
Total	2.8%	6.5%	2.2%	10.1%
2. Other Developed	2.5%	5.4%	10.2%	11.4%
3. Less Developed	-0.4%	5.9%	3.1%	9.2%
4. All Countries	2.1%	6.3%	3.0%	10.8%
5. All Countries, ex. U.S. and U.K.	5.6%	9.4%	6.7%	13.0%

Source: Based on IFS data for 90 countries (including Switzerland) converted into U.S. dollars as a common denominator. "Reserves" refer to official international reserves of monetary authorities, including Reserve Position in the Fund. "Domestic Credit" refers to domestic credit extended by monetary authorities and deposit money banks.

Table 7

Sources of World Reserve Growth 1961-66
$ Millions

	1961	1962	1963	1964	1965	1966	1961-1966 Amount	1961-1966 % Total	Percent% Total 1961-64	Percent% Total 1965-66
Non-Traditional Sources:										
1. IMF Credit tranche use	1,011	-434	84	339	1,528	-14	2,514	23.4%	12.2%	58.9%
2. U.S. Foreign Exchange Holdings	116	-17	113	220	349	540	1,321	12.3%	5.3%	34.6%
3. Dollars generated by U.S. swaps Activated by others	-	-	50	150	275	75	550	5.1%	2.4%	13.6%
4. UK Securities taken into Reserves	-	-	-	-	-	885	885	8.2%	-	34.4%
Total Non - Traditional Sources	1,127	-451	247	709	2,152	1,486	5,270	49.0%	19.9%	141.6%
Traditional Sources:										
5. Additions to World Monetary Gold (Soviet sales)	600 (300)	335 (215)	840 (550)	750 (450)	240 (550)	-100* (0)	2,665 (2,065)	24.8%	30.8%	5.4%
6. Additions to Foreign Exchange not accounted for above **	509	307	2,132	1,210	-1,489	-210*	2,404	22.3%	50.8%	-68.2%
7. Other factors	-201	114	181	-219	457	34	421	3.9%	-1.5%	21.2%
Total Traditional Sources	908	756	3,153	1,741	-792	-276	5,490	51.0%	80.1%	-41.6%
Total Change in World Reserves	2,035	305	3,400	2,450	1,360	1,210*	10,760	100%	100%	100%

* Estimated

** Change in foreign exchange reserves as shown in IFS, excluding lines 2,3, and 4

Table 8

Sources of Reserve Growth Outside U.S. 1961 - 1966
$ Millions

	1961	1962	1963	1964	1965	1966	1961 - 1966 Amount	1961 - 1966 % Total	Percent Total 1961-64	Percent Total 1965-66
U.S. B/P Factors										
Gold Sales to Foreign Countries (includes (BIS)	970	833	392	36	1,288	431	3,950	25.9%	20.5%	39.4%
Net use of IMF Reserve Position, excluding U.S. Gold Subcription payment	-135	626	29	266	165	537	1,488	9.8%	7.2%	16.1%
Net increase in Liabilities to Official Foreigners excluding monetary liabilities to IMF	741	1,173	1,666	1,376	49	-997	4,008	26.3%	45.6%	-21.7%
Total U.S. B/P Factors	1,576	2,632	2,087	1,678	1,502	-29	9,446	62.0%	73.3%	33.8%
(U.S. Official Settlements)	(-1,347)	(-2,706)	(-2,044)	(-1,547)	(-1,305)	(252)	(-8,697)			
Additions to World Monetary Gold	600	330	840	750	240	-100	2,660	17.5%	23.2%	3.2%
(USSR sales)	(300)	(215)	(550)	(450)	(550)	(0)	(2,065)			
IMF Credit Tranche Use	1,011	-434	84	339	1,528	-14	2,514	16.5%	9.2%	34.7%
UK Securities taken into reserves	-	-	-	-	-	885	885	5.8%	-	20.3%
Other factors	-546	-690	766	-146	-688	1,037	-267	-1.8%	-5.7%	8.0%
Total Factors, other than U.S. B/P	1,065	-794	1,690	943	1,080	1,808	5,792	38.0%	26.7%	66.2%
Change in Reserves, Countries other than U.S.	2,641	1,838	3,777	2,621	2,582	1,779	15,238	100.0%	100.0%	100.0%

Table 9

Aggregate of Gross Reserve Gains, Compared with World Imports and Net Additions to Monetary Gold, 1926-28, 1937 and 1954-1966
Amounts in $ Millions

	Aggregate of Gross Reserve Gains	World Imports		Addition to World Monetary Gold	
		Amount	Col (1) as % Col. (2)	Amount	Col. (3) as % Col. (1)
	(1)	(2)		(3)	
1926	314	31,163	1.0%	309	98.4%
1927	744	33,764	2.2%	128	17.2%
1928	2,538	34,475	7.4%	705	27.8%
1937	2,116	27,500	7.7%	1,350	63.8%
1954	2,922	78,700	3.7%	670	22.9%
1955	2,502	88,300	2.8%	665	26.6%
1956	3,703	97,500	3.8%	490	13.2%
1957	3,568	107,100	3.3%	690	19.3%
1958	4,835	100,400	4.8%	680	14.1%
1959	3,654	106,200	3.4%	750	20.1%
Average 1954-59	3,531	96,376	3.7%	658	18.6%
1960	6,613	118,800	5.6%	345	5.2%
1961	4,835	123,800	3.9%	600	12.4%
1962	3,013	131,800	2.3%	335	11.1%
1963	4,976	143,100	3.5%	840	16.9%
1964	4,224	160,100	2.6%	750	17.8%
1965	4,154	174,200	2.4%	240	5.8%
Average 1960-65	4,636	141,967	3.3%	518	11.2%
1966	2,906	190,000	1.5%	-100	-
Average 1954-66	3,993	124,615	3.2%	535	13.4%

Table 10

Aggregate of Gross Reserve Gains, 1954 - 1966
Major Countries and Regions
$ Millions

	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
EEC:													
Belgium	----	105	16	----	405	----	200	307	----	187	252	112	16
France	435	711	----	----	405	686	536	1,093	684	859	816	619	390
Germany	806	439	1,184	995	682	----	2,242	131	----	694	232	----	599
Italy	159	240	69	68	830	872	195	548	19	----	418	591	151
Netherlands	46	14	----	----	530	----	421	95	----	156	247	67	32
Total EEC	1,446	1,509	1,269	1,063	2,852	1,558	3,594	2,174	703	1,896	1,965	1,389	1,188
Other G-10 & Switz													
U.S.	----	----	869	1,166	----	----	----	----	----	----	----	----	----
UK	364	----	----	98	731	----	918	----	----	----	----	688	96
Sweden	----	----	13	----	15	----	50	208	65	----	206	8	55
Canada	127	----	50	----	112	----	----	287	271	56	278	146	----
Japan	38	146	194	----	234	385	502	----	356	36	----	133	----
Switzerland	69	10	35	16	165	----	261	435	113	206	45	124	80
Other G-10 & Switz	598	156	1,161	1,280	1,257	385	1,731	930	805	298	529	1,099	231
(G-10 ex US and UK)	1,680	1,665	1,561	1,079	3,378	1,943	4,407	3,104	1,508	2,194	2,494	1,800	1,323
Other Developed	435	138	277	570	446	727	459	1,114	921	1,278	1,022	184	564
Latin America	73	333	632	555	66	365	270	191	48	573	279	553	95
Middle East	125	119	117	27	90	55	112	184	281	484	150	372	223
Other Asia	110	201	156	58	98	389	280	220	191	383	189	373	493
Other Africa	135	46	91	15	26	175	167	22	64	64	90	184	112
Total all countries	2,922	2,502	3,703	3,568	4,835	3,654	6,613	4,835	3,013	4,976	4,224	4,154	2,906

Table 11

Aggregate of Gross Reserve Losses, 1954 - 1966
Major Countries and Regions
$ Millions

	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
EEC:													
Belgium	46	---	---	71	---	247	---	---	60	---	---	---	---
France	---	---	664	666	---	---	---	---	---	---	---	---	---
Germany	---	---	---	---	---	1,089	---	---	207	---	---	453	---
Italy	---	---	---	---	---	---	---	---	---	449	---	---	---
Netherlands	---	---	185	98	---	97	---	---	12	---	---	---	---
Total EEC	46	---	849	835	---	1,433	---	---	279	449	---	453	---
Other G-10 & Switz													
U.S.	480	181	---	---	2,292	1,036	2,145	606	1,533	377	171	1,222	569
UK	---	642	116	---	---	304	---	401	10	161	831	---	---
Sweden	15	21	---	34	---	38	---	---	---	43	---	---	---
Canada	---	44	---	109	---	9	40	---	---	---	---	---	334
Japan	---	---	---	442	---	---	---	283	---	---	39	---	33
Switzerland	---	---	---	---	---	---	---	---	---	---	---	---	---
Other G-10 & Switz	495	888	116	585	2,292	1,387	2,185	1,290	1,543	581	1,041	1,222	936
(G-10 ex US and UK)	541	888	965	1,420	2,292	2,820	2,185	1,290	1,822	1,030	1,041	1,675	936
Other Developed	294	496	159	193	286	190	666	171	68	40	132	901	316
Latin America	242	306	112	363	688	449	220	278	507	91	124	56	213
Middle East	---	86	90	173	56	160	113	101	25	7	91	47	59
Other Asia	186	96	418	750	324	32	203	156	218	47	197	57	51
Other Africa	37	57	55	249	59	289	74	341	85	315	141	42	78
Total all countries	1,300	1,929	1,799	3,148	3,705	3,940	3,461	2,337	2,725	1,530	1,726	2,778	1,653

Table 12

Aggregate of Gross Reserve Gains and Losses Compared with World Imports)* 1954-1966
$ Millions

	Gross Reserve Gains	as % world Imports	Gross Reserve Losses	as % world Imports	Difference between Gross Gains and Losses	as % world Imports
1954	2,922	3.7	1,300	1.7	1,622	2.1
1955	2,502	2.8	1,929	2.2	573	.6
1956	3,703	3.8	1,799	1.8	1,904	2.0
1957	3,568	3.3	3,148	2.9	420	.4
1958	4,835	4.8	3,705	3.7	1,130	1.1
1959	3,654	3.4	3,940	3.7	-286	
1960	6,613	5.6	3,461	2.9	3,152	2.7
Average 1954-1960	3,971	4.0	2,755	2.8	1,216	1.2
1961	4,835	3.9	2,337	1.9	2,498	2.0
1962	3,013	2.3	2,725	2.1	288	.2
1963	4,976	3.5	1,530	1.1	3,446	2.4
1964	4,224	2.6	1,726	1.1	2,498	1.6
1965	4,154	2.4	2,778	1.6	1,376	.8
1966	2,906	1.5	1,653	.9	1,253	.7
Average 1961-1966	4,018	2.6	2,125	1.4	1,893	1.2
Average Total Period 1954-1966	3,993	3.2	2,464	2.0	1,529	1.2

* The data are not fully comparable, because individual reserve statistics are not published for all countries included in total world trade figures. Similarly, the difference shown between gross reserve gains and losses do not fully reflect net changes in total world reserves; the totals of aggregate gains and losses are derived from individual country data and add up to different totals than the published total for global reserves, which includes countries not shown individually.